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Value Investor INSIGHT

The Leading Authority on Value Investing

Art and Science

Nearly everyone today claims a global approach, but Sarah Ketterer has been investing that way – with considerable success – for more than 20 years.

Sarah Ketterer has a simple answer for why stocks in today's hyper-competitive investing world can still, reliably enough, become attractively cheap: "Nobody's patient anymore," she says.

Ketterer's calm in the face of market storms has served her investors well. Her Causeway Capital Management now manages $13 billion in assets and its global value equity strategy has earned a net annualized 10.5% since inception in 2001, vs. 5.4% for the MSCI World index.

Combining quantitative stock screens with detailed company research, Ketterer and co-founder Harry Hartford are uncovering bargains today in such diverse areas as money-transfer services, grocery stores, emerging-market capital spending and energy infrastructure. See page 2

INVESTOR INSIGHT

Sarah Ketterer
Causeway Capital Management

Investment Focus: Seeks companies for which actual growth opportunities far exceed the myopic investor expectations currently built into the share price.

Seeing the Forest

Top-down investing is more in fashion since the financial crisis, but Jay Bowen and his father before him have been successfully using that strategy since 1972.

INVESTOR INSIGHT

Jay Bowen
Bowen, Hanes & Co.

Investment Focus: Seeks companies with the most attractively priced stocks in industries poised to benefit from what he considers key global economic trends.

Had his father's investment company not employed a big-picture approach to identifying attractive stocks, Jay Bowen, armed with an English Literature degree, probably would have looked elsewhere for work in 1986. "I'll admit a bottom-up, number-crunching approach probably wasn't for me," he says.

The fit has turned out wonderfully for Bowen, Hanes & Co. investors. The firm now manages $2.3 billion and its longest-lived equity portfolio has generated a compound annual return of 14.9% since 1974, vs. 11.8% for the S&P 500.

Keying primarily on trends tied to economic globalization, energy and commodities, Bowen today is finding opportunity in such areas as chemicals, water infrastructure, coal and railroads. See page 9

Inside this Issue

FEATURES

Investor Insight: Jay Bowen

Bowen, Hanes & Co.'s Jay Bowen explains why he's particularly enamored with stocks in Canada, what companies he expects to benefit from an industrial renaissance in the U.S., the development that would dampen much of his long-term optimism, and why he believes Canadian Pacific Railway, Teck Resources, Xylem and DuPont are mispriced.

Your strategy is driven more by the analysis of big-picture themes than company-by-company specifics. Why?

Jay Bowen: The firm since my father started it in 1972 has always taken a top-down approach. We begin with a broad analysis of global macroeconomic, political and technological trends, the objective being to determine how these trends will impact specific industries and companies. Our view is that if we can get in front of big trends and position our portfolios in sectors with the most secular growth potential, we're better setting ourselves up to add long-term value. There are plenty of ways to invest successfully – ours is not the only way and it certainly isn't always successful, but it's worked for us over a long period of time.

Give an example showing how you move from the top on down in your analysis.

JB: There are typically several pieces to the puzzle. We're very focused today on Canada, for example, based on a variety of political and economic trends. The government is pursuing economic reforms that we believe will keep it on a path with higher growth, lower unemployment and a stronger currency than will be possible in the U.S. They're cutting corporate taxes, reducing federal debt as a percentage of GDP and consistently moving higher on country rankings of economic freedom.

With that favorable economic-policy backdrop, Canada's abundant resources and best-in-class companies serving global commodities markets also make it ideally suited to benefit from growing secular demand for natural resources in an industrializing world. Once we've made these types of broad conclusions, it's then a question of finding the best ways to play them. For us today that translates into holdings in commodity producers, such as Teck Resources [TCK] in coal, copper and zinc and Canadian Natural Resources [CNQ] in oil and natural gas. It means holding railroads like Canadian Pacific Railway [CP] and Canadian National Railway [CNI], and pipeline companies like TransCanada [TRP]. It even supports our position in Bank of Nova Scotia [BNS], one of our few financial holdings, which has the tailwinds of being in Canada without the regulatory headwinds that U.S. banks face and which we fear could turn them more into utilities than thriving business enterprises.

