The Commonsense

INVESTLETTER

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Wall Street:

- DJ 12262
- S&P 500 1323
- NASDAQ 2279

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Risk

One persons risk is another persons security. The meaning of risk varies equally with the number of investors it applies to.

We have spoken several times about risk. It is a very difficult to define the term risk as it relates to investing. The many meanings are both personal and varied. Volatility is often used interchangeably with risk. Through the first four months of the year the stock market has exhibited above average volatility. Many companies have seen their share price cut in half or rise greater than 100%. The former more frequently than the latter. Volatility is the trait of being unpredictable. When share prices plummet unhinged from the value of the representative company you have volatility. Our former holding Gencor was a terrific example. The company rose 200% in a matter of weeks. While the company was undervalued at the beginning of this run, there was no event that caused the value of the company to increase. After the value of the companies shares matched the underlying value of the company, the rise above that completely unpredictable and unwarranted. The share price has exhibited volatility. None of the shareholders experiencing the gain felt they were being exposed to much risk.

Amtech Systems' share price went from $17 at the end of November to $9 in January a drop of a bit less than 50%. Again, a classic example of volatility. However, with little doubt, I will venture that many investors felt this increased the risk in investing in Amtech Systems. All the while this was occurring, the company was landing millions of dollars in new contracts. Again there is no real relation to the underlying value of the company, only this time investor's interpretation of this event is dramatically different, even though both companies exhibited volatility one is perceived to be more risky.

Investment risk is defined in a multitude of ways. Here are a few. Inflation risk, liquidity risk, time risk, principal risk, business risk, valuation risk, force of sale risk. Popular finance defines risk in terms of volatility. The common measure is the standard deviation of the price. If the price jumps all over the place, the investment is deemed to have a high degree of risk. So Gencor and Amtech can both be described as volatile. Officially Gencor's measure of volatility (beta of .67) is considered low and Amtech Systems (beta of 2.02) is considered high. The measure is dependent on the timeframe that the measure is calculated over. Gencor's measure of beta has certainly risen over the past several months. Suffice it to say both are volatile.

So which company's stock is risky or are both of them risky? Our argument will be in terms of which one is riskier. When a company's share price has risen rapidly past the value of the underlying company, the risk that the share price will decline rises. To us this is an increase in risk. When a company has a sharp decline in share price for unknown reasons, investing in the company's shares generally becomes significantly less risky. With many more companies seeing sharp declines in their share price than those seeing sharp increases so far this year, how has the finance community described the risk in the stock market? The vast majority of the talking heads spend countless hours talking about how risky the markets have become. Phooey, the further the markets decline, the less risk that is present. It makes much more sense to be a buyer of Amtech Systems at $9 than it does to be a buyer of Gencor at $30, even though popular finance theory will tell you that Amtech is the riskier of the two due to its higher beta value.

Beta as a measure of risk is another modern finance concept that is most useful when it is completely ignored.

Nobody feels good seeing the value of their investments plunge. Having the share price drop does not make your investments riskier; worth less, not less risky. Gencor selling at $9 per share in January was a far less risky investment than it is currently. Volatility on the other hand presents the opportunity to benefit from the folly of the markets. Wild price swings give us the chance to pick up shares as the risk becomes less.

Risk can often be described in more personal terms. Risk is not having enough to retire on. Risk is outliving your assets. Risk is not having enough incomes to be able to afford your healthcare costs in retirement (or sooner with the rate healthcare prices are increasing). Risk is in terms of your personal goals and objectives. Putting some of your assets in bonds to lower the risk of your portfolio (as defined by popular finance theory) so you can avoid volatility is shortsighted if it will keep you from accumulating enough money for retirement. However, if moving investments from stocks into bonds is to decrease your risk of running out of money then the move may prove to be valuable, regardless of how the finance community interprets it..

Amen to AMIN

American International (AMIN) has announced they are distributing two dividends to shareholders. The are making one of their annual 20% stock dividends and are spinning out shares of one of their subsidiaries, Hammonds Industries, in a special stock dividend.

AMIN is currently a $32 million company. Last year they had $35 million in sales, including sales from Hammonds they consolidate with their financials. AMIN owns 48% of Hammonds Industries (HMDI). HMDI is a $17 million company meaning AMIN owns $8.2 million worth.. They also own $2.3 million worth of Rubicon Financial (RBCK) and land valued at more than $16 million. The investments and land represent a total of $26.5 million. The land value is contingent on the company's ability to close the sale they have pending. Nonetheless, the value of the company is hidden in complex accounting.

