The Commonsense

INVESTLETTER

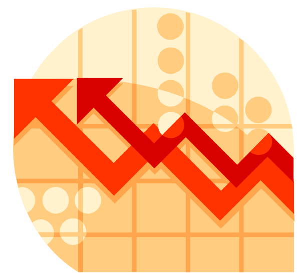
Volume 4 Number 9

Wall Street

- DJ 12081
- S&P 500 1368
- NASDAQ 2367

Fancy Charts and Graphs

Fancy charts, complex computer programs and reading squiggly lines on charts will not increase your chances of picking a market beating portfolio. This does not keep Wall Street from trying. A recent article in the New York Times provides the evidence. A $20 billion hedge fund had approached a prominent MIT professor about designing a neural network to analyze market data for patterns that humans cannot see. He declined the opportunity after he determined that the investors had no idea how such systems work. He went on to state that, "There are some pretty substantial misconceptions about what these things can and can not do."



Fancy does not equate to success.

If markets remained static this type of analysis may prove to be extremely useful. The only problem is that markets tend to be very dynamic. The factors that provide a great influence at one point in time may exert very little influence at another.

The assumption that the inputs equal the outputs, which they often don't, is a fatally flawed view of markets. The way news impacts share prices is very sensitive to the greater context of the importance that piece of news has at that particular point in time, weighted by the investors view of how important this news is to a particular company. Often a small piece of rather insignificant news can have a dramatic effect on the share price at one point in time but little affect at another. News regarding a company that makes bomb screening equipment would have one impact before 9/11 and a much larger impact after it.

Another example of the inputs not equaling the outputs is given by a company that misses earnings by a penny only to see their market value slip by hundreds of millions. At various points in time markets tend to over react in the positive direction and at other times in the negative direction. The tech bubble was an example of an overreaction in the positive direction.

There are too many variables to consider to develop useful computer models. Add to this the fact that nobody even knows all of the variables and that the variables and their weighting that affect today's markets probably will not be the variables or the same weighting in which they affect future markets.

There is no substitute to understanding how businesses work and basic finance principles. There is no one piece of information or no magic recipe where you plug the numbers in and out spits the perfect investment. It is important to remain cognizant that Wall Street will try to impress on small investors that they can't compete with their fancy computer programs and vast amounts of data. To which we would reply we don't have to, because it gives them no advantage. Don't be taken in by fancy Wall Street lingo or dissuaded by their apparent technological advantage, in the end it is all a mirage to help separate you from your money. At this, they truly do excel.

Inside this issue:

Watch List

Finally we added shares of Rayonier (RYN) to our portfolio. After a strong 3rd quarter earnings report we felt comfortable adding shares. Especially with the prospects that the 4th quarter results will be even stronger with strong land sales leading the charge. The company is solid if unspectacular. We should get a modest amount of appreciation and the strong dividends will be a big help.

We made two moves on this list in the past month. The first was that Alico (ALCO) received a demotion after we sold our remaining position from our portfolio. Now we sit and wait for the price to return somewhere closer to the $50 dollar range, where we would be content to be owners again. We will miss their nice dividend checks and are glad to have added the fat dividends of Rayonier before ALCO departed.

You will notice a new addition below in Graham corporation. After attending the WNY Investors conference and speaking for some time with the COO/President of Graham and having dinner with him and a small group of other investors we got the chance to gather some in depth information about the company. They are the world leaders in the condensers, heat exchangers, vacuum pumps and ejectors they manufacture for the petroleum, energy, and chemical industries. They have a reputation of producing extremely high quality products. Some recent capacity and raw material price level problems have caused them to have less than stellar results the past few months. Every indication is that these problems will be short lived. They have enough business lined up to increase production 20% next year and have been able to pass along price increases that will boost profit margins. We are in our final stages of analyzing this company. It is always easier to consider an investment after a company has a 20% one day price slide. The current price is nearly 50% off from the 52 week high. The old saying buy low and sell high is very insightful. Unfortunately, many have trouble buying after the price of a stock has been pummeled. The tendency for many investors after a stock's price has been beaten un-mercifully is to assume it is going to continue to go down, making it difficult to pull the trigger when the price becomes low. This is exactly the point at which we enjoy becoming trigger happy. We will have decision shortly after we model next years performance.

