The Commonsense

INVESTLETTER

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Saving for Retirement

Will you have enough when you get there?

How are Americans doing when it comes to saving for retirement? The Congressional Budget Office (CBO) asks that question every three years in order to formulate projections regarding taxable distributions from pensions, annuities, and IRA's to use in revenue projections for the federal budget. The latest report released this past March covered data from 2003. Recent pension law changes began to be implemented in the time frame between the 2000 data used for the last report and the most recent numbers. Overall retirement plan participation rates remained the same at 50%. Changes like allowing catch-up contributions for certain older taxpayers were examined to determine their impact on citizens retirement savings habits. Here is what they found.

Retirement savings have shifted slightly towards older taxpayers, higher-income taxpayers, secondary earners in two-earner married couples, and nonearning spouses in one earner married couples. A 1% increase in employer based plans which was solely explained by an increase in 401k participation was matched by a 1% decrease in IRA participation. A meager 7% of the population participate in IRA's. The 1% drop was mostly linked to phaseout limits preventing higher income taxpayers from participating.

The average 401k contribution was $3,257 in 2003, which was 7% higher than in 2000. Even with higher contribution limits the increase still did not match the 10% increase in contributions from 1997 to 2000. Some of this may be attributable to the stock market slide we were emerging from in 2003 making retirement savers reluctant to risk their capital. Throughout history investors have repeatedly had their timing wrong. Pouring money in, in 2003, made a great deal more sense than in 2000. Your bang for your buck was much higher investing in 2003 when an already beaten down market was more likely to show solid gains, than in 2000 when the market was at stratospheric levels.

The increase in contribution limits decreased the number of participants subject to constraints to 5% down from 9% in 2000. Just about everyone can save all they want in their 401k account. For IRA accounts the lower contribution limits left 55% in traditional IRA's and 44% in Roth IRA's bumping up against the limits. This was still 16 percentage points lower than in 2000.

Workers under 30 who stand to gain the most from allowing their contributions to compound tax free saw their participation rates drop from 35% in 1997 to 32% in 2003. Workers in the 45 to 59 age group saw their participation rates drop slightly from 64% to 63%. Those who have the least to gain from compounding participate more frequently. As could be expected income also plays a prominent role in determining how likely taxpayers are to save for retirement. Twenty percent of

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those making less than $20,000 participate while 82% of those making $120,000 to $160,000 participate. Those making above $160,000 show a decrease to 79% due to phaseout limits.

A bit of good news comes in the average contribution to 401k plans measured in 1997 dollars. For those 30 to 34 who are saving for retirement the average contribution rose from $2,681 to $3,084 or a 15% increase since 1997. Across all age ranges and all income groups savings increased. Contributions to IRA's showed similar results. The news media likes to jump on the fact that savings rates in the US are down. They fail to fully explore the reasons why. With more money being diverted to tax advantaged savings vehicles you would expect savings in other areas to drop. Savings in retirement accounts is not included in the savings numbers you often hear quoted.

If you plan on retiring early you will be best served by having some money available outside of tax deferred accounts.

This is a move in the right direction. Our wish would be to see more liberal IRA contribution limits to allow individuals to save more outside the constraints of a 401k plan. Currently the contribution limits for an IRA is $4,000, while for a 410k you can defer up to $15,500. We favor IRA's with the opportunity for an investor to have more control over the investment of their assets. An IRA can easily be moved to another service provider at the behest of the account holder. With a 401k you are stuck with the options offered by your employer.

Our advice has been to max out your IRA if you are eligible to contribute and then worry about funding a 401k. Depending on your particular situation, you may be better off in some instances saving outside of a retirement account. For anyone who has intentions of retiring early it is essential to have money available that is outside of tax deferred accounts like IRA's and 401k's. Investments can be managed to minimize taxes and show nearly the same results as a tax deferred account. You can control the timing of any gains carefully planning the sale of investments. The recent acquisition of OMI is an example where this concept does not always hold true. Withdrawing money from a taxable account eliminates the 10% penalty on early withdrawals from an IRA or 401k plan, along with limiting taxes to the 15% capital gains rate. The early withdrawal penalty is applicable to tax deferred account holders younger than age 59 1/2.