Once focused on an industry, how do you select individual companies to own?

JB: Our top-down work is meant to uncover not just absolute trends, but those which we also believe will happen faster or with greater magnitude than anticipated. For that reason we generally expect the companies in a given target industry to perform better from a growth and profitability standpoint than what appears to be priced into the stocks. So in many ways picking individual stocks at that point turns for us into an in-depth relative-valuation analysis.

If we get the asset class right, the country right, the sector right and the industry right, we believe we're really at least 90% of the way there. The truth is that if we're interested in Deere [DE] and Caterpillar [CAT] – each of which we own – there's a good chance both are going to do pretty well. When choices have to be made, we go with the better value.

While we certainly don't have a black-box approach to stock selection, we're typically buying companies that have P/Es based on our forward earnings estimates that are below the market, earnings growth rates based on our estimates that are above the market, current dividend

Jay Bowen

Compounding Power

Two years after Jay Bowen's father, Harold, co-founded Bowen, Hanes & Co., the firm landed a prized client, the Tampa, Florida Pension Fund for Firefighters and Police Officers. The pension fund invested $12.1 million on September 30, 1974, starting a remarkable long-term relationship that provides an object lesson in the power of compound returns.

Tampa's portfolio consists of both stocks and bonds, although Jay Bowen, now CEO of the firm, says the fixed income portion is managed mostly for income and stability, so has more or less matched its benchmarks. The overall portfolio's outperformance, then, is due primarily to the fact that over more than 37 years it has earned on common stocks 3.1% per year more than the S&P 500, 14.9% vs. 11.8%.

The bottom-line result of that outperformance? Even after more than $600 million in net withdrawals, Tampa's assets with Bowen, Hanes have increased to more than $1.5 billion. The 3.1% per year alpha in common stocks has resulted in 2.75 times more money from equities than would have been generated by investing in the market index. Not a bad way to build a long-term client relationship.

yields and 10-year dividend growth rates that are above the market, and foreign revenues that are at least 50% of the total, with an emphasis on emerging rather than developed markets.

Is the dividend emphasis relatively new?

JB: We have been paying much more attention to dividends over the last couple of years. In this interest-rate environment, where consistent dividend payers are yielding more than government and corporate bonds, the demand for higher-yield stocks should continue to go up from investors looking for income. The long-term record for dividend payers is impressive: One study from last year found that from 1972 to 2011, when the S&P 500 returned 6.8% per year, shares of companies that didn't pay dividends returned 1.2% annually, while those that initiated or grew dividends over that period returned 9.1%. We think we're in a period in which the share of total return coming from dividends is likely to revisit the high levels of the 1950s and 1960s.

You've made the case for a "multi-year industrial renaissance" in the U.S. Describe that.

JB: One of the most important trends we're looking at is our belief, triggered by the shale-energy revolution, that over the next ten years it's possible that the U.S. overtakes Russia and Saudi Arabia to become the world's top oil and gas producer. That would have a significant impact on our entire manufacturing base, as a result of lower energy input costs and the heightened activity around the development, production and transportation of all the oil and gas.

The tentacles are long with something like this. The CEO of Nucor, the steelmaker, is talking about building lower-cost natural-gas-powered plants that can produce the same amount of steel with about one-quarter of the capital needed for a traditional coal-powered plant. You have lower production costs, lower input costs, savings for the customer and less emissions, making it a win-win for jobs, industry and the environment. In places like Ohio, investors have committed $2 billion to shale operations in the state and the French company Vallourec is spending several hundred million dollars to build production capacity for pipeline infrastructure. Those types of investments can transform a struggling Rustbelt state, and play out over and over again elsewhere.

What companies do you consider particularly poised to benefit?

JB: Some of the Canadian firms I mentioned earlier, including TransCanada and the railroads, would be big beneficiaries. As would companies like Dresser-Rand [DRC], which manufactures and services equipment that is primarily used in the exploration, production, processing and transportation of oil and natural gas. Even though their stocks have been fairly strong lately, we also still like the long-term prospects of machinery and equipment companies like Kennametal [KMT], which makes a variety of tooling and engineered products used in industrial production, and Timken [TKR], which makes bearings and related products used by original-equipment manufacturers.

