The Commonsense

INVESTLETTER

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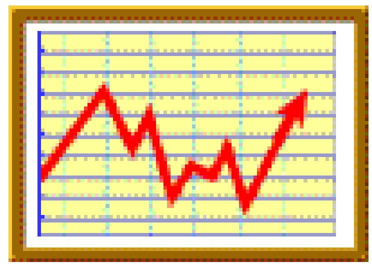
Wall Street

- DJ 12222
- S&P 500 1401
- NASDAQ 2432

Inside this issue:

How Long is Long



Do Stocks Add Up Over The Long Run?

Stocks are considered to be a risky investment. Risk is somewhat undefined in finance. In finance theory risk is defined as price variance. If the price of a stock moves all over the place it is considered to be risky. If a stock's price fluctuates between a narrow range it is considered to be less risky. We find that definition to be absolutely useless. In our estimation, stocks are risky when you pay too much for them and less risky when you can buy them for less than they are worth. It is not always easy to identify what a company is worth, but then we are under no obligation to be able to value each and every company we investigate anyways. Even when we can reduce the risk we take on, we still can be outright wrong or even "wrong" for a period of several years. By "wrong" we mean the price can be lower or not much higher than we paid for a company for quite some time.

If you pay too much for a company the odds that the share price will rise high enough to yield a nice profit on your investment are much smaller. As we have stated in the past, our goal is to double our money every five years, or earn about 15% per year. Over a five year period the price of a company's shares should reflect the price a company is worth for at least a small part of the time. At other points the company will trade for less than it is worth and at others for more than it is worth. Our recent purchase of Rayonier (RYN) is a good example. We feel the company is currently worth something closer to $65 per share. At some point over the next 5 years we expect the price to move above the value of the company at which we become more likely to sell our position. In order to double our investment we need RYN to reach a price near $80 (less when you take dividends into account). Over the course of time the company will become more valuable by gaining ability to generate higher income and the $65 value we pin on the company will rise with it.

We have examples that tend to defy having their share price rise above their underlying value at some point over a five year time frame. Take OMI for example. The company's share price has risen rapidly in the time we have owned them. The value that management has created has outpaced even the strong price increases the company's shares have had. It makes it easy to continue to hold the shares. Sometimes Wall Street is not as quick to realize a companies ability to generate earnings (cash flow) as quickly as we are.

Over the long term how does all of this affect the risk of investing in stocks and how should you look at risk? Over the long term stocks are less risky than other investments. (See the May 2006 edition.) Over rolling five year periods it is unlikely that you will lose money investing in stocks. About 87% of the time you will have more money than you started with. Over a ten year time frame it is almost a sure bet. In only 2 of the past 72 rolling ten year periods have stocks failed to

How Long is Long

generate positive returns. Over the long term (since 1926) stocks average 10.4% yearly returns versus bonds 5.5% return. Is it worth greatly reducing your potential returns to remove the chance of showing negative returns over a ten year time span that happens only 3% of the time? Not in our estimation. The last time a rolling ten year period showed negative returns occurred in the time period ending in 1939. This encompassed a good many of the years during the great depression.

Our job at the Blue Collar Investment advisors is to buy stocks that reduce our risk of loss even further. We carried on average a large cash balance amounting to 18.7% of our portfolio so far this year, which is not subject to price declines. The whole goal of investing in our opinion is to maximize your returns. Investing in stocks is the best way we know how to do this.

Stocks still remain the best way to increase your wealth. In all but the shortest of the long term time frames, stocks are highly likely to show positive returns. The higher yields that stocks produce, more than compensate for their added uncertainty.

Over shorter time frames, say a year, investing in stocks can yield less predictable results. Still the odds are in your favor that you will show positive returns. In 14 out of the last 18 years you would have showed positive gains invested in the S&P 500 index.

So, the long term for us is a three to five year time frame. Almost everyone except the geriatric set has more than this length of time to keep their assets invested. As we approach the end of our third year of publishing, we have almost a long enough track record to talk about the performance of the newsletter in the long term. In all of our experience, we have only experienced one year of negative returns. Having averaged over 17% returns in our 15 years investing certainly has made the risk of facing a down year seem tolerable. In the long term these blips are barely noticeable. Although, when your portfolio is declining in value it feels as if the suffering will never end.

