



April 12, 2010

Quarterly Commentary

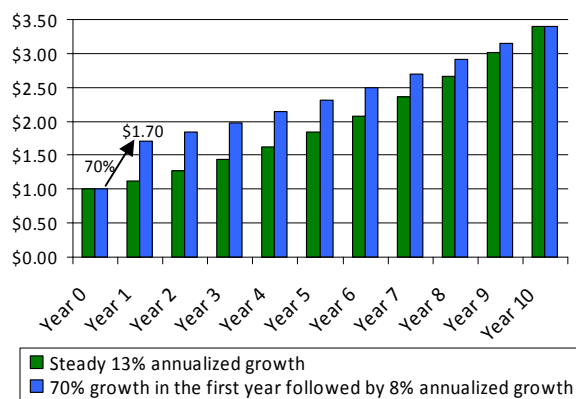
1st Quarter 2010

“Be careful what you wish for. You just might get it.”

You may recall that just a short twelve months ago we were informing our clients that bargains in public equities abounded to such an extent that our buy list had more than doubled in short order. The stock markets’ disdain for well-financed leaders of industry had created the buying opportunity for which we had been hoping. Stocks officially bottomed on March 9, 2009, a little more than one year ago. A powerful stock rally of sizable proportions (approximately 70%) has followed. While we are thankful for the compressed returns that this rally has provided, it makes our job of producing attractive long-term future returns on your capital more difficult. Let us explain.

We prefer to think of returns over long periods of time. This is why we strongly encourage our clients to make the minimum commitment of five years to our firm. We believe the more our clients can think as long-term investors in businesses, the likelihood of success increases substantially. While five years should be a bare minimum time horizon for stock investors, we prefer to think in even longer periods of at least ten years. One year ago, when we were presented with a market of stocks selling at sizable discounts to their intrinsic values, we believed that long-term (ten-year annualized) future returns for stocks would likely be above-average. Since long-term returns for stocks over approximately 100 years have been roughly 10% per year annualized, we could have made a case that the next ten-year returns could be in the 12%-13% range. Our current challenge is that we have now received approximately five years of return concentrated in one year. This compression of return on the front end could negatively affect the back end.

The simple math goes something like this: a 13% annualized return for ten years grows \$1 into \$3.40. However, should you receive a 70% return in year one, the remaining return over the next nine years is approximately 8% annualized to end up with that same \$3.40 at the end of the ten-year period (see chart to right). Put simply, our job of finding bargains for you has become more difficult as stock prices have rapidly appreciated.



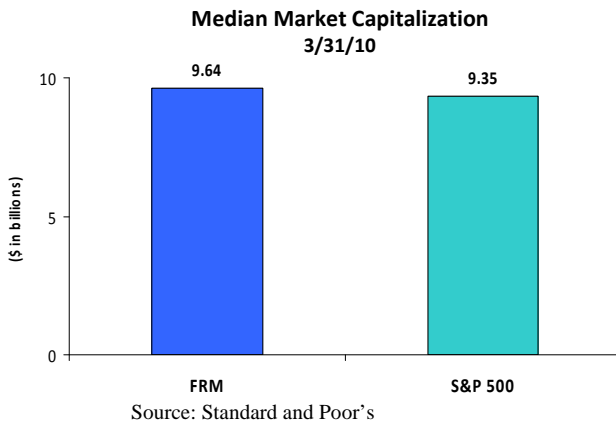
Since we last wrote you in early January, our investment team has analyzed approximately 60 additional companies and their stocks. Every company that we analyze is accorded a buy price and a sell target should we eventually purchase the stock for you. Our analysis is consistent and conservative. Generally, we are willing to purchase a stock if we believe the company has a solid balance sheet to weather potential financial difficulties and a stock price that is adequately discounted from intrinsic value to provide an annualized return on our clients' capital of approximately 15% (higher quality companies could be slightly less, lower quality companies should be more). This return on capital is sufficiently high so that we receive a margin of safety should our original analysis be flawed (definitely a possibility).