ON U.S. "RENAISSANCE":

Within ten years it's possible the U.S. overtakes Russia and Saudi Arabia as the world's top oil and gas producer.

You own several consumer packaged-goods companies. What's the thematic element there?

JB: We've always had a solid representation in consumer-products and food companies, such as PepsiCo [PEP], Colgate-Palmolive [CL] and Procter & Gamble [PG]. Part of that is our view that they will incrementally benefit from the more rapid economic growth in developing markets, but we also like that they pay healthy and growing dividends and provide a cushion to the portfolio during sharp downturns. Given that we usually have high cyclical exposure, that defensive component has helped us over the years.

Every single holding isn't going to tie into a global, thematic trend. For example, we own John Wiley & Sons [JW/A], the book publisher, for no other reason than it's been a solidly growing niche company that has consistently delivered over the years and is attractively valued. We're not overly active in technology, but we've done very well with Teradata [TDC], which has a variety of proprietary enterprise computing solutions that we think provide a long-term play on cloud computing. In this case, we also believe it could prove to be an interesting takeover candidate, so it's somewhat of a special situation in that regard.

Do you have any portfolio rules or guidelines on things like position sizing or industry weighting?

JB: We really don't. On individual position sizes, our core positions at cost tend to be of relatively comparable weight – we don't try to distinguish that one idea is 20% better than another so we should have 20% more of it. As for industry and sector weightings, we are aware of the level of exposure we have, but have rarely found it necessary to pull back in any one area because we considered ourselves over-exposed. One thing we do pay attention to is an individual position becoming too large. If a stock gets beyond 5% or so of the portfolio, we'll usually take some profits and scale it back.

Elaborate more specifically on why you find Canadian Pacific Railway to be so compelling.

JB: Railroads have been an important part of our portfolios for years and this one fits nicely into any number of powerful top-down themes. With direct links to eight different ports in the U.S. and Canada, including Vancouver and Montreal, Canadian Pacific benefits directly from continued expansion in global trade. It plays a key role in the energy supply chain in Canada and the northern U.S., serving key resource areas such as the Bakken formation, Marcellus shale, Alberta oil sands and major ethanol production areas in the U.S. Midwest. It is a big player in soft commodities such as grain and fertilizer, serving the expanding global agricultural trade. Also, after heavy investments in infrastructure, the company has a major presence in intermodal shipping, which has increasingly become an efficient and cost-effective option for more and more companies.

From an industry perspective, we expect the operating leverage and pricing power exhibited by railroads in recent years to continue. That is especially true if high oil and gasoline prices persist, which enhances the cost-efficiency argument for railroads over truckers. We even consider railroads an attractive inflation hedge, given how they'd benefit from growth in demand and prices for natural resources.

What makes this particularly interesting is the potential here for an operating turnaround. Canadian Pacific under its existing management has long been a performance laggard relative to its primary competitor, Canadian National Railway, which has been a core holding of ours for many years. That underperformance has prompted a proxy fight by Bill Ackman of Pershing Square Capital, who wants to install five new board members as well as a new chief executive, Hunter Harrison, who is a former CEO of Canadian National. Canadian Pacific shareholders are scheduled to vote on Ackman's nominees at the annual meeting in May.

We take it you're not backing current management.

JB: There's a compelling case for change and we think the company is going to lose the proxy battle. Hunter Harrison says there's no reason Canadian Pacific can't move its operating ratio [operating expenses divided by net sales] from a current level of 78% to closer to the 65% Canadian National realized while he was running it. That's a realistic five-year goal and Harrison is ideally suited to lead the turnaround – you don't have to speculate about whether he can pull it off because he's done it before.

The shares have rallied since Pershing Square's entry into the picture and now trade at $75.25. What upside do you see from here?