The issuance of the 20% stock dividend will do nothing to clarify the situation. Last year when the company issued the dividend the market did not correctly interpret the results. This year we eagerly await the response. The stock dividend is nothing more than a small stock split. For each five shares of AMIN you own you will receive one more share which is equivalent to a 6 for 5 stock split. The differences between a split and stock dividend are trivial for our purposes, the reaction is what we are concerned with. Adding the shares in this fashion is aimed at sneaking under the radar. Ideally the share count will rise 20% and spread the value of the company over 20% more shares, while the share price will drop less than 16.67% that would be expected (I know it sounds like it should drop 20%, but think of the number of shares increasing from five to six and divide each into 50. The price would drop from $10 to $8.33, or 16.67%). The dates further confuse the issue. Owners of the shares on May 16 will receive their additional shares on July 16. Last year the corresponding dates were July 24 and September 19. In the two weeks leading up to the record date the shares rose from $4.40 to $5.85 on July 19, the last day to buy shares and get the dividend.

The share of HMDI we will get for each share of AMIN will make a nice dividend. Our plan is to try and quickly convert them to cash. HMDI currently trades at $.35. Even at $.25 it will represent a 5.6% yield. The company may also be aiming to eliminate the need to consolidate the results of HMDI in their financials. With HMDI losing money currently, eliminating these results will go a long way to highlighting the value of AMIN's underlying operations which would be profitable without HMDI being consolidated.

Closing the 287 acre land sale is the event that could add the largest amount of value for shareholders. In the meantime, the dividends are a great way for the company to unlock value for shareholders. You won't see any shares until July, but the May dates may be accompanied by some welcomed volatility. Not risk, but volatility.

Watch List

We have removed several companies from the list below and have a new batch of companies that we are actively investigating. Almost all of them are small companies, which just happens to be where we are seeing the best bargains. The companies we removed no longer fit our criteria or did not pan out as we expected. Next month we will spend more time discussing the changes.

Company	March price	February price	Change from February	P/E	52 Week High	52 Week Low	Estimated '08 EPS	Dividend Yield
Alico/ALCO	$44.15	$40.85	8.08%	n/a	$65.00	$35.35	n/a	2.70%
Alliant Techsystems Inc./ATK	$103.53	$104.94	-1.34%	16.4	$120.90	$85.50	$6.39	n/a
Arch Coal/ACI	$43.50	$51.09	-14.86%	21.5	$56.15	$27.76	$2.38	0.70%
Bioanalytical Systems, Inc./BASI	$5.82	$6.19	-5.98%	n/a	$9.39	$5.89	n/a	n/a
Culp/CFI	$7.52	$7.30	3.01%	13.8	$12.30	$5.68	$0.53	n/a
Gencor/GENC	$17.21	$18.00	-4.39%	8.8	$20.97	$8.50	n/a	n/a
Graham Corp./GHM	$35.61	$38.48	-7.46%	18.7	$60.96	$11.11	$1.85	0.30%
St. Joe Company/JOE	$42.93	$38.45	11.65%	79.0	$60.85	$26.70	$0.64	1.60%
Landauer, Inc./LDR	$50.34	$47.80	5.31%	22.3	$54.39	$45.50	n/a	4.10%
Mesa Labs/MLAB	$21.93	$24.00	-8.63%	14.7	$27.00	$17.90	n/a	1.70%
National Technical System/NTSC	$5.95	$6.22	-4.34%	22.1	$7.48	$5.44	n/a	n/a
Park Ohio Holdings Corp/PKOH	$15.71	$20.67	-24.00%	9.0	$32.00	$13.70	$2.17	n/a
Schuff International/SHFK	$27.00	$27.00	0.00%	4.1	$35.00	$19.50	n/a	n/a
Servotronics Inc./SVT	$20.17	$19.35	4.24%	21.2	$20.00	$8.34	n/a	n/a
Span America Medial Sys/SPAN	$11.79	$12.36	-4.61%	11.1	$30.95	$9.88	n/a	2.90%
Tejon Ranch Co./TRC	$37.32	$35.40	5.42%	n/a	$52.00	$34.50	$0.42	n/a
Torm/TRMD	$29.74	$30.25	-1.69%	2.6	$47.10	$26.52	$3.51	15.80%