Company	October price	September price	Change from September	P/E	52 Week High	52 Week Low	Estimated '06 EPS	Dividend Yield
Alico/ALCO	$62.00	$58.51	5.96%	48.0	$62.92	$42.17	n/a	1.80%
Alliant Techsystems Inc./ATK	$77.21	$81.06	-4.75%	15.3	$84.90	$70.26	$5.06	n/a
Altria Group, Inc./MO	$81.33	$76.65	6.11%	15.3	$85.00	$68.36	$5.31	4.20%
Arch Coal/ACI	$34.63	$28.91	19.79%	20.7	$56.45	$25.85	$1.67	0.70%
Bioanalytical Systems, Inc./BASI	$5.32	$5.26	1.14%	n/a	$7.80	$4.75	n/a	n/a
Canadian Natural Res./CNQ	$52.15	$45.06	15.73%	12.9	$64.38	$40.29	$2.86	0.50%
Graham Corp./GHM	$13.64	$17.59	-22.46%	16.8	$26.00	$12.55	n/a	0.70%
Kensey Nash/KNSY	$30.41	$29.27	3.89%	37.6	$33.69	$21.41	$0.80	n/a
Landauer, Inc./LDR	$54.77	$50.75	7.92%	24.9	$57.29	$43.11	$2.20	3.30%
Markel	$399.50	$410.66	-2.72%	14.4	$413.87	$307.41	$28.55	n/a
ModPac/MPAC	$11.14	$11.20	-0.54%	n/a	$12.50	$8.00	n/a	n/a
QLT Inc./QLTI	$8.50	$7.60	11.84%	26.1	$8.71	$5.93	$0.32	n/a
Servotronics Inc./SVT	$9.40	$6.15	52.85%	12.8	$10.30	$4.02	n/a	n/a
Tejon Ranch Co./TRC	$48.50	$42.43	14.31%	n/a	$49.74	$37.55	n/a	n/a
Universal Forest Products/UFPI	$45.38	$49.05	-7.48%	12.2	$80.28	$44.94	$3.60	0.20%

The Investletter Portfolio

How about an early start to New Years resolutions. We have some real doozies to explain this year. Sometimes it is all in the timing, and we have exhibited how poorly it can work out when you get it wrong. Lets start with Cell Genesys. They have been a glaring example of perennial underachievers. The company has got to the point where they have backed themselves into a corner. They have failed to partner up with a larger pharmaceutical firm to market their drug candidates and have repeatedly missed internally set deadlines. Although they still have a large amount of cash on their balance, investors can see past the end of the cash hoard. The net result is this puts the company in a weak negotiating position with potential partners. They are no longer dealing from the strength of a huge cash balance an the ability to feign they can bring their product to market without any help. It appears they will need to raise some cash by selling more shares if they can't get a partnership agreement and everyone knows it. Potential partners are content to wait and see if the share price drops some more due to the threat of dilution from additional shares. Whatever happens it is unlikely it will be good for shareholders. It has also become more likely that the company will be bought out for a small premium by a much larger suitor. This could happen at a 50% premium and it still would not help us much. Now is the time to either sell your shares completely or double up the number of shares you own with the intent to sell of the original holdings more than 30 days down the road. This will allow you to still have an ownership stake and capture the capital loss for tax purposes.

Headwaters is another company where things have not gone our way. Oil prices are the main culprit here. The high oil prices caused many of the company's customers alternative energy facilities' to shut down for half of the year when there was uncertainty regarding the ability to garner IRC §45 tax credits (IRC - Internal Revenue Code). The credits phased out over a sliding scale of oil prices. As prices declined this fall it became apparent the average price would be below the full phaseout level and the plants restarted production. This still cost Headwaters a significant amount of profit. With the uncertainty surrounding the availability of the tax credits going in to next year, the price is still depressed. Fortunately the company still has a large number of new projects about to launch and add revenues over the next several years. They have an ethanol plant scheduled to begin production in early 2007, a super efficient hydrogen peroxide facility beginning production within the next year and a new nano-catalyst to upgrade heavy oil refining. The value that this chemical adds to the refining process makes it easy to justify for refiners. This business has the possibility to really take off over the next several years. Even thought the investment has not done as well as we would have liked the company still has bright prospects. It appears we will just have to wait a bit longer than we had originally expected. Headwaters is another example of a company that may be worthwhile to double up on and sell of the original investment after 30 days. If you have any questions regarding this strategy please contact us for a more in depth explanation.