JB: We assume that over the next five years revenue can grow by around 6% annually. If the proposed operating-ratio goal is met, that would translate into around $10 in per share earnings five years' out. At a reasonable 14x multiple, that would get us close to a double in the share price.

The lower operating ratio would also give the company more cash to reinvest in the business or return to shareholders in the form of dividends – the current yield is 1.6% – or share buybacks. That would be another plus if they can pull it off.

Staying in Canada, what's driving your interest in Teck Resources [TCK].

JB: We spoke earlier about our bullishness on global commodity demand, which will benefit Teck as a major producer of coal, copper and zinc. The more specific driver of our interest, however, is coal, which accounts for 50% of the company's revenues and which we believe is poised for a period of significant growth.

INVESTMENT SNAPSHOT

Canadian Pacific Railway
(NYSE: CP)

Business: Class I railroad operator hauling shipments primarily of intermodal containers, grain, coal and fertilizer in Canada, the U.S. Midwest and the U.S. Northeast.

Share Information
(@2/28/12):

Price	**75.26**
52-Week Range	44.74 – 77.55
Dividend Yield	1.6%
Market Cap	$12.79 billion

Financials (TTM):

Revenue	$5.18 billion
Operating Profit Margin	18.7%
Net Profit Margin	11.0%

Valuation Metrics
(@2/28/12):

	CP	S&P 500
Trailing P/E	22.5	15.8
Forward P/E Est.	17.6	13.1

Largest Institutional Owners
(@12/31/11):

Company	% Owned
Pershing Square Capital	14.2%
Artisan Partners	5.1%
Wentworth, Hauser & Violich	4.4%
Royal Bank of Canada	3.9%
BMO Capital	3.0%

Short Interest (as of 2/15/12):

Shares Short/Float	n/a

CP PRICE HISTORY

THE BOTTOM LINE

Jay Bowen believes the company is not only well-suited to capitalize on several key economic trends, but is also ripe for an operating turnaround currently being instigated by Pershing Square Capital. Assuming 6% annual revenue growth and that proposed margin goals are met, he believes the shares can reach $140 within five years.

Sources: Company reports, other publicly available information

What really caught our attention was last December's United Nations' conference in South Africa on climate change, which couldn't agree on a replacement for the existing Kyoto Protocol agreement that will remain in place until 2020. That means there's no binding long-term global agreement limiting greenhouse gas emissions, which we consider a bullish scenario for coal producers.

Another key point is that the Chinese domestic coal industry has been unable to keep pace with surging demand from its steel industry for metallurgical coal. For the country to achieve an efficient, stable coal-based infrastructure, it is going to have to rely on significant imports over the next several years. While Australian coal miners will be obvious beneficiaries, we believe demand will be high enough for Teck – already the second-largest exporter of metallurgical coal in the world – to benefit as well. It has the capacity to significantly increase its annual output of metallurgical coal and can do so at relatively low capital cost. It doesn't hurt its prospects in China that the company's largest shareholder, following a 2009 forced recapitalization, is the sovereign wealth fund China Investment Corp.

On the thermal-coal side, all our analysis points to strong global demand as new coal-fired electricity generating capacity is installed worldwide over the next several years. We're keeping a particularly close eye on Japan, which is expected to move sharply away from nuclear power following last year's Fukushima disaster. That will likely lead to significant import demand from Japan for coal.

Is anything particular of note going on elsewhere in the company?

JB: Demand for both copper and zinc should primarily benefit from expanding GDP growth in emerging markets. Copper probably offers the most potential for revenue growth, as the company has several advanced-stage projects entering production over the next five years.

Another kicker, which is not a generator of revenues or profits today, is Teck's Frontier oil-sands asset located in the Athabasca region of northeastern Alberta. They recently bought out their partner on the project and appear very committed to bringing it on line. It's all quite speculative at this point, but if it happens at anywhere near the scale projected, it could account for a meaningful portion of the company's market value within the next ten years.

Trading at around $41, how inexpensive are the shares?

JB: Earnings are likely to be volatile, but we believe with all the secular tailwinds can increase at a low- to mid-teens annual rate over the next five years. That would result in $7 to $8 per share in earnings, which at even a 10x multiple would result in close to 100% appreciation from today's price.

