The Commonsense

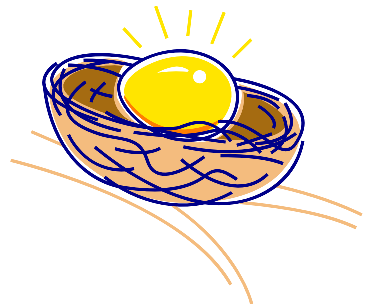
INVESTLETTER

Volume 5 Number 4

Wall Street

- DJ 13628
- S&P 500 1531
- NASDAQ 2605

Financial Planner



How is your nest egg doing and how will you protect it?

I happen to subscribe to several financial advisor trade (rags) publications. I find it amazing what gets written in some of the articles they publish. When I subscribed my assumption was that these magazines would focus on how investment advisors could help better serve their clients. Sometimes your initial assumptions turn out to be wrong. With one of the publications in particular I couldn't have been more wrong. I operated under the impression that one of the most important things a financial advisor can do for a client is to help him/her achieve better investment returns. That is not always the reality.

Investment advisors come in many different variations. Certified Financial Planners, CPA's, insurance agents, wealth managers and many others. They often are characterized by having a fiduciary relationship (put their client's interests before their own) with their clients. They should be interested in obtaining the best possible returns for their clients and be well trained to the point that they can provide advice that will put a client in a better position than they would be without the advisor's advice. Advice regarding protecting assets or passing wealth to future generations are two examples where an advisor can save a client huge amounts of money. Overall advisors can be a useful tool as part of a comprehensive financial plan. Their advice generally does not come cheap and when it comes to investment performance they are often subpar. They have to generate revenue in some fashion and your investment returns can take a beating as a result. A 1% asset management fee is not at all uncommon. If the market rises 10% then an advisor's client will need an 11% return just to break even. I have read enough articles to know that as a group, they believe that it is next to impossible to beat the market on any consistent basis. Here is a comment from a recent May issue, "*...has a 20-year time horizon and thinks he or she can beat the market by 2% a year (we call this dreaming)*". I am sure there are progressive advisors who are bright enough to realize that beating the market is done on a regular basis by a small contingent of investors.

Their relationship with their clients tend to be long term and result in them securing a steady recurring revenue stream. As long as they manage a clients assets they make a comfortable living. How comfortable is staggering. In 2007 the average salary was reported in a study by the College for Financial Planning and Financial Planning Magazine to be $283,000, up from $233,000. That is a healthy 21.5% raise in one year. Sure they have a fiduciary relationship and they also have a family to feed (and luxury car payments to make and country club dues and so on). Guess who financed this rise in income. That's right their clients. A healthy stock market also helps. When the market rises the advisor has more assets he/she is managing and 1% of $33mm generates more than 1% of $30mm that those assets were worth the year before in a market that rose by 10% year over year.

Inside this issue:

Financial Planner

But the fiduciary relationship must be worth something, isn't it? Often times it is, but it is hard to tell from much of what I read. Countless articles paint a very confusing picture. One line of articles I see repeatedly revolve around how to grow your practice. Advice is given to increase your assets under management. Get more clients. That will certainly aid the cause. With $33mm in assets under management you don't need any type of client you need big clients. So much of these articles are devoted to how you can land clients with a large amount of assets. At least someone is treated to a fiduciary relationship. At the same time you may have a client with many fewer assets to manage. What is a poor time constrained advisor to do? Well their decision gets easier if a client takes up more time than the average client; easier to justify dropping them as clients. This is an extremely popular theme, cut back on your smaller clients and try and land more big fish. Growing your practice often has nothing to do with providing better service, obtaining better investment performance or helping more people. Rarely is any mention of loyalty or responsibility made.

Buyer beware. Just like any profession financial advisors have their good and their bad.

On average an advisor has about 5 hours of contact with a client each year. A huge amount of time is spent on compliance activities. Making sure account applications are filled out correctly, reviewing a clients investments, examining their firms investment policy and bureaucracy that is due to various regulations. Another activity that consumes an advisors time is cultivating new clients. (It is important to find that big fish so they can watch their earning go up.)

All of this goes on to ensure their clients as a whole receive advice that can't even beat the market averages. No wonder they find it convenient to proclaim the market can't be beaten with any regularity. Who has time to focus on investing with all of the other tasks they have to do.

At Investletter our idea of a fiduciary relationship is a bit different. Dropping a client doesn't sound very fiduciary to us, just because you have the good fortune to land a couple with fat investment accounts. Our relationship with our subscribers breeds a different type of relationship. We do the same work no matter how many subscribers we have (subliminal message: send your friends and neighbors to us). We don't need to drop anyone to make room for the most recent "fat cat". We also have the time to devote to finding the best investment opportunities without having a complex, highly regulated business that revolves on time consuming personal relationships. The best thing we can do for our clients is to grow your investments as quickly as possible and you won't owe us a single penny more if we do.

