The Commonsense

INVESTLETTER

Volume 5 Number 8

Wall Street:

- DJ 13896
- S&P 500 1527
- NASDAQ 2702

Now is the time to start tax planning for 2008. As part of the Jobs Growth Relief and Reconciliation Act signed by President Bush in 2003 and modified by the Tax Increase Prevention and Reconciliation Act signed in 2005, capital gains rates were reduced to 15%. For those in the two lowest tax brackets the capital gains rates were reduced even further to 5% and then to 0% for years 2008 through 2010. The two lowest tax brackets (which happen to be at the top of the chart on the next page) are the 10% and the 15% tax brackets.

The time to start planning for 2008 is now.

If you are single and have taxable income of less than $31,850 or have taxable income of less than $63,700 (subject to inflation adjustment in 2008) for married taxpayers filing jointly, you qualify for the 0% tax on capital gains. Taxable income is your income after deductions. After you take your personal exemptions, standard or itemized deduction you arrive at your taxable income. This is greatly simplified but you get the idea.

Any gains you have (or qualified dividends) count towards your income. For example, a married couple with $50,000 in income before capital gains (and qualified dividends) can have another $15,000 in capital gains (this is assuming that the 15% tax bracket rises to $65,000 in 2008) and pay no more in taxes. The tax savings is $750 computed by the difference in paying capital gains tax (on the $15k) at the 5% rate and the 0% rate.

Our goal in 2008 is going to be to sell as many highly appreciated securities as possible to reset the cost basis before buying back the shares. We will repeat this exercise each year until 2011 when the capital gains rates reset to a maximum of 20%. Upon entering 2011 we hope to have all of our securities at a cost basis of nearly the year end 2010 price. This will also make it easier to realize any capital losses. Not that we are in a hurry to recognize losses but sometimes they can work to our advantage. Buying shares at $5 selling them at $50 towards the end of 2010, re-buying them at $50 and selling them sometime in 2011 at $45, before re-buying them again at $42 could result in $0 dollars in capital gains paid in 2010. This also creates the possibility of subtracting capital losses (on a drop from $50 to $40 per share) from our earned income, thus reducing our taxable income and therefore the amount of tax owed in 2011. On a 200 share lot it could result in a tax savings of $450 and the ability to claim a loss of $1000 thus reducing taxes owed by $150 dollars (for a 15% taxpayer).

All of this depends on your ability to fit into the two lowest tax brackets which describes 75% of all filers. If your income is too high it still does not eliminate you playing along. Adult children (children older than 18) in low tax brackets can be gifted (given) appreciated stock which they can then sell and pay no taxes. (This is limited to $11,000.) Of course you are then out the money, but if you were planning on gifting the money anyways, it makes a great deal of sense to gift it in the

Inside this issue:

Difference Assets

form of appreciated stock. This does not work as well with minors due to the intricacies of the kiddie tax, which forces much of a child's unearned income (capital gains and dividends) to be taxed at their parents higher rate.

These lower rates will pose a challenge when making changes to our Investletter portfolio. I personally will be selling shares for tax purposes to lock in as much of the 0% rate as the tax brackets will allow me. Some will be close to the end of 2010 which will be rather small gains that I will be zeroing out before 2011 begins. Other large positions, like Astronics will consist of sales over possibly all three years to reset my basis to a new higher purchase price whenever it occurs. We will give a thorough explanation of how each sale fits into the bigger picture of dealing with the law changes. In no way will we be giving tax advice in the newsletter. Tax planning is best done on an individual basis.

There is no tax rate better than 0% and it is coming in 2008 for those who qualify. Take inventory of how much in gains you have now 'cause we sure piled up plenty in '07.

Usually earning extra income will put you in a better position. The next three years will turn this rule of thumb on its head. It will become more important than ever to do tax planning over the next couple of years. At the Blue Collar Investment Advisors we stand ready to help. With each person tax situation being different, the method to take advantage of this extended capital gains tax holiday will vary. Start now by taking inventory of how much in unrealized gains you have in your account(s) and start projecting what your income in 2008 will look like. Be assured we will have much more to say about this timely issue.