The Investletter Portfolio

Amtech Systems (ASYS) recently announced another $5 million in orders. The company manufactures equipment that is used in the manufacturing of solar cells. Without getting into too many of the details, solar cells are made in a similar fashion to semi-conductors and the same manufacturing equipment is used in both industries. Fortunately, Amtech's equipment is being extremely well received in the solar business. They are doing extremely well selling their equipment to pacific rim companies that are the leading producers of solar panels. So much so, that the company has already booked orders in the first six months of their fiscal year exceeding last years revenue. Last year the company had around $45 million in revenue and this year they have taken orders for over $47 million dollars of equipment. At some point we are going to experience the straw that broke the camels back syndrome. Last month they announced $9.5 million in new orders, this month it was another $5 million; in no quarter out of the past 5 has the company had revenue over $13.1 million. In the past two months the orders total $14.5 million. The share price after they announced the past two orders has risen from $11.38 to $12.04. The company has a clear shot at having revenues rise over 50% and earnings maybe even more. In response the company's share price has gone dormant. The overall market has helped buffet any price increase. Each news release adds a little more fuel that may eventually cause the share price to react violently. Stock price movements aren't smooth and predictable. Like dripping sand onto a pile one grain at a time, you can see the pile continually build higher and eventually you get a slide where a whole bunch of sand falls in an avalanche. You can't tell exactly which way the slide will go or how large it will be, only that you know it will eventually happen. This is a typical pattern in nature and is also present in the stock market. This typifies a fractal system as we have discussed previously.

At some point a piece of news or positive earnings report is going to send ASYS over the edge and the share price out of control. It may not be a particularly big news item either. The company would need to have an abrupt reversal of fortunes to quell all of this building backlog of good news. With oil prices remaining strong, the incentive to switch to alternative forms of energy is high. Higher oil prices make the cost of solar that much more attractive. Heating oil is twice as high as natural gas currently and natural gas has been rising as reserves have recently dropped below the five year average. It is suspected that the persistently high oil prices in relation to natural gas over the past few years is going to finally drive the conversion to natural gas, further increasing pressure on gas prices. All fuels for production of electricity have moved higher over the past few years. Either way solar will be that much more competitive, especially when combined with the more efficient solar technology being produced with the more sophisticated production equipment... like ASYS sells.

