The Commonsense

INVESTLETTER

Volume 5 Number 5

Wall Street:

- DJ 13408
- S&P 500 1503
- NASDAQ 2603

Miscellanea

Adviser Article Follow Up:

Here are our rules for safe investing.

Don't let excessive fees keep you from getting what you have coming

1) Cut out the middleman: By directing your own investments you reduce the transaction costs and reduce the risk that some miscreant will abscond with your money. The pool of investment returns in the country is limited. As it relates to the stock market, the total pool of returns available to investors is the total value of the rise (drop) in price of all the companies on the stock market. Each layer of middlemen that gets added to the system, the less that is available for the investor at the end of the chain. If you invest using mutual funds, the fund company skims off a layer before you ever see your money. There is such a thing as a fund of funds. It is a mutual fund that invests in a portfolio of mutual funds. Now you have a mutual fund paying fees to other mutual funds before they charge their investors another layer of fees. Again, the owner of this "ponzi" scheme is ultimately shouldering the cost. These expenses reduce the total pool of returns available to be distributed to investors. Hedge funds are also laced with abusive expenses. Often a hedge fund skims off 20% of the returns above a predetermined level after already collecting expenses on the total pool of assets they direct. With a hedge fund managing hundreds of millions or billions of dollars, the take can be as high as a hundred million dollars. By cutting out the middleman the extra returns flow right into your account.

2) Do it yourself and/or find competent advice: Research your investments, find a proven emotionless process that allows you to make superior investment choices. Or, find competent proven advice to guide your decision making. If you don't see yourself enjoying the process of reading regulatory filings and researching companies there are many ways to obtain proven advice. We certainly have our preference.

These two rules can help you maximize your returns and eliminate anyone from getting their hands on your money.

Process Versus Noise:

Emotions are an impediment to successful investing. Emotions lead you astray and cause investors to focus with their heart instead of their intellect. The process by which you analyze investments determines whether you are successful. Wonderful short term results don't imply you are a successful investor. Your results are a measuring stick not confirmation that you have successfully found a means of continually producing superior performance. Here is an excerpt from a book by Michael J. Mauboussin titled More Than You Know: Finding Financial Wisdom in Unconventional Places:

Inside this issue:

Financial Planner

... This anecdote draws attention to one of the most fundamental concepts in investing: process versus outcome. In too many cases, investors dwell solely on outcomes without appropriate consideration of process. The focus on results is to some degree understandable. Results-the bottom line-are what ultimately matter. And results are typically easier to assess and more objective than evaluating processes.

But investors often make the critical mistake of assuming that good outcomes are the result of a good process and that bad outcomes imply a bad process. In contrast, the best long-term performers in any probabilistic field-such as investing, sports-team management, and pari-mutuel betting-all emphasize process over outcome.

It's the process! Too many investors mistake short term success with superior ability, to their later regret.

We are in complete agreement. In the short term, excellent results can lead you to draw the wrong conclusions. Recently a waitress won a national stock picking contest. She announced that she had absolutely no stock picking experience whatsoever. This is not one bit surprising. Over the course of months it is possible for someone to get lucky in the same vein it takes some luck to win the lottery. If this waitress parlays this experience into thinking she is gifted at picking stocks and takes it upon herself to self direct the investment of her new found wealth, she would more than likely produce much lower returns. What the whole experience proves is that in the short term it is sometimes better to be lucky than to be right.

It is the process that controls. In the short term a poor process can produce fabulous results, but it is factors other than the process that causes those results. It is unlikely to be reproduced. Conversely, a strong process can yield poor results in the short term. Over the long term these results are guaranteed to reverse. In a game of blackjack when you have 17 it is against the odds to take a hit and beat the house. In any particular game it may happen where the player draws a four and wins the hand. If this is your process, the odds will dictate that you will become one of the casino's best customers, because you will fail miserably at the game of blackjack.

Over time, a good process based on solid fundamental principles is the only way to succeed. And the devil is always in the details. With investing there is no one process that is guaranteed success. There is more than one way to consistently deliver superior performance. A successful system for analyzing investments can take on many variations. Ultimately it comes down to being able to tilt the odds in your favor when comparing the value of a company to its market price in relation to the future probability that this disconnect is erased.

On our website we announce that *"We follow fundamental investment principles and aim for market beating returns."* It is our process and the results it produces that we highlight. We are poised for an eigth straight year of beating the S&P 500 market average. At some point we are bound to play the odds and still lose, just as the odds would suggest. Over the long term the table is tilted in our favor.