Of those 60 companies we have formally analyzed over the last three months, only one stock has measured up. Much of this challenge is due to the rapidly rising market. We began buying this particular security during the past quarter and the stock price ascended so rapidly that we were only successful in purchasing it for approximately half of our clients. Remember, we hang our hat on our price sensitivity. We remain patient and prepared to purchase additional shares with a reasonable pullback in the stock, and we will inform you of the name once our position is fully acquired. Keep in mind though that none of this work on these 60 companies is lost. We are constantly monitoring these, as well as many other, researched companies and are prepared to take them off the shelf for re-analysis if their buy price target is triggered. What we have created is a growing inventory of potential future investment gems. However, we must buy them on our terms, not the current markets'.

This rare occurrence gives us an opportunity to discuss with you our firm's trade execution order policy. In order to be equitable to all of our clients, we use a computerized random order generator segregated by custodians. This way no single client or group of clients with a particular custodian is favored or hindered. Over time, each client should have equal opportunity to be first in order to purchase and sell stocks. Because generally we are buying on weakness and selling on strength, we usually are able to execute orders for all of our clients in a consistent fashion. Sometimes patience is required.

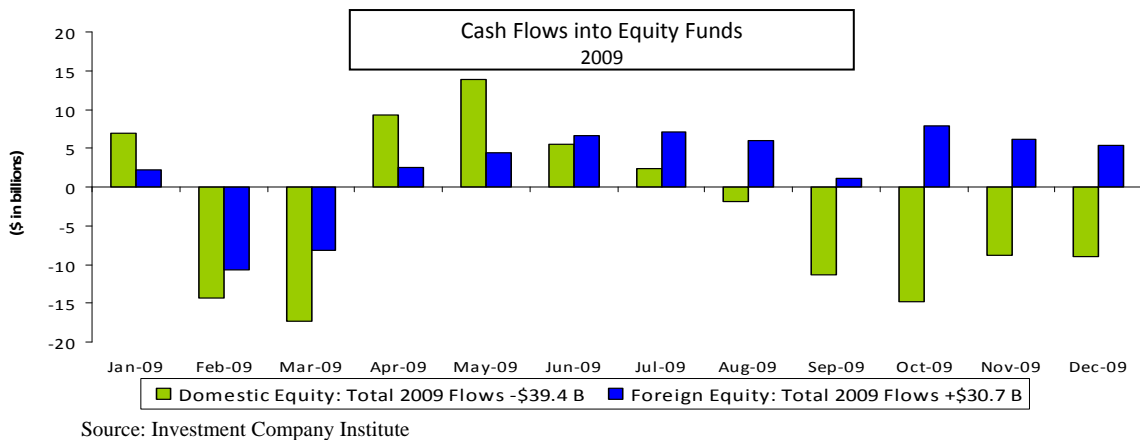
All Cap Value

One thing that we have attempted to do at Foundation Resource Management is identify and implement the few factors that give us, and hence you, the advantages necessary to provide you with superior long-term investment performance. We mentioned earlier how important it was to maintain a long-term focus by considering a five-year minimum investment horizon. Another critical advantage to our past and future success is our ability to locate and invest in a broad array of different size companies. This is why we are often referred to as an All Cap Value Manager. This freedom to invest across the size spectrum provides a tremendous advantage for our clients. We have found throughout our careers that there can be periods when certain sized companies can be unpopular or ignored. This can create considerable investment opportunity. If we were restricted to investing exclusively in large cap, mid cap, or small cap companies, we could be hindered from capitalizing on the markets' best offerings. For this freedom, we are thankful to you, our clients, and believe strongly that we have both benefited. Interestingly, we have recently found most of our investment opportunities in many stocks that would clearly fall into the



large cap category. Since value managers generally attempt to buy low and sell high, if there is a bias to our value investment approach, it is toward smaller companies as their capitalizations generally are depressed upon purchase. Probably for the first time in our careers, however, we have a portfolio with a median market capitalization larger than the S&P 500 Index (see chart to left). We believe that this is noteworthy.