With articles like "Follow the Money: Broker-Dealers sum up the future of advisory services in two words: rich folks." and "Finding Even Greater Growth: The Financial Advisor Symposium in Las Vegas focused on practice growth strategies" it is easy to see what occupies the minds of financial advisors. Who is left to work with the little guy who wants to accumulate money for retirement. Financial Advisors seem to be interested in helping you invest for your retirement as long as you have good deal of assets already accumulated.

That just does not sit well with us. Like anything there are good advisors and ones that aren't so good. If you or family or friends plan on using the services of a financial advisor

Watch List

Our sale of shares in Culp appears to have been a bit early. The company had just emerged from a long turnaround process at the time we sold. They are on steady return to profitability. Management has done an extraordinary job of pulling of a major restructuring in an industry that is definitely on life support. When you mix great management with a poor business it is often the reputation of the business that remains intact. Textiles in the US have almost completely moved offshore. Culp has bucked the trend so far. Their business could return to respectable profit levels. In the long run the business is doomed to mediocrity. The US based textile business will probably never be subject to anything close to rapid growth. It will be easier to pick businesses in stronger industries the have a larger margin of error.

Our friends over at ModPac have been suffering a similar fate. Several years ago they allowed their largest customer to buy their way out of a long term contract. They have yet to replace the revenue. The short run printing business is characterized by many small businesses. ModPac is fond of promoting this fact as an illustration of how they can take part in industry consolidation and increase their revenues. So far this has not happened. The profit margins are slim and more and more advertising is done on the web, reducing the demand for printed material. The demand for printed materials has not been a fast growth business even before the internet. As a result, ModPac has the same share price they had 3 years ago. At some point they may finally grow themselves out of the excess capacity they acquired for what proved to be the temporary added business of their ex large customer. While their business has been in dire straits, their share price has not been dire enough for us to find it interesting. At some point when they are about to turn the corner our attention may be piqued, but not now.

We are still waiting for the right price to purchase Amtech Systems. The price dropped into a range that we felt comfortable with but did not remain there long enough for us to get the word out. We will keep waiting and the market will keep on offering us prices. Lets hope they offer us one we like soon.

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

We have previously voiced our concern over the topic of naked short selling. Recently there has been action by the SEC (Securities and Exchange Commission) that is a first step in the curtailment of the illegal naked short selling. Originally when regulation SHO was put in place by the SEC, all existing trades that had delivery failures were grandfathered in what was probably a violation of SEC regulation. The thought was that eventually these trades would get cleaned up as shares became available to borrow from account holders, to deliver to the purchasing party of a short trading transaction. With this activity grandfathered and no incentive to clean up the illegal short sales due to the intentional delivery failures, many of these trades remained technically uncompleted for well over a year. Some companies spent over 500 days on the Regulation SHO list with what amounted to counterfeit shares trading the entire time. These artificial shares put downward pressure on the affected company's share price. This artificially transfers wealth from the owners of a company to the person naked short selling (again they are naked because they never borrow the shares to deliver to the buyer) the shares.

The pressure on the SEC has been building over the past year to take action to eliminate this outrageous practice. This past week the SEC finally eliminated the grandfathering of the naked short sales that existed at the beginning of 2005 when regulation SHO went into effect. Additionally, the SEC opened another comment period on eliminating the market makers exemption that allows firms that make a market in a company's shares, to legitimately sell naked short to provide liquidity to the markets. This is also being abused, just as the grandfathering rule was. This comment period is expected to draw strong opinions as to why this practice should not be altered. Most of these opinions will come from the groups that primarily benefit from this illegal activity, the prime brokers, the industry groups that represent them and the hedge funds. Only in America can you protest the disruption of your illegal activity and theft of America's small investors. assets In the recent past it seems the SEC has been beholden more to the interests of the large brokerage houses than the small investors they are charged with protecting. Here it is straight from their mission statement:

> *The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.*

It is important to note that they are to protect investors, not companies, hedge funds, or brokerage houses. It remains to be seen if the elimination of the grandfathering provisions is an attempt to appease the individual investor while leaving the dangerous market maker exemption untouched. Or, are they just trying to stall as long as possible to allow the prime brokers to squeeze every last penny they can from naked shorts. Hopefully neither of the above are true and the market maker exemption will be regulated into oblivion just as the grandfathering provisions have been. Allowing the market maker exemption is definitely not in the best interest of America's small investors or the US capital markets.