The strong returns we have seen over the past year will not continue at this pace. So make sure you thoroughly enjoy this time period where our portfolio rises what seems like daily. Over the long term we should make out just fine.

Watch List

Over the winter we spent a fair amount of time evaluating Graham Corporation as an investment candidate. At the time we decided to wait to see if they could strengthen their profit margins before we committed any capital to them. In the interim, the company has proceeded to land one large (for them at least) contract after another. This has driven the share price rapidly upward. We have not yet been able to confirm whether they have indeed been able to strengthen their margins and now the share price is out of reach. We will not be able to invest in every stock that performs well for a multitude of reasons. Here the price shot up due to factors we could not predict, before we received confirmation from reported numbers. It is not the first time we will miss out on rapid gains nor the last. Achieving large gains because we are fortunate in our timing is fun but unsatisfying because we have no way of reproducing the results. Achieving large gains because our analysis was correct is very satisfying because these are exactly the results we have control over and have been able to reproduce regularly. If we miss out on these opportunities we have no one else to blame.

It is better to have a good process to evaluate companies than to get lucky. It is the best way we can sum it up. Both make a lot of money for the portfolio but the process will do it over and over again. So look down at the chart below and the 63% returns we missed out on in Graham Corporation and think of all of the investors in Graham Corporation that new better than we did and are having the same kind of fun we are having with ATRO, KTII and previously with OMI. I am sure they find it rewarding.

Our approach will remain the same as we try to uncover those types of companies before they show large increases in value and we will certainly miss out on some worthy candidates. With over 8,000 companies trading we have no shortage of candidates to still kick the tires and check under the hood.

Company	June price	May price	Change from May	P/E	52 Week High	52 Week Low	Estimated '07 EPS	Dividend Yield
Alico/ALCO	$60.99	$59.94	1.75%	50.2	$64.62	$46.25	n/a	1.70%
Alliant Techsystems Inc./ATK	$99.15	$101.00	-1.83%	16.5	$102.81	$75.50	$6.22	n/a
Altria Group, Inc./MO	$70.14	$71.10	-1.35%	16.7	$90.50	$66.91	$4.26	3.90%
Amtech Systems/ASYS	$8.75	$8.01	9.24%	28.1	$9.21	$5.95	$0.31	n/a
Arch Coal/ACI	$34.80	$40.38	-13.82%	22.7	$42.59	$25.85	$1.54	0.80%
Bioanalytical Systems, Inc./BASI	$7.23	$7.19	0.56%	n/a	$7.80	$4.75	n/a	n/a
Canadian Natural Res./CNQ	$66.35	$66.57	-0.33%	17.6	$69.97	$40.29	$3.83	0.50%
Culp/CFI	$9.00	$8.80	2.27%	19.6	$4.37	$9.45	$0.51	n/a
Graham Corp./GHM	$28.15	$17.25	63.19%	19.3	$28.50	$12.55	n/a	0.30%
Kensey Nash/KNSY	$26.81	$23.33	14.92%	47.6	$33.69	$22.26	$0.57	n/a
Landauer, Inc./LDR	$49.25	$49.68	-0.87%	22.3	$57.29	$44.45	$2.20	3.80%
Markel/MKL	$484.56	$493.00	-1.71%	14.4	$505.89	$351.00	$33.65	n/a
ModPac/MPAC	$10.21	$9.88	3.34%	n/a	$12.50	$8.00	n/a	n/a
QLT Inc./QLTI	$7.44	$7.53	-1.20%	26.1	$9.92	$6.64	$0.27	n/a
Servotronics Inc./SVT	$10.80	$9.20	17.39%	19.0	$12.00	$6.05	n/a	n/a
Specialized Health Products/SHPI	$0.76	$0.78	-2.56%	37.5	$0.99	$0.40	n/a	n/a
Tejon Ranch Co./TRC	$44.20	$49.27	-10.29%	n/a	$57.09	$40.00	n/a	n/a
Universal Forest Products/UFPI	$42.26	$48.08	-12.10%	15.1	$54.61	$41.94	$2.96	0.30%

The Investletter Portfolio

June was a rather unremarkable month except for Astronics. When the largest position in the Investletter portfolio rises 23% good things happen. With second quarter earnings season soon to begin, any future large moves will require solid quarterly results. With plane makers like Boeing announcing new orders at a rapid pace, Astronics is bound to be busy for years to come. It is a “tuck it away and forget about it” type company at this point in time.

