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Thanks Skip

In the midst of the 2008 market correction, we received a note from Hans W. Wanders, the retired Chairman of Wachovia Bank. Skip, as he is more commonly known, served Wachovia from 1970-1988 when the bank had the reputation of being the strongest regional bank in the country. His comforting words came during the very uncomfortable month of October 2008 and read as follows:

> *"Andy-Hope all is well. This is the moment for clear heads to remain optimistic. Quality will be rewarded. Regards, Skip"*

That encouraging note—now prominently posted in Hamilton Point's offices—served as welcomed ballast as we responded to the unfolding banking crisis. In this Newsletter we hope to answer the question of just what is meant by the term "quality" which was once so important to Wachovians like Skip and drives our investment process here at Hamilton Point.

"Quality is Not an Act, it is a Habit" -- Aristotle
By way of background, Hamilton Point's proprietary Global Core Equity philosophy took shape nearly twenty years ago with an uncommon emphasis on quality. Of course, whether or not an investment is of high caliber has always been a matter of opinion, but the discussion now goes beyond what should be considered "blue-chip" as further qualifiers like *green*, *sustainable* and *socially responsible* have come into vogue. As indicated with our Sustainability Report cited in our cover letter, we remind investors of the benefits of careful in-house research and point out that selected global companies are exceedingly attuned to being good citizens, recognizing that treating employees, customers and suppliers well is perhaps the best way to enhance shareholder value over the long term.

Before talking further, allow a review of the screening process we use to develop Hamilton Point's Global Core Buy List. We first select those public companies with market capitalizations of at least $2.0 Billion, thus identifying some 1,300 candidates. This list is pared down to around 200 once we eliminate outfits with high debt, low margins and/or intermittent profitability. The most quantitative part of our process, this allows deeper research on only those companies with truly outstanding financial fundamentals.

We then sort out companies operating in industries with poor competitive environments like steel, autos, airlines and many retailers. The theory here is that except in cases where you invest in a company that has a clear dominating advantage, a high quality industry is one where most participants are healthy and act sensibly. We further eliminate companies and industries that lack regulatory clarity such as most healthcare segments and, most recently, banks and brokerage companies since they have largely become "wards of the state" rather than entrepreneurial enterprises, in our view.

A critical hurdle a company must also pass is that of selling a "value added" product or service. This is a subjective qualifier, not based on any moral twist, but strictly on business issues. For example, **Phillip Morris** passes quantitative financial tests but fails our criteria because its products are bad for customers and

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regulators despise the industry. Much the same can be said of casino companies whose overall "value proposition" is certainly skewed away from customers.

Who Does Sustainability Sustain?
Looked at in this light, we ask ourselves the question, "if we want to invest to meet the demands of the emerging global consumer—and can do so owning companies that make useful products like food, toothpaste, sneakers or elevators—why would we bother owning tobacco, sugary drinks companies or gambling houses?" This may sound elementary, but it can get complicated. For example, we own defense companies whose business is to help soldiers better communicate or to have night-vision glasses—not necessarily a pretty endeavor, but one we deem to be "value-added" in terms of using technology to make our world safer. We also own a company that develops and sells genetically modified agricultural seeds that, on an industry-wide basis, allow billions more to eat well, but some argue that investing in this kind of aggressive science may eventually turn out badly.

So we do the best we can, directing our research in ways we believe will preserve capital and provide growth for investors while avoiding obviously malevolent businesses and unhealthy industries. Together with valuation discipline and the previously mentioned financial criteria, our process steers us clear of wide swaths of the market. The effect is dramatic when comparing our Buy List of approximately thirty five stocks to index funds or those closet-index managers of many of the largest so-called Blue Chip funds.

Big is Rarely Better
Investment performance cannot be guaranteed, but an investment secret of ours is that it is not only what we *buy* in client portfolios —it is what we *avoid* that matters as well. For example, a whopping 50% of the value of the S&P 500 is comprised of just fifty huge companies. If there is one thing the banking crisis should have taught investors it is that poorly managed, debt-laden companies are not a source of comfort simply because of their size or brand name. Notably we own only 14 of the 50 largest companies (no banks, brokerages), favoring instead many mid-sized companies with high quality attributes. Using the flexibility offered by our size, we can be uncertain about the broad market while simultaneously being optimistic about our Global Core Equity investing because we believe *every stock we own is a well-managed, low-debt, continuously profitable company that operates in a rather clean industry with a modicum of regulatory clarity."* A mouthful you say? Yes, but our philosophy just the same.

We should also mention that most portfolios we manage are on either a Fully Diversified Balanced or Fully Diversified Equity basis. Therefore our Global Core Equity process comprises a meaningful part of every portfolio, but is supported by individually-purchased, high quality bonds and selected funds that give clients "endowment-like" exposure to other categories like TIPS, Foreign Bonds, Gold, Emerging Markets and Small Companies.

Before closing, let us share two reasons why we so freely disclose some of our proprietary investment methodology in the form of a Newsletter published on our website. First, even if they wanted to, money managers with billions upon billions under management could not physically invest all that money on such a selective basis (advantage us) because of stock liquidity reasons. Secondly, many managers in the business are, to a fault, risk takers/traders and our style would quickly bore them (but probably not their clients!).

We hope readers now have a better idea of what we mean when we say the word "quality" and we offer belated, but sincere, thanks to Skip Wanders for his kind words.

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Hamilton Point Investment Advisors is an independent and independent-minded, boutique investment advisory firm. Please contact us for a complimentary review of your portfolio. In addition, visitors to the firm's website, www.HamiltonPoint.com, can read past investment newsletters.