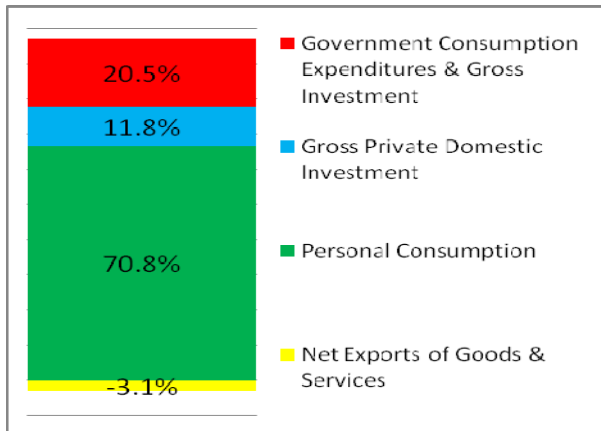
While stock prices have risen over the last year, there is little evidence that this rally is due to increased sponsorship of stocks by individual investors. As can be seen from the chart below, there has been no significant movement of money into stock mutual funds in the last year. What little in-flows there have been into equity mutual funds have been concentrated into emerging foreign markets. This drought of money flows into stock mutual funds, however, is not unusual, since cash in-flows into equity funds generally do not begin to pick up until the second year of a market rally. According to Standard and Poor's Equity Research, this is the fourth bull market since 1987, and during each bull market it has been the second year before sizable cash in-flows into equity funds began. As is common, stock investors appear to be looking in the rear view mirror in making their investment decisions. Most investors are well aware that the past decade was the worst decade of stock returns in U.S. stock market history.



Living Within Our Means

Seasonally, the first calendar quarter of each year is a busy time for client meetings. These meetings are two-way in nature in that an important function of our job is to listen. When we notice a pattern of communication amongst our clients, we often take note. Recently, we have been hearing from our clients a great deal of angst about government policies regarding the subject of national debt. What makes us take note is that this consternation seems to be bi-partisan. There appears to be enough blame from our clients for both parties. While government policies and statistics generally dominate the headlines, we believe it is important to try to put things into perspective. As you can see from the following chart, the U.S. economy consists of three major factions. While the current and past fiscal and

monetary policies of our government concern us, we can not ignore certain positive trends by consumers (70.8% of 2009 GDP) and corporations (11.8% of 2009 GDP) that could outweigh the government sector (20.5% of 2009 GDP). While it is most people's opinion that, as a nation, we have been living beyond our means, individuals and businesses have finally begun to adjust their respective lifestyles to a more healthy condition. Sadly, our federal government has not yet gotten this message. Total U.S. household debt, including mortgages and credit card debt, fell 1.7% in 2009 to \$13.5 trillion. This is the first annual drop for individuals since records began in 1945. This debt amounts to \$43,874 per U.S. resident, still a very high number. Before you begin to