One last issue when dealing with risk and time frames deals with how you compartmentalize your assets. Assets that you look at in your mind as long term assets, help make it easier to tolerate swings in value. If you have money set aside for a vacation next year it may be more emotional seeing swings in the value of your portfolio. Money that put aside that will barely be enough to fund a child's education set to begin in three years will be viewed differently than money you are saving to buy a vacation home. If you don't have enough money to pay for the education it may create a financial hardship, while coming up short in saving for a vacation home may delay you from purchasing it for a couple of years while you save the additional funds. How you view a specific pool of assets will affect how you view the risk surrounding any investment using those assets. Risk is framed over the time period you are investing and how important the pool of assets you are investing is to your financial future.

When you think about your long term, keep in mind that by investing in stocks, you have experience on your side. It gives no guarantees, but speaks strongly as to the likelihood of the outcome. Our aim is to help you maximize your returns while taking on as little risk as possible.

Watch List

We have reached a decision on Graham Corporation as far as adding them to our portfolio. The company has been landing a steady stream of new contracts and is in an area of the market that will continue to do well for the next several years. The COO is a likable, serious, determined individual that appears to have the capability to be a strong leader. Shrinking operating margins are the only thing holding us back from making an investment. Some of the contracts they bid at the end of 2005 and early 2006 were bid at prices that now make them unprofitable. Until all of this work moves through production, earnings will be depressed.

If the price of the shares were to drop sharply from the levels they are at currently, or earnings were to be stronger than we anticipate, our interest in the company would quickly increase. We estimate earnings will fall somewhere between the broad range of $.18 to $.26 this next quarter. At the high end would mean the company has worked through most of their low margin business. If earnings come in towards the low end of the range, it may cause the shares to drop comfortably lower.

We also mentioned we may be interested in shares of Alico if the price drops back to the $50 range. The management of the company is the Three Stooges of the corporate executive suite. If there is a way to screw it up, they probably invented it. The acquisitions they have made over the past few years have all been embarrassments. They have been forced to renegotiate the terms of a land sale they made several years ago which raises suspicion regarding the purchasing party's ability to pay. If we weren't able to pick up the assets so cheap we would have never purchased them in the first place. We are going to hold out a while longer and see if maybe we can add shares in the mid $40's.

One important business lesson that often holds true is very important when considering a business run by a management team such as Alico has. In a wonderful business with crappy management, it is often the reputation of the management team that comes through unscathed. If we can acquire Alico with the land valued so cheap that we can't help but make money we can look past the incompetence, otherwise management is a secret weapon that we are not even close to being able to fire...in more ways than one.

Company	November price	October price	Change from October	P/E	52 Week High	52 Week Low	Estimated '06 EPS	Dividend Yield
Alico/ALCO	$56.99	$62.00	-8.08%	48.0	$62.92	$42.17	n/a	2.00%
Alliant Techsystems Inc./ATK	$77.31	$77.21	0.13%	15.3	$84.90	$72.37	$5.07	n/a
Altria Group, Inc./MO	$84.21	$81.33	3.54%	15.8	$85.55	$68.36	$5.31	4.10%
Arch Coal/ACI	$35.90	$34.63	3.67%	21.5	$56.45	$25.85	$1.67	0.70%
Bioanalytical Systems Inc/BASI	$5.50	$5.32	3.38%	n/a	$7.80	$4.75	n/a	n/a
Canadian Natural Res./CNQ	$54.27	$52.15	4.07%	20.0	$64.38	$40.29	$2.72	0.50%
Graham Corp./GHM	$13.60	$13.64	-0.29%	16.8	$26.00	$12.55	n/a	0.70%
Kensey Nash/KNSY	$30.68	$30.41	0.89%	38.4	$33.69	$21.67	$0.80	n/a
Landauer, Inc./LDR	$54.39	$54.77	-0.69%	22.8	$57.29	$43.11	$2.39	3.50%
Markel	$447.75	$399.50	12.08%	14.0	$456.25	$307.41	$32.05	n/a
ModPac/MPAC	$11.00	$11.14	-1.26%	n/a	$12.50	$8.00	n/a	n/a
QLT Inc./QLTI	$8.66	$8.50	1.88%	27.0	$9.00	$5.93	$0.32	n/a
Servotronics Inc./SVT	$8.10	$9.40	-13.83%	12.8	$10.30	$4.30	n/a	n/a
Tejon Ranch Co./TRC	$50.77	$48.50	4.68%	n/a	$52.71	$37.55	n/a	n/a
Universal Forest Products/UFPI	$46.65	$45.38	2.80%	13.0	$80.28	$43.61	$3.60	0.20%