We have been able to deploy most of the proceeds from the OMI buyout. With our recent alert to add shares of QEP Company, our cash position may finally drop below 20%. With more frequency we are hearing the pundits lamenting that the stock market is becoming overheated or prices are destined to fall; we just don’t see it yet. When the market gets to the point that it is significantly overvalued, we are usually struggling to find companies that are selling cheap enough to be worthy of purchasing. So far that has not been a problem. Gencor, American International, QEP Company and Headwaters are 4 examples of companies we feel are selling at reasonable valuations. When we come up empty for months in our search for viable investments it is often a sign that everything has reached levels that are fully or a bit overvalued.

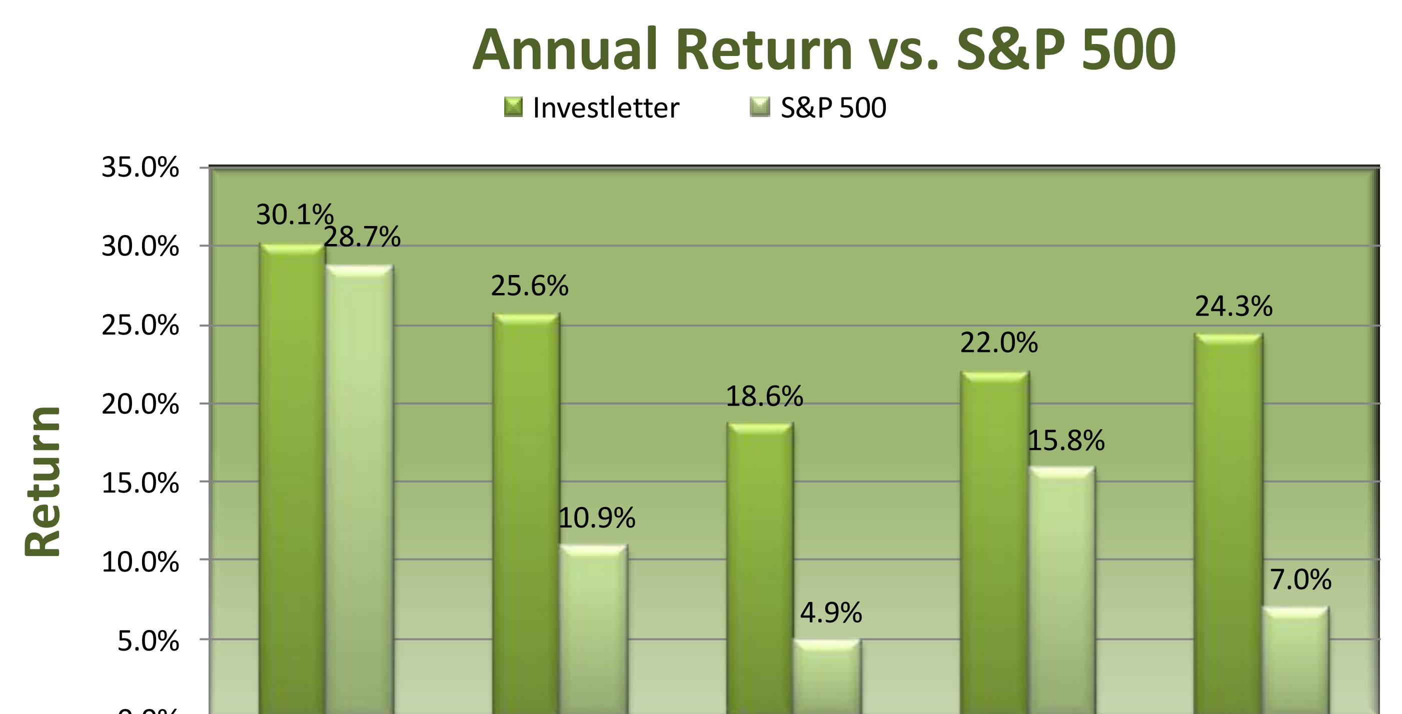
Share price has a funny impact on some investors. Many find high share prices an impediment to making an investment. For us it makes entirely no difference. You can see we cover a pretty wide range. We have Terra Systems at $.29, all the way up to the $3,605 of our Berkshire B shares. K-Tron makes a good example. We first bought shares at around $30. Many investors that are turned off by high share prices would not have viewed the $76 dollar share price that the company entered the year with very favorably. Since that point in time the shares have risen another 40% to cross the $100 mark. When Atrion gets over the $100 hump we will have three companies in our portfolio trading at over $100 per share. The only thing that matters is what they do next. A $1 stock that rises to $2 shows the same return that a $100 stock does when it rises to $200. We don’t care which one we have in our portfolio as long as we pick the one that will double in price. Everything else equal, the odds are the same. The share price is just the collective thought process of what a company is worth at any given point in time. It doesn’t necessarily mirror the value of the company. We have the choice to accept the offer or wait until we find a price that is more to our liking. The price itself has no deep meaning. It is just a marker in time that investors can use as a measuring stick to determine how well they have done. Over long periods of time it will track the changes in the value of the company more closely. If we buy a company with a $500 share price, we obtained the shares cheap enough and the company performs well, our investment is likely see the share price rise considerably no matter what the share price currently is. A well performing company will see a rising share price whether it starts from $.50 or $500. Berkshire A shares are a classic example. Back in the 1960’s shares could be bought for around $20. They now trade for over $100,000. It was the company’s performance that drove the share price regardless of what that price was at a given point in time.