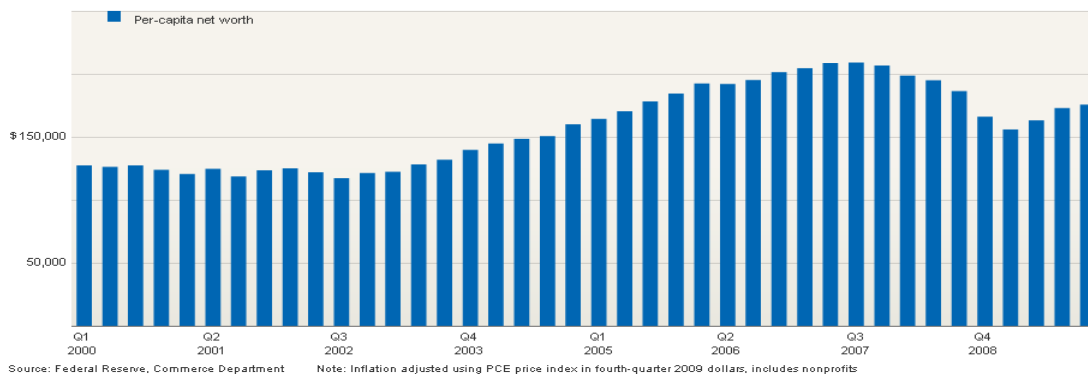


Source: Bureau of Economic Analysis

celebrate about the improvement, it should be disclosed that a significant part of that debt reduction has come from defaults on mortgages and other financial obligations. Combined with an increasing savings rate (up to 4.1% currently from 1.2% in early 2008) and an increase in the per capita net worth (see chart below), this news gives us more confidence that the consumer is improving his financial condition. This can lead to improved economic activity.

Making Gains

Per-capita net worth in the household sector rose 5.7% in the fourth quarter from a year earlier.



Source: Federal Reserve, Commerce Department

Note: Inflation adjusted using PCE price index in fourth-quarter 2009 dollars, includes nonprofits

Source: Wall Street Journal

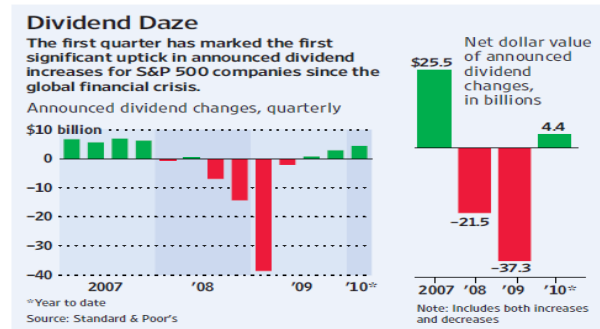
Likewise, corporate balance sheets have been rapidly improving. As of year end 2009, non-financial corporations held a record \$832.4 billion in cash, up by more than one-third since year-end 2008. This record liquidity is being driven by a recent rebound in corporate profits as well as conservative cash deployment. S&P 500 companies tripled their per share earnings in the fourth quarter of 2009 as compared to the fourth quarter of 2008, the bottom of the recent financial downturn. Thomson Reuters is projecting a 36% rise in per share profits and a 10% rise in revenues for the first quarter of 2010.

We would counsel you to keep your eye on the entire picture. While government decisions seem to add daily to our offspring's share of the national debt, we are seeing some encouraging signs in the corporate and consumer sectors. As flawed as we might be, the

U.S. is still where we choose to live due to our nation's entrepreneurial spirit, our rule of law, and our broad array of freedoms.

How Important Are Dividends?

Historically, more than 40 % of the total return of stocks comes from dividends. Until very recently, dividends have been in a bear market. In 2009, the companies in the S&P 500 Index reduced their dividends by a net \$37.3 billion (see chart) on a current total payout base of \$206 billion. During the financial crisis of 2008-2009, many companies were forced to cut dividends to maintain their creditworthiness and to conserve cash during the credit crunch. However, many other companies have declined to pay dividends by choice rather than by necessity. As signs of recovery become more broad-based, companies have the ability to raise capital more freely.



Source: Wall Street Journal

So far this year, companies in the S&P 500 Index have raised annual dividends to the tune of \$4.4 billion. In 2010 we have seen increased dividends in our holdings from **ConocoPhillips, Fairfax Financial, Pfizer, Raytheon, and Sanofi-Aventis**. Also, **Freeport McMoran Copper and Gold** reinstated their dividend. Unfortunately, portfolio holding **Valero** was one of only two companies in the S&P 500 Index to cut their dividend this quarter.

Personnel Update

In March, we hired Lauren Edmondson as a Portfolio Accounting Manager. Lauren will be a great addition to our administrative team. She has a B.S.B.A. degree in accounting from the University of Arkansas. Lauren also has investment industry experience with another investment advisor as well as with a brokerage firm. As our firm steadily continues to grow, we are thrilled to be able to add quality personnel like Lauren to serve our clients.