The Investletter Portfolio

One inevitable consequence of successful investing is taxes. We make every reasonable attempt to minimize the tax consequences of our actions while limiting the influence tax consequences have in our decision making. Doing well investing creates tax consequences when you sell an investment for more than you paid for it. This is much better than reducing your income (limited to $3,000 in capital losses matched against your income) because you only have losses. So success comes at a price. Ideally you would like to have a very large tax bill, which translates into large gains in your portfolio. It is a measure of success that will help you solidify your place among the top half of taxpayers, which achieved a notable distinction in the last year. Many myths swirl around the topic of taxes. One is that the Bush tax cuts hurt the poor. The evidence is just not there to support that assertion. For the record, I personally was vehemently opposed to the last few rounds of tax cuts for a variety of reasons.

If the taxpaying public was split in half based on income how do you think the tax liability would fall, 80% / 20% or 70% / 30%? Not even close. The top half of taxpayers ranked by income paid 96.7% of the taxes in 2004. This is up from 86.1% in 1949. Tax policy incorporates large doses of social policy. Incentives and disincentives are created by the tax system to encourage or discourage politically desired behavior. Tax incentives are used to increase the sales of politically desirable hybrid vehicles and a disincentive was created by eliminating the tax deductibility of the interest on mortgages for second homes. The type of social policy that is expressed in our tax code is dependent on the party in charge at any point in time. With the democrats taking back Congress in November we can expect changes that target more of their constituents. Unfortunately, no matter who is in charge, the changes that are made rarely result in simplification of the code.

Last month saw few dramatic changes in our portfolio. We are a still struggling to put our cash to work in what has become our theme for this year. We have one position we are looking to pare back if we can get the price to stabilize long enough. Gencor at a price of $12 or more is close enough to what we feel is fully valued. The shares trade so thinly that we have had few chances to put out a sell order before the price drops back down. Keep your eyes open for an alert regarding them soon.

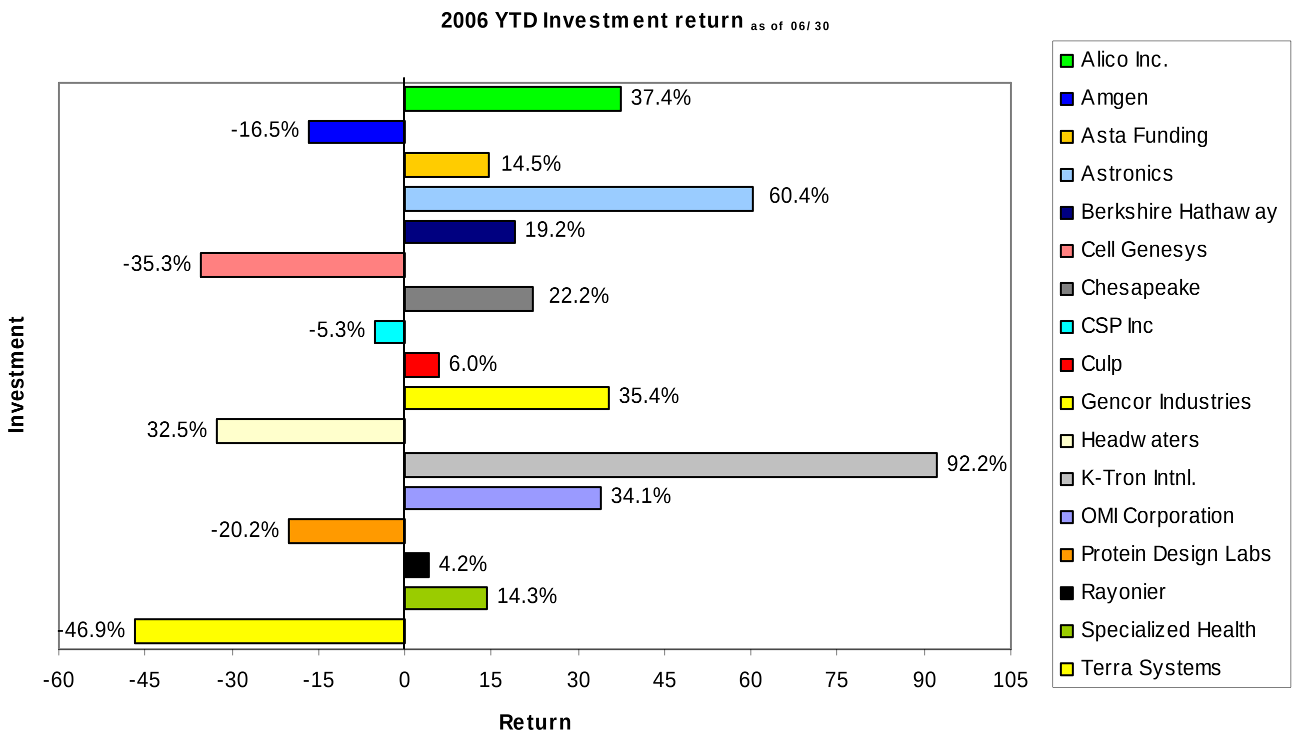
The downside is that this will only increase our bulging cash balance. Fortunately we have a few issues that are still trading at comfortably low levels. Rayonier and Chesapeake are two prominent examples. OMI also falls in that group.