Company	Portfolio Percentage	June price	May Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
American International/AMIN	5.40%	$4.45	$4.30	3.49%	$4.95	n/a	n/a
Astronics Corporation/ATRO	23.20%	$34.72	$28.04	23.82%	$26.00	27.1	n/a
Atrion/ATRI	6.10%	$98.79	$91.08	8.47%	$93.00	16.6	0.80%
Berkshire Hathaway B/BRK.B	7.40%	$3,605.00	$3,625.00	-0.55%	$3,300.00	15.0	n/a
Cash	25.70%	$1.00	$1.00	n/a	n/a	n/a	n/a
Chesapeake/CHK	7.10%	$34.60	$34.86	-0.75%	$33.00	11.6	0.80%
Gencor/GNCI	7.00%	$9.30	$9.25	0.54%	$9.70	7.9	n/a
Headwaters/HW	1.40%	$17.27	$19.72	-12.42%	$17.50	8.8	n/a
K-Tron International/KTII	8.20%	$100.53	$93.55	7.46%	$90.00	19.3	n/a
Protein Design Labs/PDLI	0.90%	$23.30	$27.51	-15.30%	$21.00	n/a	n/a
Rayonier/RYN	7.40%	$44.96	$44.96	0.00%	$41.00	18.7	4.18%
Terra Systems/TSYI	0.20%	$0.29	$0.26	11.54%	$0.30	n/a	n/a

Year to Date

In June we added another four percentage points to our return. Over the trailing 12 months the Investletter model portfolio is up a smidge over 39%. This can be compared to the 20.6% gain in the S&P 500 average. In an environment where nearly everything is performing well it is hard not to generate solid returns. It will not last. The market returns over the second half of the year will invariably be lower. We have a chance to widen our lead slightly if a few of our companies keep up their strong operating results. Two companies, American International (AMIN) and Gencor (GNCI) need an event or two to go their way and each could show sizable gains in the second half. If AMIN is capable of closing their land deal we expect the stock to immediately jump about 40%. Nothing says they are going to be able to close the deal. With GNCI we need the average oil price to stay below $70 and them to receive a couple of payouts from their partnership interests to get a solid boost maybe back to the $12 range we last sold at..