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

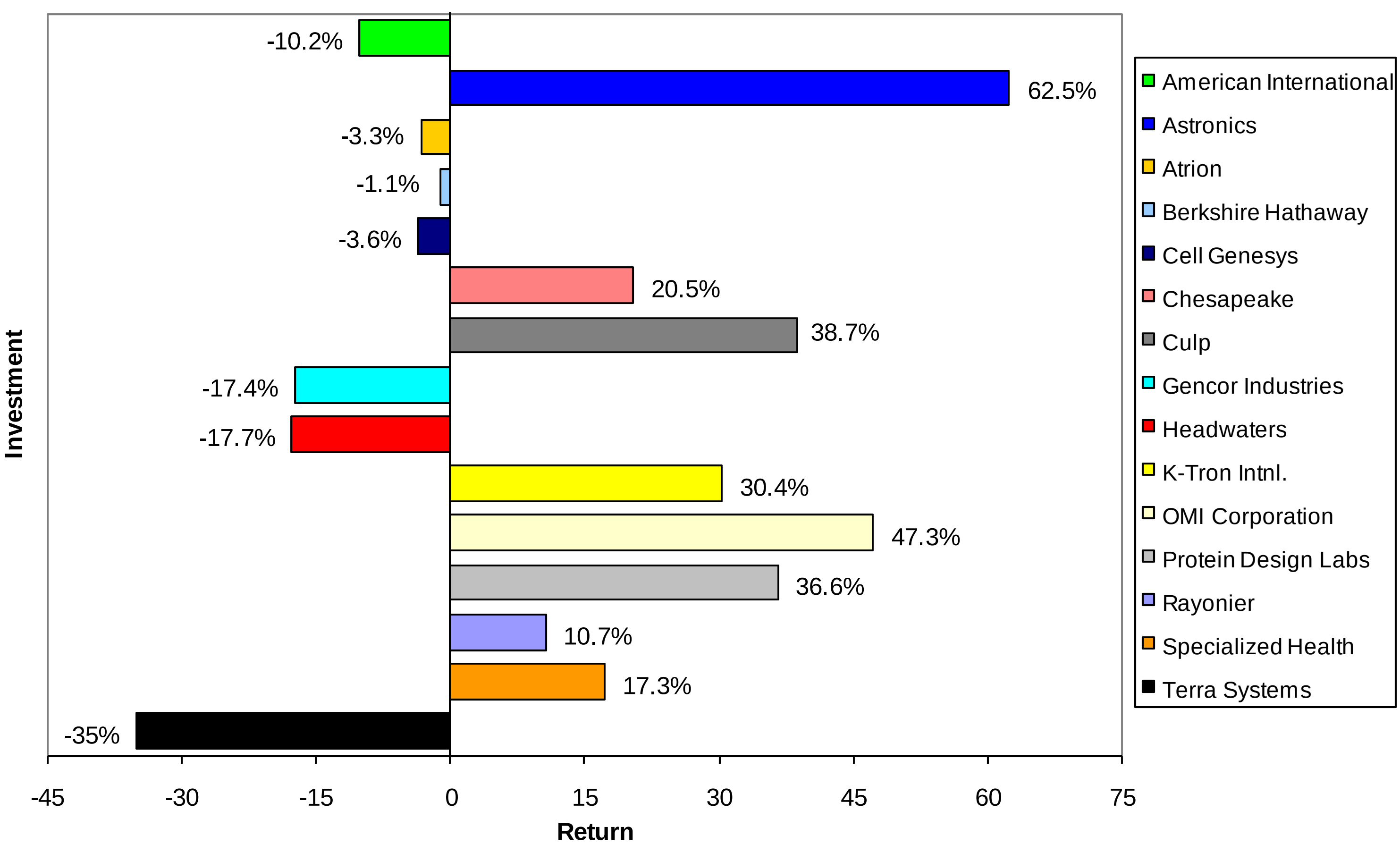
Year to Date

The chart below highlights the performance of our investments so far this year. What is notable is the performance of our largest investments. Our two largest positions, both representing over 15% of our assets at the beginning of the year, have also been our two largest gainers. To make it even more satisfying they both performed well last year. Astronics is up 62.5% this year and OMI gained 47.3% in 2007. Last year the pair was up 57.6% and 20%. Astronics may be up considerably more over the rest of the year and could easily double over the next three to five years. Their revenue growth will be extremely strong over the next few years.

OMI will not perform nearly as well going forward. We are saddened to see the completion of the takeover by the two acquiring companies and as of the end of the trading day on June 9, OMI no longer existed as a public company or will ever trade a share again. It was an extremely profitable investment for us and will be difficult to replace. We are going to carefully monitor the exploits of the management team that ran the company. If they become involved in another venture we will be extremely interested in being part of it. They are second to none in the tanker business.