Married Filing Jointly

If taxable income is over --	But not over--	The tax is --
$0	$15,650	10% of the amount over $0
$15,650	$63,700	$1,565.00 plus 15% of the amount over 15,650
$63,700	$128,500	$8,772.50 plus 25% of the amount over 63,700
$128,500	$195,850	$24,972.50 plus 28% of the amount over 128,500
$195,850	$349,700	$43,830.50 plus 33% of the amount over 195,850
$349,700	no limit	$94,601.00 plus 35% of the amount over 349,700

Single Filer

If taxable income is over --	But not over--	The tax is --
$0	$7,825	10% of the amount over $0
$7,825	$31,850	$782.50 plus 15% of the amount over $7,825
$31,850	$77,100	$4386.25 plus 25% of the amount over $31,850
$77,100	$160,850	$15,698 plus 28% of the amount over $77,100
$160,000	$349,700	$39,148.75 plus 33% of the amount over $160,850
$349,700	no limit	$101,469.25 plus 35% of the amount over $349,700

Watch List

A recent news brief in Fortune magazine referenced a survey of 642 full-time finance professors and found that 60% think the market is more or less efficient. This implies that picking stocks on the basis of publicly available information (as we do in the Investletter Portfolio) may not be the best strategy. Even more surprising only 57% of the academics feel the market can be outperformed using non public information, otherwise known as insider information. That means a significant number (probably something less than the other 43%) of hardcore efficient market supporters believe that the market can't be outperformed using insider information. With the academic community turning out graduates educated in this fashion it is no wonder it's possible to outperform the markets. As long as the academic community remains intent on finding a neat and tidy mathematical explanation explaining the movement of stock prices we are assured of having little competition in analyzing companies. This helps keep the playing field tilted in our favor.

Only when the academics start turning out graduates that realize that real markets aren't as neat and tidy as classical finance would suggest, will our task will become more difficult. Then we will have more competition looking for the companies that are mis-priced in the market. With Columbus Day near, it can be used for a fitting analogy. If it is common knowledge that the world is flat, it doesn't make sense to venture too far from what is known. For those who know otherwise, they can take advantage of the wealth that can be found past what is charted without having to worry about impending doom. If the common knowledge in the stock market says that every stock is accurately priced at about what the company is worth, then it doesn't make much sense to investigate companies to see if they may be underpriced.

Fortunately, many investors do not adhere to this erroneous line of thinking. It still doesn't keep the academic community from continuing to teach it. The larger the number of investors that follow this classical theory the less completion we have.

Company	September price	August price	Change from August	P/E	52 Week High	52 Week Low	Estimated '07 EPS	Dividend Yield
Alico/ALCO	$43.34	$51.15	-15.27%	n/a	$65.00	$43.00	n/a	2.30%
Alliant Techsystems Inc./ATK	$109.30	$105.31	3.79%	17.8	$115.95	$75.50	$6.32	n/a
Altria Group, Inc./MO	$69.53	$69.41	0.17%	16.2	$90.50	$63.13	$4.29	4.30%
Arch Coal/ACI	$33.33	$29.49	13.02%	29.4	$42.59	$27.18	$1.15	0.80%
Bioanalytical Systems, Inc./BASI	$6.96	$6.78	2.65%	n/a	$7.82	$4.98	n/a	n/a
Canadian Natural Res./CNQ	$75.75	$68.31	10.89%	20.4	$78.90	$43.15	$3.68	0.40%
Culp/CFI	$10.38	$10.20	1.76%	19.2	$4.37	$12.30	$0.54	n/a
Graham Corp./GHM	$41.11	$36.30	13.25%	20.4	$45.75	$12.55	$2.08	0.20%
Kensey Nash/KNSY	$26.11	$23.83	9.57%	27.9	$33.69	$22.26	$0.94	n/a
Landauer, Inc./LDR	$50.96	$50.69	0.53%	23.2	$57.29	$45.50	$2.22	3.70%
Markel/MKL	$484.00	$475.66	1.75%	14.3	$521.90	$389.76	$34.65	0.20%
ModPac/MPAC	$8.60	$9.83	-12.51%	n/a	$12.50	$7.44	n/a	n/a
QLT Inc./QLTI	$5.69	$5.87	-3.07%	20.9	$9.92	$5.23	$0.26	n/a
Servotronics Inc./SVT	$16.50	$14.87	10.96%	29.2	$17.00	$6.15	n/a	n/a
Specialized Health Products/SHPI	$0.72	$0.74	-2.70%	34.8	$0.99	$0.59	n/a	n/a
Tejon Ranch Co./TRC	$41.40	$41.38	0.05%	n/a	$57.09	$37.70	n/a	n/a
Torm/TRMD	$41.10	$39.62	3.74%	3.5	$43.13	$24.92	2.30%	11.90%
Universal Forest Products/UFPI	$29.90	$37.29	-19.82%	16.0	$54.61	$29.51	$2.02	0.40%

The Investletter Portfolio

One of our oldest holding is Berkshire Hathaway. We bought our initial shares back in 1999. Since then the company has significantly increased their earnings power, seen a huge increase in cash and investments, and has barely seen their share price double. The company has been growing internally at about the same rate. Over time a companies return on the capital their investors supply will roughly equal the returns in the market.

