TRIAD
INVESTMENT MANAGEMENT

Client Commentary
May 23, 2012

With the recent higher level of uncertainty in global economies and markets, it's an appropriate time to discuss what's going on globally and how we plan to deal with the environment.

Fear and greed drive markets in the short-term, while economics and business results matter in the long-term. Right now, uncertainty has increased, and FEAR is back in control. Fear of collapse in Europe, specifically Greece, but more importantly the contagion effect on other countries in Europe, including Spain, Italy, Ireland, Portugal, and even France. If Greece drops out of the Euro currency, investors will assume the worst that other Euro-based countries will do the same. Short-term panic may occur.

Most European countries are deeply indebted, with current government budget deficits from moderate to severe. Not unlike the U.S. However, unlike the U.S., austerity has been the approach Europe has tried for the past 2 years, with varying degrees of success. Unfortunately, austerity and budget cutting have led to recession in many of these countries, and the economic outlook may get worse later this year and into next year. A battle is brewing between Germany and the rest of Europe over the approach taken to deal with budget woes. Germany continues to stress budget cuts, while the other countries want to focus on growing their economies and cutting budgets later, after growth resumes, unemployment declines and tax receipts improve. I don't know what the outcome will be, although I'm guessing when push comes to shove, there will be agreement among the major European countries to modify policies to incorporate some budget cuts along with measures to improve growth prospects.

However, we have other problems. Here in the U.S., tax increases and budget cuts are automatically set to take place next year, unless the children in Congress agree on some sort of long-term deficit reduction plan. The financial markets, as Europe has shown, will not wait forever. Even a dysfunctional U.S. Congress will be forced to take action. Let's hope it occurs soon. Like Europe, a mix of budget cuts over the long-term will likely be combined with tax increases, probably starting next year. A wild card is the outcome of the U.S. presidential election. Regardless, markets will want to see real action on deficit and debt reduction.

Lastly, China, the source of significant demand during the past 3 to 4 years for many global commodities, including iron ore, coal, copper, oil, steel, cement, etc. has seen recent slowing in its economy. A serious slowdown in China's economy would impact the world, given China's size and the fact that it has recently accounted for roughly 30% to 40% of the global growth in demand for many commodities. China is at an interesting point in its evolution, as it is facing higher wages domestically, reducing global demand for Chinese products somewhat, while much Chinese infrastructure spending, especially real estate, is set to slow down. The result? China needs to re-orient its economy to lessen the dependence on exports and put more emphasis on domestic and consumer demand. It's a big ship to turn, but that's what the Chinese will be facing over the next few years. Let's hope they get it right.

Whatever happens, I'm comfortable that we will come through this period with your capital intact. While we are subject to the same SHORT-TERM market forces which can temporarily depress prices, I'm confident that we own the right companies with the financial strength to make it through another POTENTIAL period of turbulence. We own good businesses, run by people with the integrity, smarts, and personal self-interest (via large stock ownership) to navigate a tough period. Furthermore, the valuations were attractive before the recent 7-8% market declines we have experienced in the past 3 weeks, and even more so as I write this.

Remember, short-term volatility can be beneficial, as we can take advantage of panic selling to buy bargains and improve our long-term prospects. This worked to our advantage during the worst of the financial crisis of 2008-09 and I don't see any reason why this won't be the case again, if markets decide to really panic. My shopping list is just sitting here, should greater bargains appear. In short, I'm still very optimistic about the next 2 to 3 years.

I appreciate your patience and trust. If you'd like to discuss the current situation in greater detail, please email or call me with your specific questions or concerns.

-John Heldman, CFA