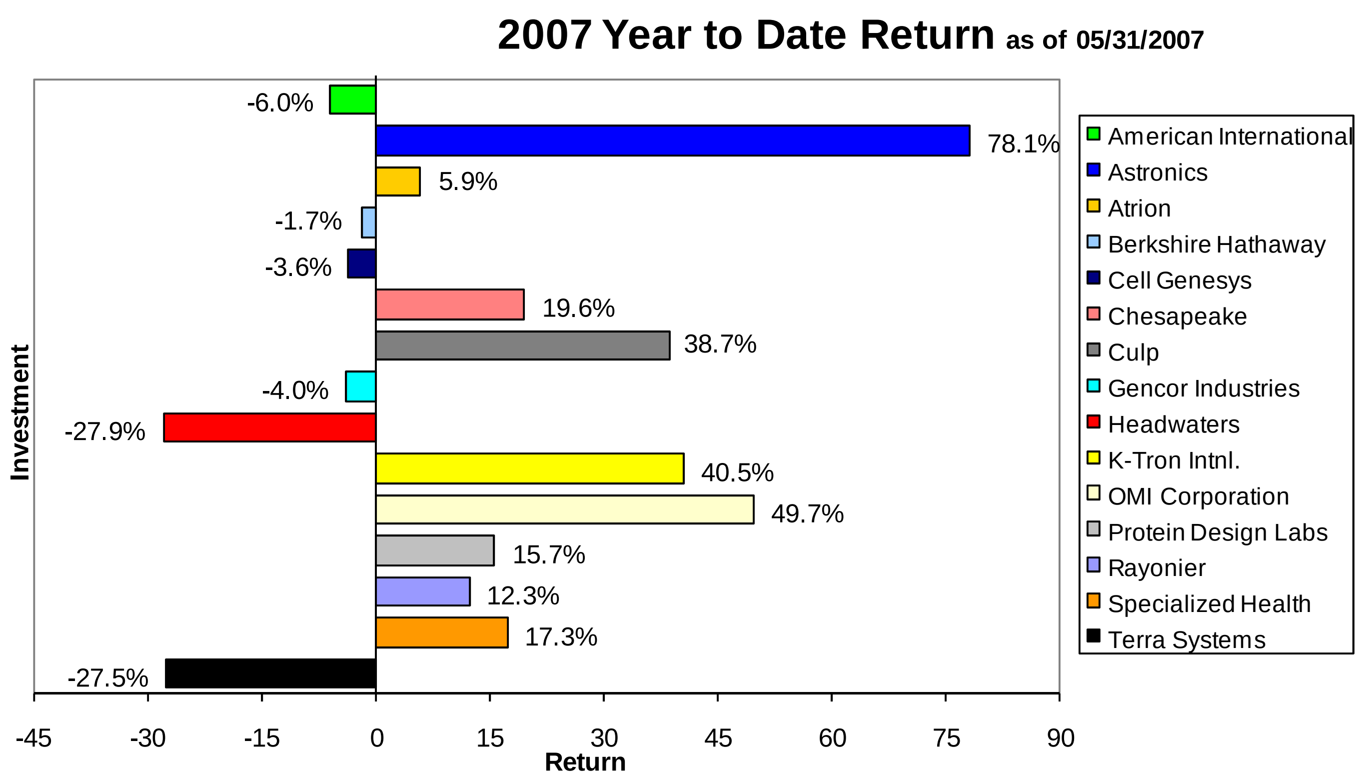
Astronics is another wild card. If they continue to show revenue and earnings gains they could easily trade close to $40 by year end. If they show any signs of weakness in either measure we could get knocked back to the low $20's or worse. Either way it would have a huge impact on our portfolio. Anything other than structural changes to their business would signify that any weakness will only be a temporary delay in moving closer to $40 per share. Our healthy cash position also gives us some ballast in any market weakness in the second half. The crystal ball we use is not any shinier than yours. All of our outlook is based on the underlying value of the businesses we own. If the above events happen and cause the value of these businesses to change, we will all have big ear to ear grins by the end of the year. Even having covered these few scenarios, we are not willing to make any predictions.



	2003	2004	2005	2006	2007
Investletter	30.1%	25.6%	18.6%	22.0%	24.3%
S&P 500	28.7%	10.9%	4.9%	15.8%	7.0%

Performance

The chart below pretty much says it all. Our two largest holdings at the beginning of the year are up 49.7% and 78.1%, OMI and Astronics respectively. Both extremely well managed shareholder friendly companies. It is a pleasure finding companies like them that can be bought at agreeable prices and then forgotten about for many years until their value has multiplied greatly. I have personally owned Astronics for much longer than I have published the newsletter. I first bought shares in early 1999. They performed well until 9/11. Anything to do with airplanes got pummeled. The share price was the same six years after I bought them. They were still a compelling investment and it made a great deal of sense holding on to my ownership stake. You can never tell when the stock market will price coming good news into a company's share price. For Astronics it was at the beginning of 2005. Sometimes owning certain companies can test your faith. If you know your chances are good that you are going to be right, eventually it gets built into the price. Even if it means waiting for six years. In 2005 ATRO returned 112%, in 2006 it was 57.6% and so far this year, 78.1%. Dramatic appreciation prefaced by six years of stagnation. This may be an extreme example but stocks often trade either above or below the true value of the underlying company. It only makes sense to buy them they trade below true value and then just wait. Many times, but not always, things will work out in our favor.



Subscription Information

To subscribe to The Commonsense Investletter visit our web site at www.investletter.com. Click on the subscribe link to enter your subscription. Or, you can contact us at contact@investletter.com with any questions. Checks made out to BCIA

The Commonsense Investletter: Published by BCIA
100 Burgundy Terrace, Amherst, New York 14228
www.investletter.com