Berkshire's CEO Warren Buffett has often talked about the company being an elephant. Not the most nimble creature and needing to consume a lot to make any difference in its appetite. Berkshire is so large that a fast growing subsidiary will have very little impact on the growth of the company. Growing larger requires the company to swallow very large acquisitions to even make a dent in its appetite. Acquisitions this size are difficult to come by at agreeable prices. Berkshire is a $187 billion company. Acquiring a $10 billion company will hardly have an impact on the overall performance of the company.

Years ago we reported the company had over $45 billion in cash. After making numerous acquisitions they now hold over $46 billion in cash. Add in another $25 billion invested in bonds and $75 billion in stocks and the company has over $145 billion in cash and investments. A few years ago Buffet hinted that if the company can't put all of the cash to use, a dividend may be in order. His inability to put the large cash balance to work acts to depress the companies performance. When a large part of your assets are earnings less than 5%, it takes huge returns from the rest of the company to achieve even average returns. Without the initiation of a dividend or the promise of a fairly large acquisition, we may be forced to lighten our Berkshire holdings. It will be a long time before we eliminate the company from our portfolio but it will continue to play a less prominent role as it grows slower than our portfolio as a whole.

Buffett has been busy making acquisitions in the several billion dollar range and the company has been increasing their equity (stock) investments. It is often hard to tell who is making the investment decisions at Berkshire. Buffett invests certain assets of the company and Lou Simpson invests a large amount of assets at the company's Geico subsidiary. Lately the company has been increasing its stake in railroads. Berkshire now owns over 17% of Burlington Northern Santa Fe. Railroads have been working at capacity and have seen the rates they can charge increase sharply. They have little competition and operate as near monopolies. Just the kind of business Buffett likes. Over the long term the business should perform well but not spectacular. Even owning more than 17% of the company still amounts to only a $5 billion investment. Berkshire also owns large stakes in several other railroads. These types of investments help put some of the cash to work but not fast enough to keep it from piling up. Hopefully a dividend is just around the corner.