Company	Porfolio Percentage	November price	October Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
Astronics Corporation/ATRO	**15.70%**	**$17.30**	**$17.48**	**-1.03%**	**$14.25**	**23.0**	**n/a**
Berkshire Hathaway B/BRK.B	**8.90%**	**$3,555.00**	**$3,515.00**	**1.14%**	**$2,900.00**	**13.1**	**n/a**
Cash	**17.40%**	**$1.00**	**$1.00**	**n/a**	**n/a**	**n/a**	**n/a**
Cell Genesys, Inc./CEGE	**3.10%**	**$3.88**	**$4.38**	**-11.42%**	**$5.00**	**n/a**	**n/a**
Chesapeake/CHK	**8.60%**	**$34.03**	**$32.44**	**4.90%**	**$30.00**	**7.6**	**0.80%**
Culp/CFI	**2.40%**	**$4.93**	**$5.20**	**-5.19%**	**$4.40**	**19.6**	**n/a**
Forgent/FORG	**1.00%**	**$0.53**	**$0.50**	**6.00%**	**$0.50**	**n/a**	**n/a**
Gencor/GNCI	**7.80%**	**$11.15**	**$12.15**	**-8.23%**	**$8.50**	**6.4**	**n/a**
Headwaters/HW	**2.40%**	**$23.92**	**$24.75**	**-3.35%**	**$25.00**	**10.7**	**n/a**
K-Tron International/KTII	**5.20%**	**$66.89**	**$66.49**	**0.60%**	**$42.00**	**18.9**	**n/a**
OMI Corporation/OMM	**20.70%**	**$23.36**	**$22.32**	**4.66%**	**$18.00**	**4.6**	**2.24%**
Protein Design Labs/PDLI	**1.10%**	**$22.69**	**$21.13**	**7.38%**	**$24.00**	**n/a**	**n/a**
Rayonier/RYN	**4.20%**	**$41.70**	**$40.99**	**1.73%**	**$40.00**	**18.3**	**4.60%**
Specialized Health Products/SHPI	**1.20%**	**$0.61**	**$0.62**	**-1.61%**	**$0.40**	**n/a**	**n/a**
Terra Systems/TSYI	**0.30%**	**$0.38**	**$0.40**	**-5.00%**	**$0.50**	**n/a**	**n/a**

Performance

In November we ended the month with our portfolio up 23.3% and have a comfortable lead over the S&P 500's 14.2% gain so far this year. In our first two years and 11 months of publication our portfolio has zoomed ahead 83.4%, far out-distancing the S&P's 32.9%. As you can see from the chart below not all of our investments have done well this year. Fortunately some of our largest investments did extremely well. Alico, Astronics, Gencor, K-Tron, and OMI have all performed extremely well for us. The weakest of that bunch of five still generated 34% returns. We also have five securities that are down over 15%. Fortunately all of them had relatively small representation in our portfolio. After the large losses they now represent an even smaller part of our portfolio. As we have said in the past, we try to place larger sums in companies that we see a greater degree of certainty in regarding their future performance. Some of our smaller positions are companies that we feel can be much more volatile, but have the chance to generate much larger percentage returns. It sounds nice on paper, it would be nice to see it in action.

We would like to wish all of our subscribers and their families a very Merry Christmas and a joyous and healthy New Year.



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