Another instance where a regular account may make more sense is when the investment options in your 401k are riddled with high fees and mediocre performance and you cannot contribute to an IRA due to phaseouts. If you plan on having higher income in your retirement years, a tax deferred account is also less valuable. You may end up deferring taxes when your marginal tax rate is lower and taking distributions from your retirement monies when your tax rate is higher. Capital gains rates are another confounding factor. You can pay tax on capital gains of 15% (or 5% if you are in the 10% or 15% tax bracket), as opposed to 35% on money distributed from tax deferred accounts that ends up taxed as ordinary income. Careful tax planning can help minimize tax implications. It is important that you map out your goals and give some consideration to what mix will help you accomplish them most efficiently.

As you can imagine what is best for one persons situation is not always the best for another. Your tax situation and your goals will help determine what combination of taxable and tax deferred accounts works best for you.

Watch List

We have recently added shares of Atrion (ATRI) and are close to adding Amtech Systems to our model portfolio. Atrion is a manufacturer of medical equipment. They make tubing, valves, balloon catheters, cardiac surgery relief valves and an assortment of many other, often single use medical equipment. This leads to a steady revenue stream and many repeat customers. When a company is managed as conservatively as Atrion is, and has the fat profit margins they do, a steady stream of repeat business is an added blessing. We have the company pegged at being worth considerably more than they are selling for currently. They remind us a great deal of K-Tron International (KTII) another company extremely well run with plump profit margins. Neither business requires a great deal of cash to maintain their operations which means each one can generate a large free cash flow.

Amtech Systems (ASYS) is a bit different than many of the companies we own. They are a play on alternative energy, but not directly. They are a supplier to companies who manufacture solar panels. Their primary business is supplying equipment to semi conductor manufactures. The manufacture of solar panels is very similar and the equipment used is often the same. The semi conductor business is notoriously erratic, while the business to the solar industry is growing very rapidly. In their quarter ending March 31, 2007, the company experienced year over year growth in their solar business of 311%. Their total revenue was only up 11% which means that their traditional business, selling to semi conductor manufacturers was weak. With the sales to the solar manufacturers growing so rapidly this soon will overtake their traditional lines of business and lead to rapid overall sales growth. Flush with cash from a recent equity offering (selling new shares), the company has all of the means in place to experience rapid growth. With the cost of solar equipment dropping rapidly we expect sales to grow rapidly over the next few years. The installed base is expected to grow at a 40% rate in the short run. The one item we are keeping our eye on is a jump in inventories. The company has a reasonable explanation related to the timing of deliveries, but we will be closely monitoring inventories just to make sure their explanation checks out. Look for an alert announcing we have added them to our model portfolio when the price is right.

Company	April price	March price	Change from March	P/E	52 Week High	52 Week Low	Estimated '07 EPS	Dividend Yield
Alico/ALCO	$58.51	$57.33	2.06%	97.0	$62.92	$46.25	n/a	1.80%
Alliant Techsystems Inc./ATK	$93.13	$87.92	5.93%	15.9	$99.98	$74.41	$5.20	n/a
Altria Group, Inc./MO	$68.92	$66.72	3.30%	16.4	$90.50	$66.91	$5.60	4.90%
Amtech Systems/ASYS	$8.33	$7.30	14.11%	28.0	$9.20	$5.95	$0.30	n/a
Atrion Corportion/ATRI	$92.49	$91.82	0.73%	16.7	$95.84	$63.92	n/a	0.90%
Arch Coal/ACI	$36.07	$30.69	17.53%	23.6	$56.45	$25.85	$1.56	0.80%
Bioanalytical Systems, Inc./BASI	$7.51	$6.70	12.09%	n/a	$7.75	$4.75	n/a	n/a
Canadian Natural Res./CNQ	$59.61	$55.19	8.01%	18.7	$63.93	$40.29	$3.40	0.50%
Culp/CFI	$9.00	$7.00	28.57%	32.1	$4.24	$9.25	$0.28	n/a
Graham Corp./GHM	$17.13	$16.45	4.13%	19.3	$23.00	$12.55	n/a	0.60%
Kensey Nash/KNSY	$25.72	$30.50	-15.67%	40.2	$33.69	$23.73	$0.61	n/a
Landauer, Inc./LDR	$46.90	$50.48	-7.09%	23.7	$57.29	$43.11	$2.20	3.70%
Markel/MKL	$458.91	$484.83	-5.35%	14.5	$505.89	$325.00	$32.19	n/a
ModPac/MPAC	$10.99	$11.09	-0.90%	n/a	$12.50	$8.00	n/a	n/a
QLT Inc./QLTI	$6.64	$7.83	-15.20%	26.1	$9.92	$6.09	$0.27	n/a
Servotronics Inc./SVT	$8.35	$9.30	-10.22%	12.9	$10.46	$5.80	n/a	n/a
Tejon Ranch Co./TRC	$49.82	$47.30	5.33%	n/a	$57.09	$37.55	n/a	n/a
Universal Forest Products/UFPI	$46.46	$49.55	-6.24%	15.3	$80.28	$43.61	$3.12	0.20%