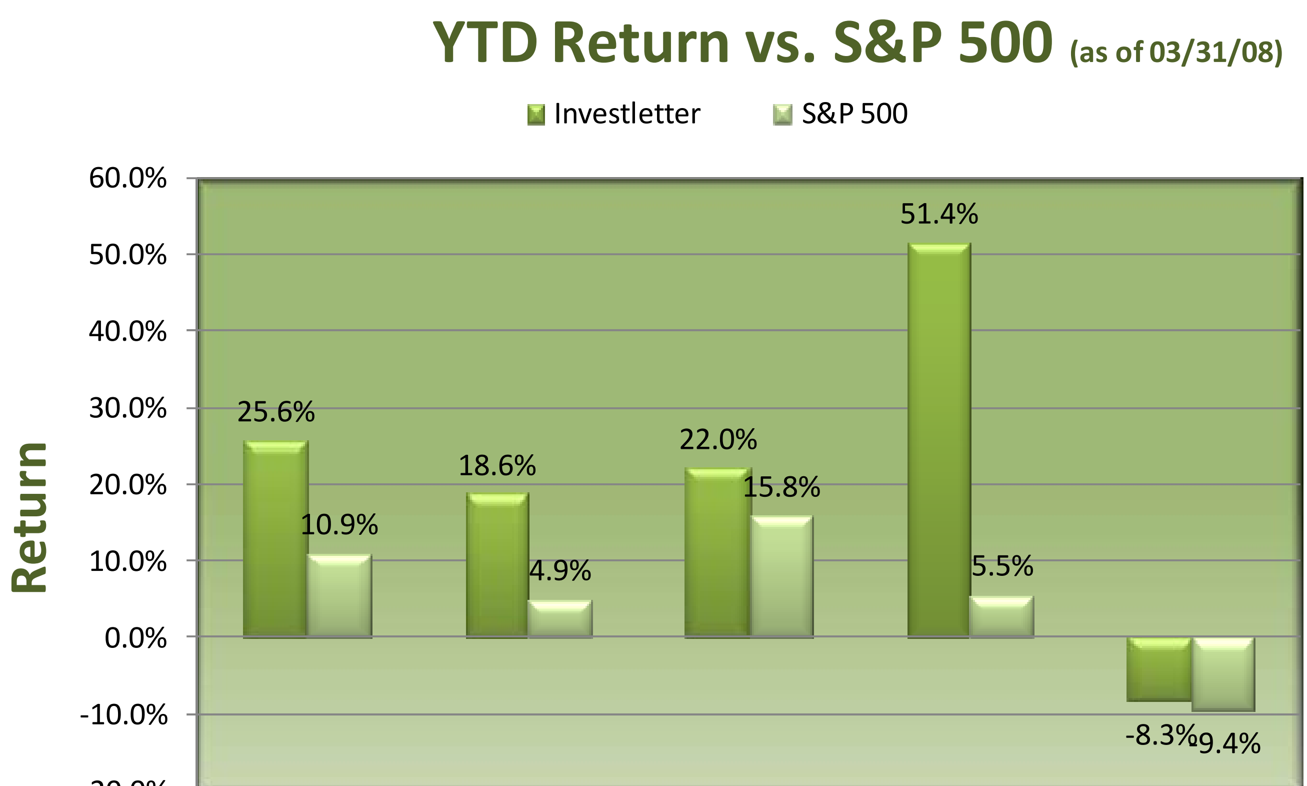
Company	Porfolio Percentage	March price	February Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
American International/AMIN	5.60%	$4.09	$4.57	-10.50%	$4.95	n/a	n/a
Amtech Systems/ASYS	7.40%	$12.04	$12.47	-3.45%	$11.15	31.9	n/a
Astronics Corporation/ATRO	8.60%	$19.32	$19.75	-2.18%	$35.00	12.4	n/a
Atrion/ATRI	6.30%	$99.99	$102.00	-1.97%	$93.00	15.6	0.90%
Berkshire Hathaway B/BRK.B	7.10%	$4,473.00	$4,674.00	-4.30%	$3,800.00	14.8	n/a
Cash	18.90%	$1.00	$1.00	n/a	n/a	n/a	n/a
Chesapeake/CHK	7.30%	$46.15	$45.22	2.06%	$33.00	15.2	0.50%
CSP Inc./CSPI	7.00%	$6.03	$6.12	-1.47%	$7.00	8.3	n/a
Griffin Land & Nurseries/GRIF	4.40%	$34.50	$33.64	2.56%	$35.00	21.7	n/a
Headwaters/HW	0.80%	$13.19	$12.26	7.59%	$14.00	14.3	n/a
K-Tron International/KTII	10.30%	$120.11	$116.73	2.90%	$90.00	17.5	n/a
Protein Design Labs/PDLI	0.30%	$10.59	$15.98	-33.73%	$15.00	n/a	n/a
QEP Corporation/QEPC	7.70%	$7.70	$9.23	-16.58%	$12.00	11.7	n/a
Rayonier/RYN	8.30%	$43.44	$42.55	2.09%	$41.00	18.7	4.60%

Year to Date

March marks another hollow victory. We still are maintaining a lead over the S&P 500 average, but are in the red for the year. Investors are waiting to find the next skeleton in the closet. Each write down by a major financial firm creates more questions. How many more write downs will there be and which is the next company to fail or teeter on the brink of failure? When there is uncertainty, there is volatility. In 2008 we have had plenty of both.

Volatility is our friend and uncertainty is a trait we wish to avoid in the companies we own, especially if it is related to poor financial reporting. Macroeconomic uncertainty is always present. Nobody knows what shape the economy will be in 6 months from now. Certain companies will be less affected than others by any type of slowdown. After any slowdown it is inevitable that the economy picks up again, profit margins expand and share prices rise. These events are controlled by no one and come and go as a series of complex and constantly varying interdependencies; not predictable and without the ability to be modeled.

There is a reason for the old adage, to buy low and sell high. It works. It is also very hard to do with consistency. When the time comes to be a buyer so many negative events may have already occurred as to leave many investors with little stomach to be a buyer of what everyone else is fleeing. Nothing good comes easy. Investing can be trying and even maddening at times. Maintaining control of your emotions and relying on your analysis is essential. Bargains don’t lie, but your emotions will try their best to trick you.