Company	Porfolio Percentage	October price	September Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
Astronics Corporation/ATRO	15.90%	$17.48	$15.75	10.98%	$14.25	27.7	n/a
Berkshire Hathaway B/BRK.B	8.80%	$3,515.00	$3,174.00	10.74%	$2,900.00	14.5	n/a
Cash	20.00%	$1.00	$1.00	n/a	n/a	n/a	n/a
Cell Genesys, Inc./CEGE	2.00%	$4.38	$4.57	-4.16%	$5.00	n/a	n/a
Chesapeake/CHK	8.20%	$32.44	$29.82	8.79%	$30.00	7.2	0.80%
Culp/CFI	2.60%	$5.20	$5.47	-4.94%	$4.40	19.6	n/a
Gencor/GNCI	8.60%	$12.15	$9.25	31.35%	$8.50	5.4	n/a
Headwaters/HW	2.50%	$24.75	$23.35	6.00%	$25.00	9.2	n/a
K-Tron International/KTII	5.00%	$66.49	$63.22	5.17%	$42.00	19.6	n/a
OMI Corporation/OMM	19.70%	$22.32	$21.71	2.81%	$18.00	7.1	2.24%
Protein Design Labs/PDLI	1.10%	$21.13	$19.20	10.05%	$24.00	n/a	n/a
Rayonier/RYN	4.10%	$40.99	$37.80	8.44%	$40.00	17.1	4.60%
Specialized Health Products/SHPI	1.20%	$0.62	$0.65	-4.62%	$0.40	n/a	n/a
Terra Systems/TSYI	0.30%	$0.40	$0.50	-20.00%	$0.50	n/a	n/a

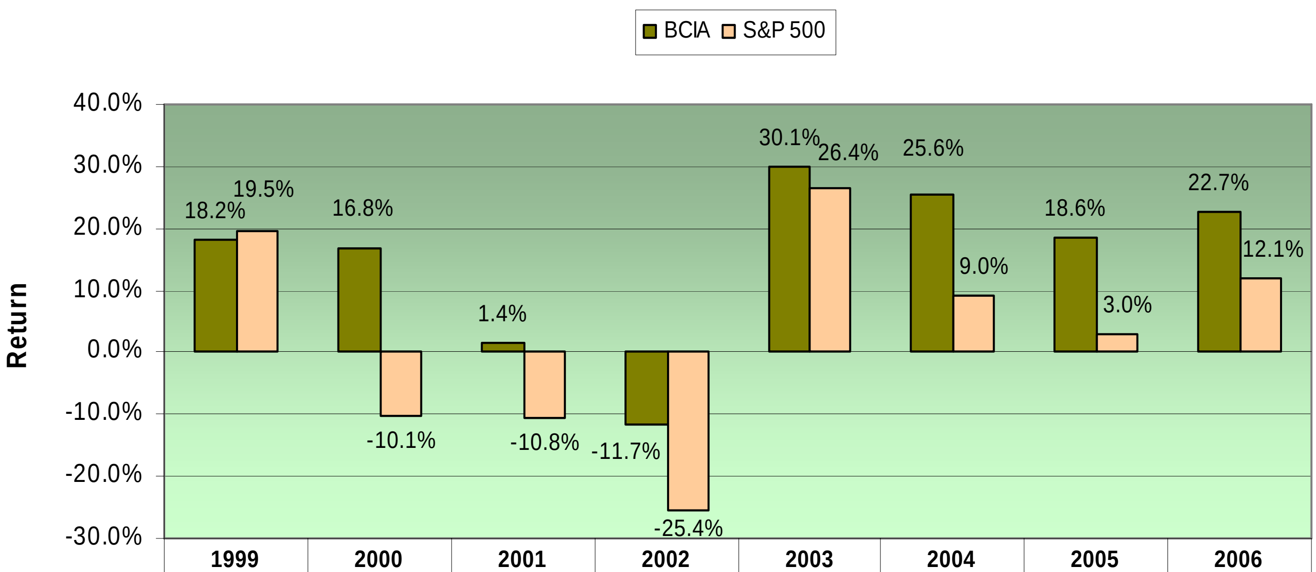
Performance

Whiz, bang, boom! After being solidly manhandled by the market averages in September, our portfolio came roaring back with extremely strong gains in October. Again we did not track the markets movements. For our purposes the stock market averages are akin to the "ignore that man behind the curtain" scene in The Wizard of Oz.. What happens behind the curtain (our portfolio) is the true focus and the flames and the big spectacle (Wall Street) are nothing but show. Flashy entertainment has no real bearing on how we operate and the only link is the medium we use, investing in equities.

While the stock market averages made solid gains, our portfolio zoomed ahead 7.2 percentage points. The S&P 500 average was up 3.2% for the month. If the year ended today we would report our 7th straight year of out performing the market.

We have made a small change in the way we report the S&P 500 average's results that will make their results more accurate. As a result, when you examine the S&P 500's results in the chart below you will see their performance improved from past charts. It improves on results that we happened to be underreporting because of the way the average is often reported without dividends.

BCIA Annual Return vs. S&P 500 6/30/2006



	1999	2000	2001	2002	2003	2004	2005	2006
BCIA	18.2%	16.8%	1.4%	-11.7%	30.1%	25.6%	18.6%	22.7%
S&P 500	19.5%	-10.1%	-10.8%	-25.4%	26.4%	9.0%	3.0%	12.1%

Year

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