The Investletter Portfolio

The past month it was Astronics, Chesapeake and K-Tron's turn to drive our performance. As many of you are aware we have profited from some very strong moves in our largest holdings. OMI's buyout was the first significant event and that has been followed up by meteoric earnings growth with two of our holdings. KTII's management has done a fabulous job adding acquisition that are immediately accretive to earnings. That was made extremely apparent with their first quarter results. Earnings rose 104% in the first quarter on a revenue increase of 46%. At the same time they have been showing strong revenue growth, they have been extremely successful rooting out costs and allowing more revenues to drop to the bottom line. Often when a business is growing fast, costs will increase out in front of revenue growth. Not with KTII. The company earned $1.72 per share in the first quarter. Recently we have expressed optimism that the shares will cross $100 this year. Not anymore. Now we see $120 as being a comfortable target. This is an old school manufacturer showing tech type growth rates. Shares we purchased at $30 less than two years ago are looking pretty cheap at today's prices. The best part is that the company is still undervalued at current prices. Good management often produces the type of surprises that put a smile on your face.

The other event was Astronics huge first quarter earnings report. They are starting to attract quite a bit of attention and the shares are poised to take off taking into account the $4.53 or 21.8% rise on May 8. Not to be outdone by a company that makes high tech products like KTII's coal crushers, ATRO reported a whopping 250% growth in earnings per share in the first quarter. This was on a solid 70% growth in revenue. We welcomed the fact that they did not broadcast the huge percentage growth in earnings in their earnings release. They are already trying to lower expectation for next quarter. Numbers like these are hard to top. The company's shares could easily be well north of $30 per share by the end of the year. They did a masterful job of controlling costs while bringing several new programs online and juggling two plant expansions.

We spoke several months ago about the small accounting issue the company had that caused their share price to plummet after their year end earnings report. At the time we reported the issue was a non event even though the share price was knocked down over 30%. Investors were reacting to events that had no effect on the underlying business. When the share price plummets sometimes you have to swallow hard and stick to what you know is right even when it feels uncomfortable. We had no idea that the company would drive this point home so convincingly. Again, well run companies often bring surprises that have you wishing for more.

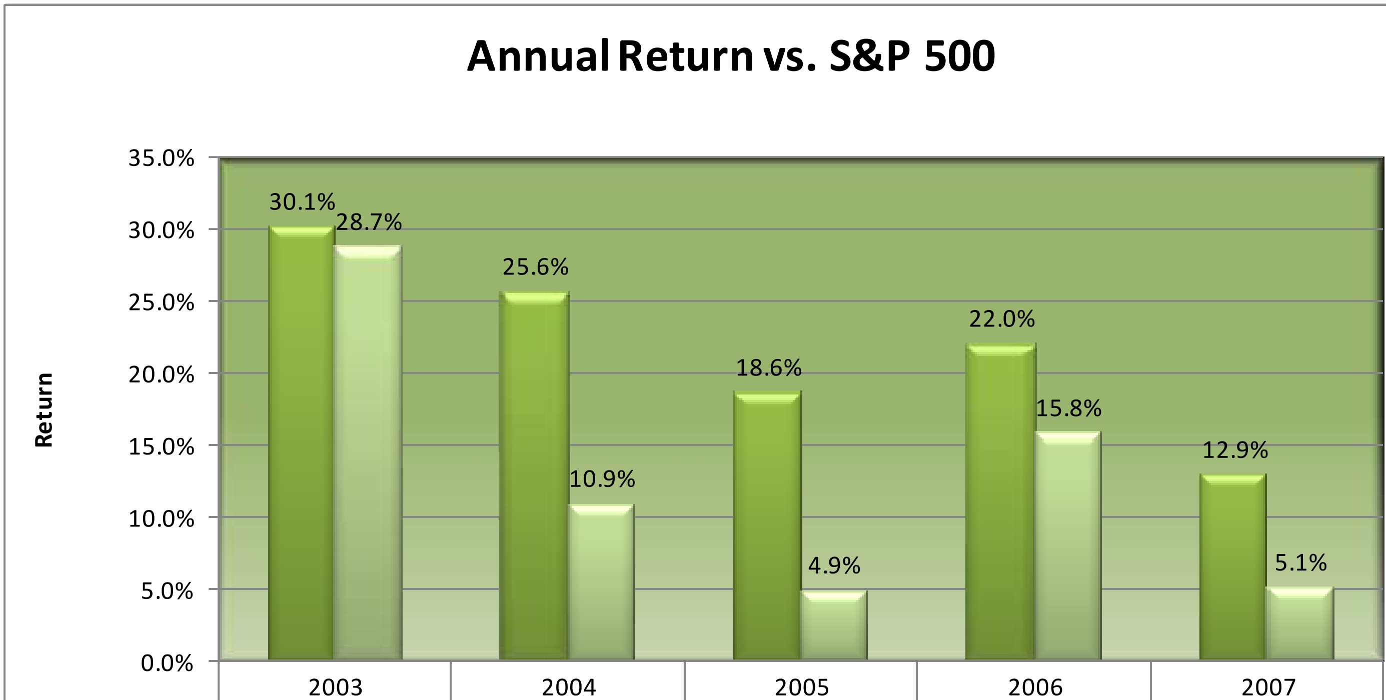
The best part is that both of these companies will probably give us another surprise or two this year. Both companies could catch the attention of the momentum investor crowd and have their share price pushed up significantly higher even to the point of becoming overvalued. Then we have a whole new problem to decipher, at what price do we sell? We'll address that if it happens. In the meantime, enjoy the ride, things aren't always this rosy.