This has not been a stock for the faint of heart, but one big positive is that the company has significantly repaired its balance sheet through asset sales and by raising equity over the past three years. Long-term debt is now something like 25% of total capital. That allows us to more confidently focus on long-term supply and demand trends that we expect to work very much in the company's favor.

INVESTMENT SNAPSHOT

Teck Resources
(NYSE: TCK)

Business: Diversified mining company focused on commodities such as coal, zinc, copper and lead, with primary operations in Canada, the United States, Chile and Peru.

Share Information
(@2/28/12):

Price	**41.06**
52-Week Range	25.76 – 59.75
Dividend Yield	1.9%
Market Cap	$24.06 billion

Financials (TTM):

Revenue	$11.53 billion
Operating Profit Margin	37.0%
Net Profit Margin	23.2%

Valuation Metrics
(@2/28/12):

	TCK	S&P 500
Trailing P/E	9.1	15.8
Forward P/E Est.	10.2	13.1

Largest Institutional Owners
(@12/31/11):

Company	% Owned
China Inv Corp	17.5%
BlackRock	8.9%
RBC Global	3.7%
I.G. Inv Mgmt	2.2%
TD Asset Mgmt	2.2%

Short Interest (as of 2/15/12):

Shares Short/Float	n/a

TCK PRICE HISTORY

THE BOTTOM LINE

While company earnings may be volatile, Jay Bowen expects them to grow at a low- to mid-teens annual rate over the next five years, primarily driven by strong global demand for coal and expanded copper production. Applying a 10x multiple to his estimate of $7-8 in EPS within five years, the shares would increase 75-100% over that time.

Sources: Company reports, other publicly available information

Water is a commodity you haven't yet mentioned. How is it driving your interest in Xylem [XYL]?

JB: Xylem is one of three businesses that ITT Corp. broke itself into last October. We had been long-term shareholders in ITT and Xylem was the only piece we decided to keep – it is the highest-quality asset and the most interesting from a thematic standpoint.

The company provides a full spectrum of products for the transportation, treatment and testing of water, serving public-utility, industrial, commercial, residential and agricultural markets. It operates in a large, fragmented global industry in which big conglomerates tend to be involved, including GE, Siemens and Pentair. Xylem is the largest pure play, but while 65% of its revenues come from overseas, it currently is only available to service maybe 10% of the nearly $300 billion global market for water equipment and services. That gives an indication of the potential we see for it.

What water-related themes do you consider tailwinds here?

JB: In developed markets, demand is largely driven by the need to replace crumbling infrastructure, the need for enhanced pump systems to move water from more distant sources, and the need for more sophisticated testing and filtration systems to meet environmental regulations. To give one example, there are estimates out there that 60% of the U.S. water infrastructure should be replaced in the next ten years, at an estimated cost of approximately $1 trillion.

In emerging markets, more rapid growth is driven by infrastructure spending required by increased urbanization and by the general need for enhanced water systems for industrial, commercial and residential users as economies grow and populations expand. U.S. water demand tripled in the last 30 years, while the population grew only 50%. As a similar dynamic plays out in China – which has 21% of the world's population but only 7% of its fresh water – you can see how ready access to water is an ongoing problem that solutions providers like Xylem will be tasked to address.

Beyond purely economic demand, there is also significant need from a public-health perspective to enhance clean-water availability. More than one billion people today live without decent access to clean water, making death by treatable water-borne diseases one of the scourges of the third world. We're not holding out Xylem or others in the industry as having answers to all these problems, but it's clear to us that their ability to provide technologies and solutions to make things better will be in high demand.

The shares, at $26.85, are up nearly 15% since the spinoff. How are you looking at valuation today?

JB: Driven by both strong top-line growth and margin expansion from operating leverage, we believe the company has a good chance to compound earnings at a low double-digit rate over the next five years, to around $3 per share. Put a normal market multiple on that and the stock would trade in the mid-$40s.

