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Client Letter - June 30, 2010

At the conclusion of our last letter, we wrote "…we have been building what we believe to be a fortress portfolio able to withstand a market pullback." It appears that pullback has begun, challenging the widely held belief that the economy is on solid footing. During the quarter, the S&P 500 closed at $1,030.71, representing an 11.43% drop, more than wiping out the gains from the prior quarter. Comparatively, the average performance across our strategies declined 8.19% for the quarter. Year-to-date, our strategies have declined approximately 3.61% versus the 6.65% drop of the S&P 500.

This past quarter, opportunities to buy securities at lower prices came our way as a result of the "Flash Crash" (an unexplained one-day drop of 6 percent on substantial volume), Greece public debt woes, and renewed concerns of a "double-dip," volatility came roaring back with a vengeance. It was déjà vu of the period spanning from October 2008 through March 2009 when massive intraday swings were commonplace. We believe increased volatility will continue in the foreseeable future and look forward to the opportunities that will surface as a result.

Becton, Dickinson & Co.

In the first quarter of the year, we sold out of our position in Covidien, a healthcare company known for their surgical instruments, as we believed it had reached our fair value estimate. This past quarter, we have essentially reinvested the proceeds from that sale into Becton, Dickinson & Co (ticker: BDX). Headquartered in New Jersey, BDX, like Covidien, is a medical company engaged in the manufacture and sale of a broad range of medical supplies, devices, laboratory equipment and diagnostic products used in hospitals, doctors' offices, research labs, and even at home. Currently, BDX has a strong global presence with 60% of their sales overseas. These revenues can be broadly categorized into three main segments: medical, diagnostics, and biosciences.

The core of BDX is their medical division (52% of revenues) which includes hypodermic needles and syringes, insulin syringes, surgical blades and scalpels, and other such disposable medical gear. Their reputation for innovation continues as they have successfully developed safety engineered needles, most recently launching the world's smallest "pen needle." The *disposable* nature of their *non-discretionary* products provides an attractive recurring revenue stream which has allowed BDX to grow revenues in spite of recent hospital spending cuts. The diagnostics unit (31% of revenues) produces devices designed for collecting and transporting blood and other diagnostic specimens, and produces instruments for culture analysis and disease screening. Finally, the biosciences segment (17% of revenues) provides products to facilitate medical researchers, such as systems for cell sorting and analysis.

Over the years, BDX management has developed a reputation for allocating their capital wisely. Not only have they proven to achieve high returns on invested capital, but they also have a great record of focusing on returning cash flow to shareholders. In addition to the steadily increasing dividend, they remain committed to returning about $450-550 million annually to shareholders via stock repurchases. This combination of dividends and stock repurchases comprises 60-80% of their free cash flow.

From a valuation standpoint, the last time BDX traded at such low multiples was 1993, when the Clinton administration was striving to nationalize healthcare. We believe now is a great opportunity to scoop up shares of a very high-quality, recession resistant company.

Concluding Remarks

Despite the recent pullback, we remain in a defensive stance. Although we believe a much more significant pullback is possible, this is not the chief reason for taking this position. We learned long ago that successful investing does not depend upon having a crystal ball of the macroeconomic future and the direction of the stock market. Rather, we are still finding the best values out there remain in these defensive companies. Thus, our concern about the economy is not to be misconstrued as a negative attitude towards all stocks. We are very optimistic about the long-term prospects of the individual stocks in our portfolios. Our high quality stocks continue to sell at very low valuations, both historically as well as currently relative to the broad market.

Thank you for your continued confidence and trust.

Sincerely,

Brian A. Yacktman
Manager

William D. Kruger
Manager

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