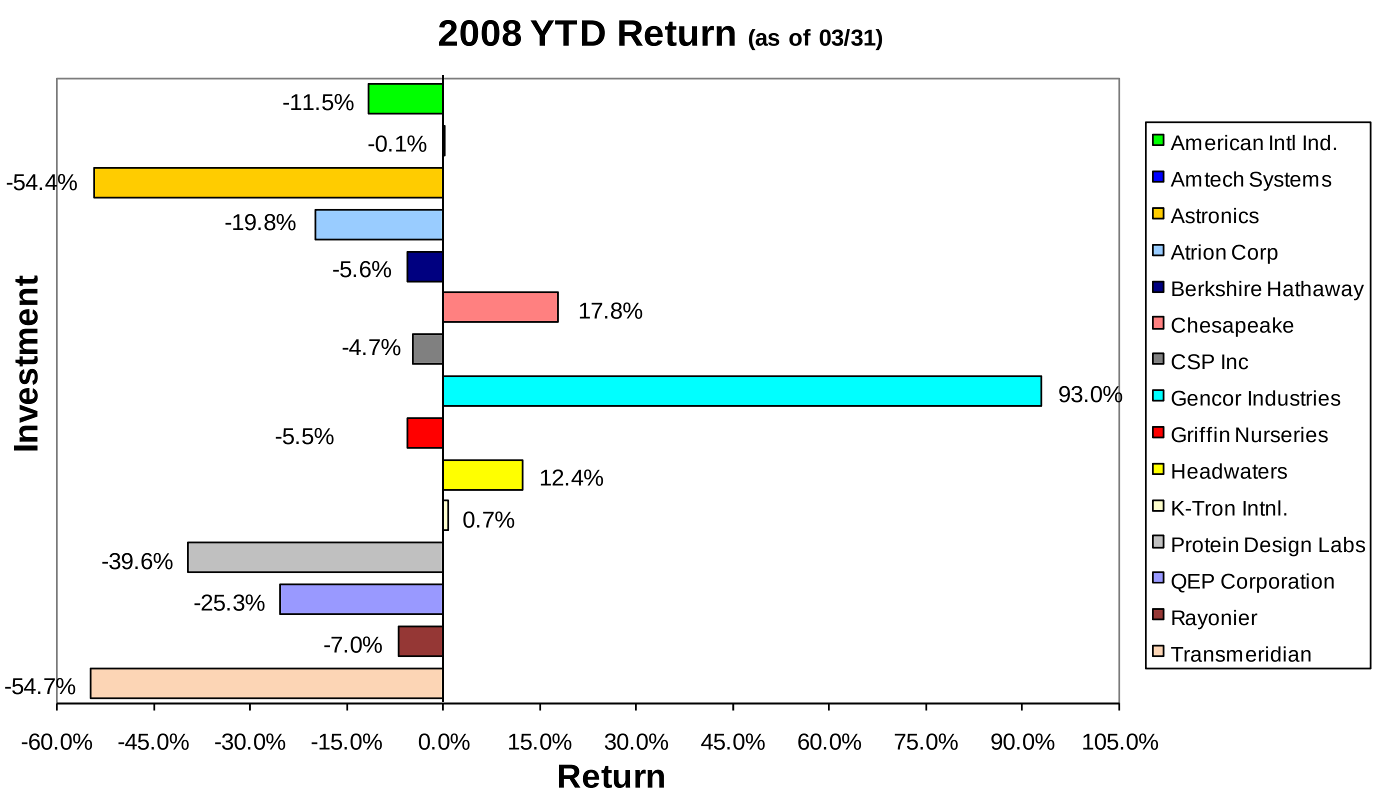


	2004	2005	2006	2007	2008
Investletter	25.6%	18.6%	22.0%	51.4%	-8.3%
S&P 500	10.9%	4.9%	15.8%	5.5%	-9.4%

Performance

It is amazing how useful a chart can be to quickly illustrate complex data. The chart below says a lot with few words. Our investment in Gencor has supported our portfolio this year. Last month we stated the company had become a bit overvalued. This changed rapidly in early April as the price moved continuously upwards and became what appears to be very overvalued. We never bought the company to be a long term holding and had hoped to get out at a lofty $14 or $15 in spite of managements poor performance. We feel extremely fortunate to have had the opportunity to sell off the remainder of our shares at more than $20.

Last spring the company went eight business days without selling a single share. This year, now that the momentum crowd has found the company, the volume has exceeded 100,000 shares in a day on more than one occasion. It now appears that the greater fool theory has taken over. Each of these hyperactive traders is hoping they can find a greater fool than themselves to sell their recently purchased shares to. All of this happens irrespective of the value of the underlying company. At some point, provided there is no earth shattering news, this exercise will become tiresome after the steady supply of greater fools runs dry. Then the crowd will move on and the price will settle back to a more reasonable level, maybe the mid teens.



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