REPORT EXCERPT OF THE INVESTMENT MANAGER

Review of the Quarter

….

Highly cyclical S&P earning power, which was deeply depressed in the economic downturn, recovered with a first half advance of about 63%. Our holdings' steadily growing "look through" earning power, which did not decline in the recession, continued to advance at a 15 - 20% annual rate, as expected. Beyond this year, we expect the growing companies we hold to grow about twice as fast as those in the averages. The portfolio presently sells at about 15 -16 times its estimated forward 12 month earning power, traditionally, a very attractive valuation.

….

Portfolio Changes

We initiated a significant new position in Apple, took profits in almost half of our holdings in Target and eliminated our remaining small positions in Techne and Chipotle.

Longer-term Prospects

Market sentiment is quite pessimistic now. Equity investors are particularly concerned with projected huge fiscal deficits throughout much of the world and lack confidence in governments' ability to remedy the situation. Accordingly, risk premiums are exceptionally high and shares in great businesses are correspondently cheap.

There has been a rush to invest in bonds where projected returns are at or near the lowest rates we've seen since WW II, providing no margin for error should inflation once again raise its head. On the other hand, many high quality businesses now provide better projected cash dividend yields than bonds do and these dividends are likely to increase over the years ahead and bond interest payments will not. While most of our holdings reinvest much of their cash for growth rather than pay large dividends, our portfolio's earnings yield (what they could pay out if they wished to) is now well over twice the ten year U S Treasury yield. Historically, good growing businesses' earnings yields have been about 75% of the ten year bond yield.

Warren Buffett has said that he is more concerned with the price he pays for a stock than in the timing of the purchase. Keeping that in mind, we are convinced that barring another major economic calamity, the price is right.

Perceived challenges to the system – wide spread and ongoing fiscal deficits in particular - are pervasive. So we do worry at least a little bit about timing. On the other hand, wide

spread pessimism is typical of market bottoms. We need to keep the following points in mind:

- Most large global businesses are exceptionally strong today.
- The worst economic downturn in recent history has created a significant amount of pent up demand while inventories are light. The stage is set for aggressive inventory accumulation when business leaders start to feel a bit more confident.
- Periods of economic expansion are often proportional to the preceding decline. Economists don't see that now. But even a little good news could move things in this direction and push concerns about long-term fiscal deficits to the back burner. At that point cautious investors' huge pile of cash on the sidelines could return to the market with a vengeance.
- The US and the developed world are operating well below their potential and a sustained advance could go a long way without creating economic imbalance.
- Consumers have been paying off their debt faster than the government has been adding to theirs and are now back to where they were in 2005.
- As the Democratic Party seems likely to lose some of its congressional seats, anti Obama concern among businessmen and many wealthy investors could diminish after the November elections.

Gave Kal's Anatole Kaletsky, has just written a book suggesting that following the 2008 debacle, the industrial world is in the process of developing a new and probably better version of capitalism that will permit well run businesses to prosper and provide great returns to their shareholders. This makes sense to me. We can buy great businesses at reasonable prices today. Accordingly, we are content with our portfolio, though we are not quite tempted to leverage it yet.

The long-term upside vs. downside looks great but how long it will take for things to work out remains unclear. It seems to me that US money supply and its turnover need to improve significantly to really get things moving. Businesses, consumers and their bankers will all have to become more optimistic for that to happen. A substantial advance from an oversold stock market could become a catalyst for that optimism.

In the long run we need assurance on only two questions: how much will the companies in our portfolio be earning in several years and what will investors be willing to pay us for that earning power? As I've pointed out in earlier reports, we aim to own a group of businesses that can more or less double their present earning power in five years and sell at 15 to 25 times that earning power, a 6.6 to 4.0% earnings yield. Achieving this goal would double or triple today's valuation for our shares and it's a plausible prospect even in a 6% bond yield environment, twice as high as investors settle for today.

Accordingly, our portfolio's long-term appreciation potential is terrific and it seems to me that it's well worth waiting for. That old adage, "they won't ring a bell when its time to buy" remains as valid as ever.

I ended my last note to you suggesting that further short-term consolidation remained a possibility. I believe we have now seen most of that consolidation and, while the future is far from clear, the market could be poised for better performance in coming quarters.

….

William P. Stewart for:
W.P. Stewart Asset Management Ltd.
Investment Manager

New York, New York
July 9, 2010