While that's not an eye-popping prospective return, we'd expect it to outperform the market and also see potential catalysts on the upside. One would be

INVESTMENT SNAPSHOT

Xylem
(NYSE: XYL)

Business: Recent spinoff from ITT Corp. offering a broad spectrum of products and services supporting the transportation, treatment and testing of water worldwide.

Share Information (@2/28/12):

Price	**26.84**
52-Week Range	22.67 – 28.28
Dividend Yield	1.5%
Market Cap	$4.95 billion

Financials (TTM):

Revenue	$3.74 billion
Operating Profit Margin	13.0%
Net Profit Margin	8.7%

Valuation Metrics (@2/28/12):

	XYL	S&P 500
Trailing P/E	15.3	15.8
Forward P/E Est.	12.7	13.1

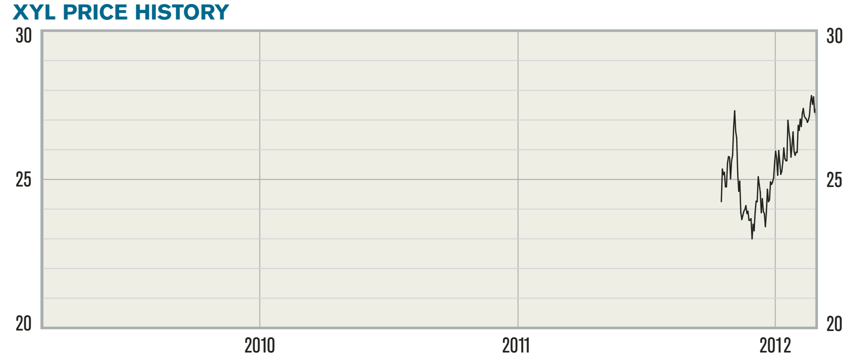
Largest Institutional Owners (@12/31/11):

Company	% Owned
Barrow, Hanley, Mewhinney & Strauss	7.0%
Vanguard Group	5.2%
State Street	3.6%
BlackRock	3.0%
T. Rowe Price	2.3%

Short Interest (as of 2/15/12):

Shares Short/Float	2.7%

XYL PRICE HISTORY



THE BOTTOM LINE

Its sole focus on water-related equipment and services positions the company to benefit from significant demand drivers in both developed and emerging markets, says Jay Bowen. Putting a market multiple on his EPS estimate five years' out, the shares would trade in the mid-$40s. A naturally higher profile would provide added upside, he says.

Sources: Company reports, other publicly available information

from multiple expansion as the earnings numbers come in and the stock generates more institutional interest on Wall Street. Since the spinoff Xylem has had a very low profile – we typically like that when establishing a position, but we expect it to change as the company prospers.

In addition, there's a very good chance that this fragmented global industry becomes less so as the leaders look to consolidate market share. We'd never own it for just this reason, but I can't help but think at some point Xylem would make a very attractive acquisition for a larger industrial company looking to expand its water business.

Describe your investment case for DuPont [DD].

JB: We consider DuPont somewhat misunderstood. It operates in a variety of traditional chemicals businesses tied to construction, electronics and plastics, but what attracts us is that 75% of its capital and R&D expenditures are allocated to segments that we believe have very strong growth prospects. It's evolving more into a high-tech science company and away from a cyclical chemical company.

At a broad level, it's geared nicely to global economic growth, with operations in 80 countries, 60% of revenues coming from outside the U.S., and 35% of revenues specifically in emerging markets. While it's getting out of businesses like car paint – which could bring in more than $4 billion in a sale – it continues to expand in strong secular-growth businesses like agricultural commodities and alternative energy.

The agriculture business provides hybrid corn and soybean seeds under the Pioneer brand name and also sells herbicides, fungicides and insecticides. Global food demand is estimated to increase 70% by 2050, with an increasing percentage of calories consumed globally coming from corn- and grain-fed animal products. Given that the amount of unfarmed arable land around the world is limited, the only way to meet that increased demand is through improving crop yields on existing farms, which is what Pioneer is all about. It's the oldest and largest seed company, has been capturing market share from competitors on a consistent basis since 2008, and has a strong pipeline of new products coming out over the next few years.