K-Tron which is now are fourth largest position is doing extremely well again. They are up 30.4% after showing a huge 122.3% return last year. Several other positions below are recently purchased and the results so far are meaningless. American International, Atrion and Gencor all have been added to the portfolio so recently that their results are insignificant and Cell Genesys, Culp and Specialized Health have been sold.

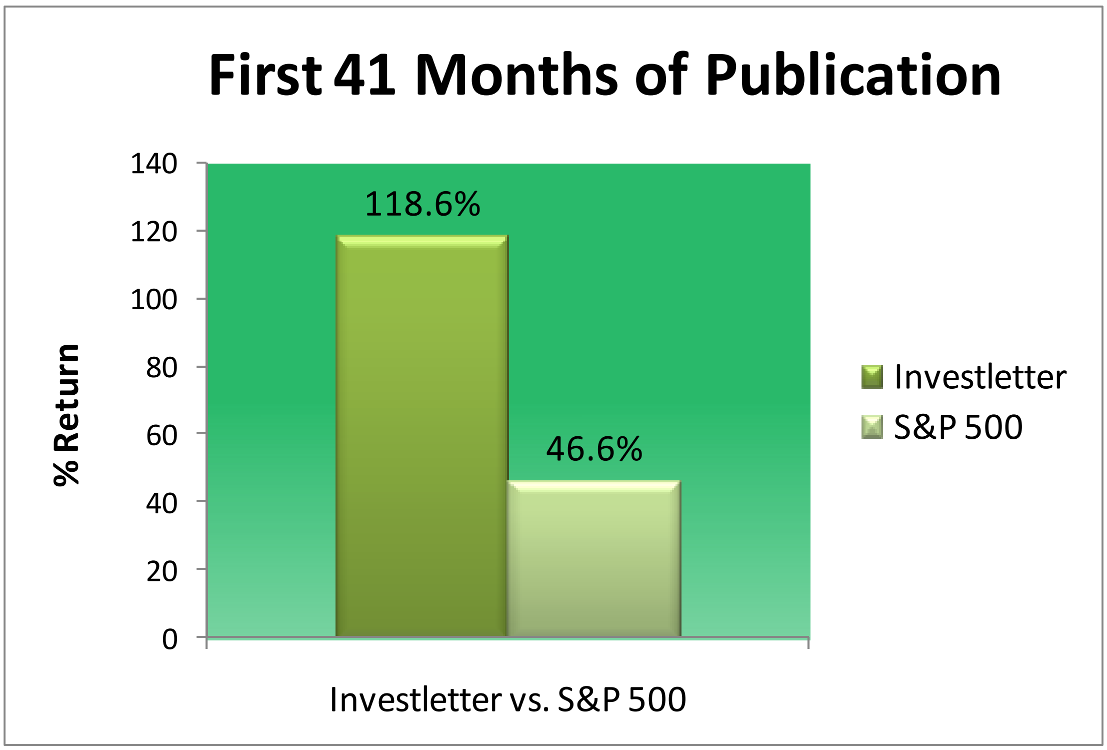
2007 Year to Date Return as of 05/31/2007



Performance

Last month we were amazed at how well our portfolio performed in April. May was somehow even better. We now are up 20.3% on the year so far which is comfortably ahead of the S&P 500's 8.8% return year to date. After 41 months of publication our portfolio has risen 118.6% compared to the S&P 500's 46.6% return. In the first five months of this year we have beaten the S&P average by 11.5%. This has occurred even though we have held cash balances of 26.3%, 26.2%, 27%, 28% and 31.4% for the first five months of the year respectively. On average our cash balance has been 27.8%. If we would have been fully invested for the first five months our return would have been boosted by another 5.6 percentage points. Our portfolio would be up 25.9% on the year. This assumes we would have distributed this money in the same proportion each investment represents in our portfolio.

You never can tell when the stock market is going to perform well. We can't even tell when one of our investments will perform well. All we can be assured of is that we stack the odds in our favor by buying companies at depressed prices. Sooner or later this imbalance corrects itself. If we pick companies with economic tailwinds at their backs, like OMI in the oil tanker business, Astronics in the aerospace business, K-Tron in the coal business and Chesapeake in the natural gas business their performance can outpace the overall market for years. This past few months you have seen a confluence of several of these factors and our portfolio has gone hurtling upward. Make sure you thoroughly enjoy this timeframe, things will not always go this smoothly.



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 can be mailed to the address below. A subscription cost $149 for 10 issues yearly. We aim to justify your subscription cost by helping you beat the market average.