Company	Portfolio Percentage	April price	March Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
American International/AMIN	4.00%	$4.50	$4.50	0.00%	$4.95	n/a	n/a
Astronics Corporation/ATRO	16.00%	$19.82	$17.60	12.61%	$16.95	25.4	n/a
Berkshire Hathaway B/BRK.B	8.20%	$3,628.00	$3,640.00	-0.33%	$3,100.00	15.3	n/a
Cash	28.00%	$1.00	$1.00	n/a	n/a	n/a	n/a
Chesapeake/CHK	7.60%	$33.75	$30.88	9.29%	$30.00	7.1	0.70%
Headwaters/HW	2.00%	$21.67	$21.85	-0.82%	$22.00	12.4	n/a
K-Tron International/KTII	7.50%	$83.04	$71.73	15.77%	$71.00	15.6	n/a
OMI Corporation/OMM	16.20%	$29.07	$26.86	8.23%	$22.00	5.9	2.10%
Protein Design Labs/PDLI	1.10%	$25.26	$21.70	16.41%	$21.00	n/a	n/a
Rayonier/RYN	7.80%	$43.37	$43.00	0.86%	$41.00	19.1	4.30%
Specialized Health Products/SHPI	1.40%	$0.81	$0.85	-4.71%	$0.40	n/a	n/a
Terra Systems/TSYI	0.20%	$0.30	$0.30	0.00%	$0.30	n/a	n/a

Performance

As good as February and March were to us, April was even better. We now are sporting a 12.9% gain in our portfolio so far this year. In the first 40 months of publication our portfolio has risen 105.6%. We have accomplished our goal of doubling our money every five years in three and a half. It's nice, but right now the only thing that matter is what we do going forward. With our large cash balance looming we will give ground to the S&P 500 average when the market moves strongly upward and will tend to further widen our lead when the market dips.

Our nice seven plus percentage point lead over the S&P average gives us a nice cushion as we plot our future moves. The flexibility the stock market offers us is great. We aren't forced to invest in any average or sub par businesses. We can hold out and only pick and choose the best opportunities. When nothing particularly interesting presents itself we can choose to do nothing. Rather that being forced to act, we get to pick and choose. So, we will continue to be selective and not be pressured by the tendency of Wall Street to encourage activity. The brokers and other sales reps, mutual fund companies all benefit from activity even when your portfolio plummets. By us not having our hand in your pocket, we have nothing to gain from being active. Plan on having plenty of cash until the right opportunity comes along.



	2003	2004	2005	2006	2007
Investletter	30.1%	25.6%	18.6%	22.0%	12.9%
S&P 500	28.7%	10.9%	4.9%	15.8%	5.1%

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