Another key growth area for DuPont is providing materials and systems for photovoltaic products used in the solar industry. It has key strategic relationships with many of the top industry manufacturers and has been an innovator in helping advance solar-module performance. Management has set a goal of $2 billion in sales into the photovoltaic market by 2014, up from $1.4 billion today, and we think that's reasonable given the still-rapid growth in solar installations globally.

There are other areas with energy, environmental, nutrition and health applications that have intense R&D and acquisition support. As these markets expand, innovations are commercialized and acquisitions assimilated, we see potential for significant incremental returns.

How does all that translate into upside for the stock, now at around $51.40?

JB: We believe the company can increase earnings per share to $6.50 to $7 over the next five years, which would result in

INVESTMENT SNAPSHOT

DuPont
(NYSE: DD)

Business: Global chemicals producer serving markets including agriculture, nutrition, electronics, communications, construction, transportation and apparel.

Share Information
(@2/28/12):

Price	**51.39**
52-Week Range	37.10 – 57.00
Dividend Yield	3.2%
Market Cap	$47.91 billion

Financials (TTM):

Revenue	$38.44 billion
Operating Profit Margin	12.8%
Net Profit Margin	9.0%

Valuation Metrics
(@2/28/12):

	DD	S&P 500
Trailing P/E	14.0	15.8
Forward P/E Est.	12.0	13.1

Largest Institutional Owners
(@12/31/11):

Company	% Owned
State Street	4.5%
Capital World Inv	4.0%
Vanguard Group	4.0%
BlackRock	2.5%
JPMorgan Chase	2.4%

Short Interest (as of 2/15/12):

Shares Short/Float	1.3%

DD PRICE HISTORY

THE BOTTOM LINE

The company's evolution beyond its cyclical industrial-chemical roots is not well recognized by the market, says Jay Bowen. Bolstered by growth in such areas as agriculture, alternative energy, health and nutrition, he believes earnings can grow as much as 10% per year and that the shares within the next five years can reach at least $90.

Sources: Company reports, other publicly available information

above-average annual growth in the 9-10% range. At the same time, on consensus 2012 earnings estimates the stock is at only 12x earnings, less than the estimated 13x at which the S&P 500 trades.

Put a 13-14x multiple on our long-term earnings projection, and the stock price would be around $90. On top of that, the shares now pay a 3.2% yield – a 70% premium to the 10-year Treasury – and the company has a history of increasing dividends at an above-market rate.

When your thesis proves faulty, does it tend to be more of a problem with the company, or with the trend you were counting on.

JB: Either can certainly happen. We had owned communications-equipment supplier Harris Corp. for many years, but concluded late last year that its revenues were more at risk from government spending cuts than we were comfortable with, and that management just didn't have as solid and cohesive a business plan as we wanted. We also recently sold Nokia after concluding that while the valuation was seemingly interesting, we had been excessively enamored with the dividend yield and also underestimated the negative impact on margins and earnings from commoditization in the handset market. Can they innovate around that? Maybe, but it wasn't a bet we were willing to make.

How did your strategy hold up in 2008 and 2009?

JB: We certainly suffered much of the pain everyone did, but one advantage we have is that our average client has been with us for close to 20 years. They value and share our long-term perspective, and were willing to ride through that period with us. That gave us the luxury of not having to liquidate holdings at exactly the wrong time, which positioned the portfolio well to come back as quickly as it did.

Most of the trends you've discussed are positive ones. What worries you the most on the downside?

JB: My biggest concern is that the U.S. doesn't get its fiscal, monetary, and regulatory-policy house in order to support economic growth. The federal budget deficit and national debt are trending to levels that will have dire, long-term economic and social consequences if not reversed. We need a policy regime that not only reduces the burden of government spending, but also increases the incentives for work, risk-taking and capital formation.

I'm optimistic, but there is a risk we don't learn from Europe and Japan, whose policies on a variety of fronts have produced economic lethargy. If that happens and we keep trying to muddle along as we currently are at the policy level, our portfolios will have to have a dramatically different complexion than they do today. VII