

*Marble Harbor Investment Counsel, LLC*  
*Excerpt from*  
*Third Quarter, 2011 Letter*

Dear Client:

Your companies typically set their own course. Their businesses are not highly dependent on the ups and downs of the economy. They operate in attractive industries, supplying items and services of need, rather than purely desire. They are able to grow despite difficult environments, due to the nature of their businesses. By maintaining strong balance sheets and generating strong profits and cash flows they can capitalize on the difficulties of others. They return prodigious amounts of cash to us as share owners. Our companies are in as good of a shape as we could expect.

That all being said, no man is an island — and no company is entirely immune from its operating environment. Our challenge remains owning businesses for you that are particularly strong — those that have characteristics that position them well to weather this persistently difficult environment. We won't rehearse for you in detail the litany of headwinds facing the global economy — a brief refresher should be adequate: Mounting debts in the public sector around the globe make it likely that GDP growth will at the least be muted for some time to come — debt-driven stimulus spending has essentially "pulled forward" some economic growth from tomorrow to cushion the blow of "The Great Recession." The Euro-zone is in a tough bind, as the strongest members may be forced to bail out the weakest, to the chagrin of all the citizens (the Greeks take umbrage at needing German help, and the German citizenry resents bailing out their profligate southern neighbor). Cracks are beginning to emerge in China's 10%-per-year economic miracle — lo and behold, it turns out that their export-driven economy may in fact be dependent on the markets to which they export, and a fair bit of their recent capital spending may have been wasted. And so China may be less of a growth engine than it has been in the recent past.

We have a dichotomy: Strong companies operating in difficult economic conditions. Where does this lead us? We go back to first principles. Acknowledge that investing is hard, and so try to line up as many things in our favor as possible. Own companies that have an economic future that we can understand. Invest in excellent businesses. Favor companies that can prosper in many different ways rather than those that are dependent on just one or two big things going right. Lean toward strong balance sheets and conservative structures. Don't invest for some pie-in-the-sky hope. Try to get returns up front (dividends) rather than in the future. At the margin, hold a bit more cash than is typical. Seek valuations that make sense even if things don't go well. This all implies a bias toward conservatism that has served us well over the past several years.

The companies you own fit these criteria. Our companies currently carry inexpensive valuations, which suggests good investment potential. This gives us some comfort in the face of the market's volatility. This cognizance of the risky environment suggests that if we are all surprised by a particularly strong economy and a stock market that races ahead, we will likely lag a bit. But that



is OK, as we continue to show more resiliency in those periods when the market is weak. After all, it is not what you make, but what you keep. And we want you to keep as much as possible!

The turmoil in the equity markets naturally begs the question, what about bonds? As we have frequently opined, bonds can have a role in portfolios, as an "anchor to weather" providing some level of price stability, especially when held to maturity. As for income, bonds are currently a poor source. The yield on your stocks is greater than a conservative portfolio of medium-maturity bonds. And we know there is no chance for an increase in the income from the bonds, while the record of dividend increases in your stocks argues for an income stream that should rise faster than inflation over the next several years.

We hope you are well. As always, please don't hesitate to call with questions or comments.

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