



## Mid-Quarter Newsletter

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### From My Corner

Jeff Mengis – President

#### Market Comments:

For the last year and a half, all sectors within the equity market have been correlated alike. Almost all stocks were affected similarly – they went down. While this is not uncommon during periods of high volatility, there are now some signs that strategic stock selection could enhance portfolio returns going forward.

In this recent rally from March lows, owning the right stocks has made a difference. For example, a company like airline parts maker Precision Castparts (PCP) had been hampered by concerns over reduced product demand due to a strike at Boeing and reduced orders for planes. However, the stock has surged in recent months as investors looked past these short-term issues. Despite a difficult 2008, they still managed to earn record revenues and profits due to a disciplined management team, which improved productivity and took advantage of reduced material costs. Above all the company benefitted from their ability to make superior specialized products that significantly improve a plane's efficiency. This competitive advantage is why we companies like Precision Castparts for the long-term.

During difficult markets, we find it reassuring to evaluate each individual holding and review why we maintain a long-term position. In this environment, we want stock in companies that at a minimum have manageable debt, advantages over competition, strong management and an ability to maintain healthy margins. Our objective is to align our portfolios in companies that will emerge from this downturn positioned to thrive when the economy does recover. While we expect market fluctuation in the months ahead, we believe this approach will benefit our investments over the long-term. If you would like to review your portfolios with us, please do not hesitate to call. As we look forward to the warm days ahead, we wish you and your family a safe and enjoyable summer.

### Investment Focus:



“Change” is a word we are all hearing a lot of these days. One sector of the economy bracing for significant change is health care and the pharmaceutical industry.

Many large pharmaceutical companies have a slate of blockbuster drugs coming off patent over the next few years. Furthermore, President Obama has proposed reducing patent protections for pharmaceutical companies. In addition, the weak economy is moving consumers away from expensive branded drugs to more affordable generic drugs. All this is occurring while the baby boomer generation nears retirement. One company that is poised to benefit from these trends is **Teva Pharmaceutical (Ticker: TEVA)**. TEVA is a global pharmaceutical company that develops, manufactures and markets generic and proprietary drugs. In 2008, 75% of Teva's \$11 billion in revenue came from generic drugs. As the trend shifts away from branded drugs toward generic, we believe Teva is well positioned to grow.

While many competitors are worried about losing revenue, Teva stands to gain revenue through new generic drugs. Currently, Teva has around 200 new product applications pending with the FDA. The branded versions of those drugs generate combined annual sales of \$110 billion. In addition, Teva is expected to realize cost savings of about \$400 million over the next three years from a recent merger with Barr Pharmaceutical, which compliments Teva's business and geographical footprint. Teva's stock price will depend somewhat on their ability to implement the merger. Fortunately, their management has experience with successful mergers over the last 5 year's. The company is also facing currency headwinds due to the stronger dollar, yet that risk appears to be priced into the stock. Teva is trading at 10X next years forecast earnings, making it an attractive entry point for a long-term holding.

