

U.S. Equity Monthly Newsletter February 2010

Review

The U.S. equity market was modestly positive over the month, as were W.P. Stewart accounts to a slightly lesser degree, recovering some of the ground lost in January.

Broadly speaking, earnings reports continued to show evidence the economy is improving, which the market had been waiting for. At the same time however, and perhaps as a result of indications of greater economic vitality, there were early signs that the cheap money that has been made plentiful by regulators seeking to support the economic recovery will become less available. In particular the Federal Reserve announced an increase in the discount rate that clearly signals a desire to exit from the extraordinary measures undertaken to provide liquidity to the market. However, we do not believe this move heralds a general rise in interest rates in the near term although this could occur if fears of rising inflation tip the balance away from concerns about protracted economic weakness. The impact of any tightening is likely lead to a period of consolidation before the market moves ahead again based on better economic fundamentals.

Portfolio Changes

We initiated a position in Myriad Genetics, a leader in genetic testing used for cancer-related personalized medicine. The lead product, BRACAnalysis, is used to help assess risk and guide treatment for hereditary breast cancer. We believe there is significant runway ahead for BRACAnalysis, in addition to the company's six other marketed tests used to assess risk or optimize cancer therapy. Moreover, the company has 12 other highly differentiated products in its pipeline, as well as plans to expand its geographic footprint. The business has been highly profitable with greater than 20% operating margins, and has been significantly cash flow generative. We expect the company to grow its earnings at a high teens rate over the next five years, and to initiate a program to return growing cash balances to shareholders. At 23x estimated 2010 earnings, we believe the stock is attractively valued given its unique franchise and growth prospects.

To fund the position in Myriad, we sold shares in Stericycle, where we believe the potential upside is less.

Outlook

We remain fully invested and enthusiastic about the potential for the companies we own to deliver accelerating earnings growth as the economy improves. Moreover, price-to-earnings multiples remain below historical averages, which suggests there could be some improvement in valuations if market sentiment becomes more bullish. That being said, we are cognizant that regulators remain wary of inflation, and that the bias to interest rates is positive. An outlook for higher interest rates could quell some of the market's enthusiasm for all types of financial assets, irrespective of improvements in the economy. However, growth equities generally fare far better than fixed income in a rising interest rate environment. We believe a commitment to high quality growth equities continues to offer great potential to achieve long-term wealth creation.