



RCB Manager Commentary
September 30, 2009

Since we used the term “massive rally” in our second quarter commentary, we are somewhat out of sorts in attempting to describe financial market activity in the third quarter. Continued improvements in worldwide credit markets, definitive signs of slowing rates of decline in economic activity, and the silent and global *whoosh* of money being pried out of non-earning mattresses and Treasury bills were the key drivers behind the continuation of the rally in equity markets.

As Woody Allen famously noted, 80% of success is just showing up and a lot of our superb performance in the quarter was just that. Having put money to work in the first and second quarter, we were prime beneficiaries of what some have called the “2009 Value Restoration Project.” As our portfolio is a mix of both economically defensive and offensive names, we were particularly pleased to keep up and beat the benchmarks in such a massive upward move. Somewhere in our first few minutes with new clients, we try to make it clear that our investment objectives are to be competitive in rising markets and outperform in downward markets. This combination of “winning by not losing” has proven to be a highly durable and mathematically correct strategy over decades. We would suggest that the practice of investment management in the past two years has been conducted under “unusual” circumstances and the wide range of short-term outcomes experienced by clients is less likely to be repeated in the intermediate future.

Going forward, we admit once again to being stymied in our attempt at original thinking post our second quarter commentary. The March lows reflected equity pricing that was so extreme it almost didn’t matter what the economy was going to do in the next two years. Our research suggests that valuations have returned to a more neutral stance, which makes an economic assessment even more confusing as you have to consider the possibility that you may not be compensated for the risk that the environment could turn out differently than forecasted. What we thought was very under-appreciated in equity prices (and still do to some extent if we were forced to admit a forecast), is that much investor attention is backward and short-term oriented when it should be long-term oriented. It is often focused on the need for tangible signs before action, when it is simply the fact that values are greatest when the near term is most uncertain. Investors are also slow to react to new information, such as the unbearably grim outlook for housing which is a viewpoint that is approaching its third birthday, and market forces have quietly been at work undermining its premise. It is thus entirely possible to imagine that economic life as we know it might truly be improving and we might be astounded at economic activity in the intermediate term, despite the busy bees in the District of Columbia.



But we don't know and frankly neither does anyone else quoted or interviewed in any form of media. We continue to assess the valuation cards offered by Mr. Market and attempt to build reasonably diversified portfolios of risk/reward candidates on our traditional analysis of the business, the value and the people who run it. We have a portfolio that our research suggests is an excellent combination of offense and defense in a variety of economic environments, and we are confident that we will be competitive in very strong markets and outperform in difficult markets.

Please do not hesitate to call us if you have any questions about your portfolio or our investment strategy.

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