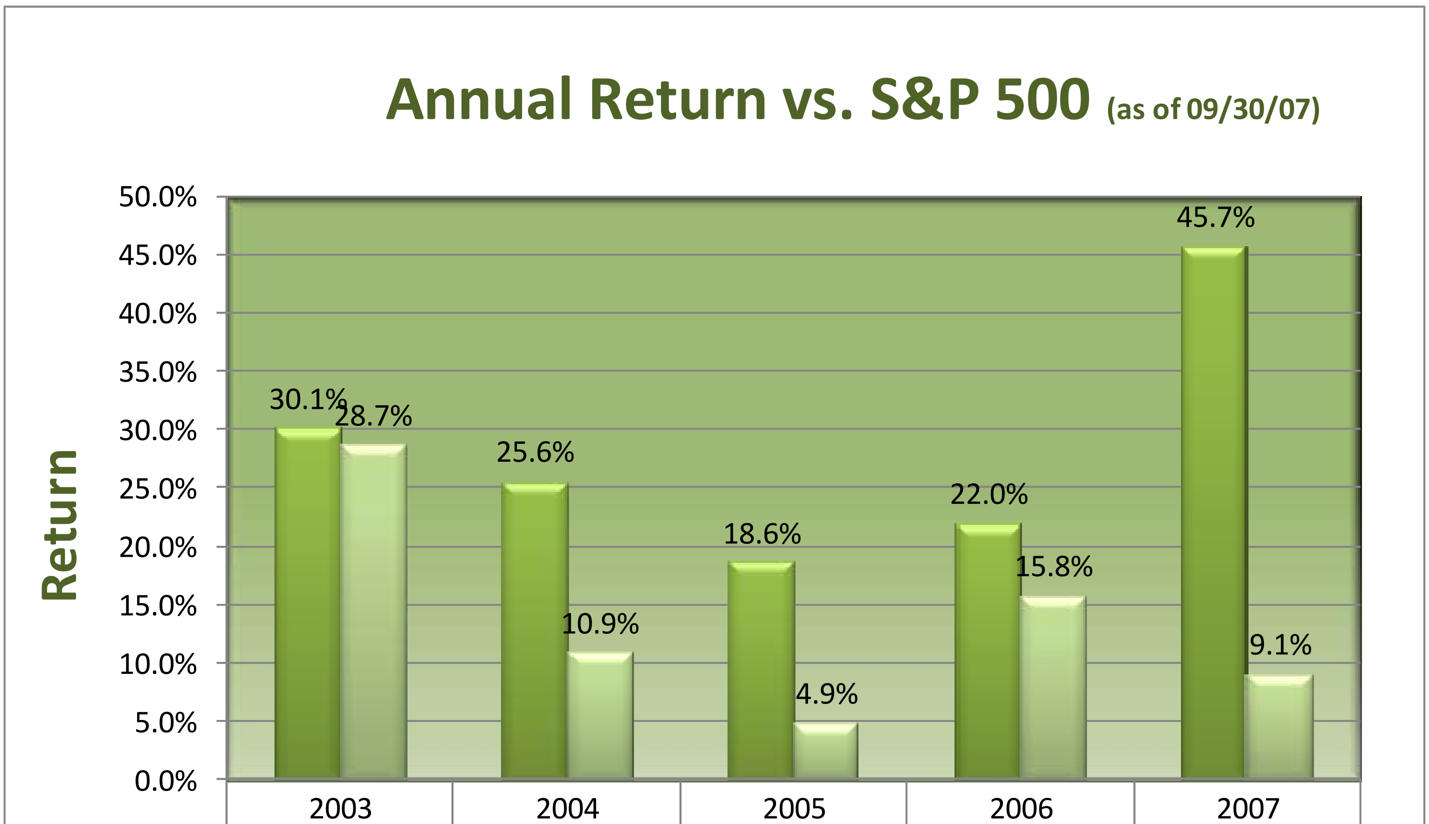
Company	Porfolio Percentage	September price	August Price	Percentage Change	Buy Price (less than)	P/E	Dividend Yield
American International/AMIN	7.30%	$5.10	$5.45	-6.42%	$4.95	n/a	n/a
Amtech Systems/ASYS	2.50%	$12.82	$11.05	16.02%	$11.15	33.6	n/a
Astronics Corporation/ATRO	22.00%	$43.57	$31.42	38.67%	$35.00	31.1	n/a
Atrion/ATRI	6.70%	$125.00	$114.00	9.65%	$93.00	18.7	0.80%
Berkshire Hathaway B/BRK.B	7.60%	$3,952.00	$3,890.00	1.59%	$3,800.00	15.5	n/a
Cash	9.60%	$1.00	$1.00	n/a	n/a	n/a	n/a
Chesapeake/CHK	6.30%	$35.26	$32.26	9.30%	$33.00	10.3	0.80%
Gencor/GNCI	7.20%	$9.90	$9.98	-0.80%	$9.70	5.6	n/a
Griffin Land & Nurseries/GRIF	5.50%	$37.00	$35.07	5.50%	$36.00	30.5	n/a
Headwaters/HW	1.30%	$14.88	$16.52	-9.93%	$14.00	6.0	n/a
K-Tron International/KTII	9.40%	$95.00	$90.01	5.54%	$90.00	16.2	n/a
Protein Design Labs/PDLI	0.80%	$21.61	$19.51	10.76%	$21.00	n/a	n/a
QEP Corporation/QEPC	7.10%	$12.82	$11.68	9.76%	$12.00	14.4	n/a
Rayonier/RYN	6.70%	$48.04	$42.74	12.40%	$41.00	20.7	4.70%

Year to Date

As of the end of September we had a 36.6 percentage point lead over the S&P 500 market average. Several months ago we passed our stated goal of doubling our money every five years and now have seen our portfolio rise 165% over the past three and three quarter years. This works out to a 31.3% annualized rate. Over that same time frame our average percentage point lead over the S&P 500 average is 17.8.

The past month saw our portfolio recover all of the drop we saw in August and then some. We gained more in September than the S&P 500 average is up for the year. Most of this surge can be attributed to Astronics more than 38% rise in September. The company announced they will be providing content on two new planes and that they have received FAA approval on new lighting products.

If we can hit 60% return for the year we will be up an even 200% over the past 4 years. Unlikely, but possible. So far this year we have managed to avoid pulling the flowers and watering the weeds. We sold Culp a few months early, but other than that we have held our winners and pared back on our losers like Terra Systems. All couple of favorable surprise and we can still tack on sizable gains this year. Next year will undoubtedly be tougher.



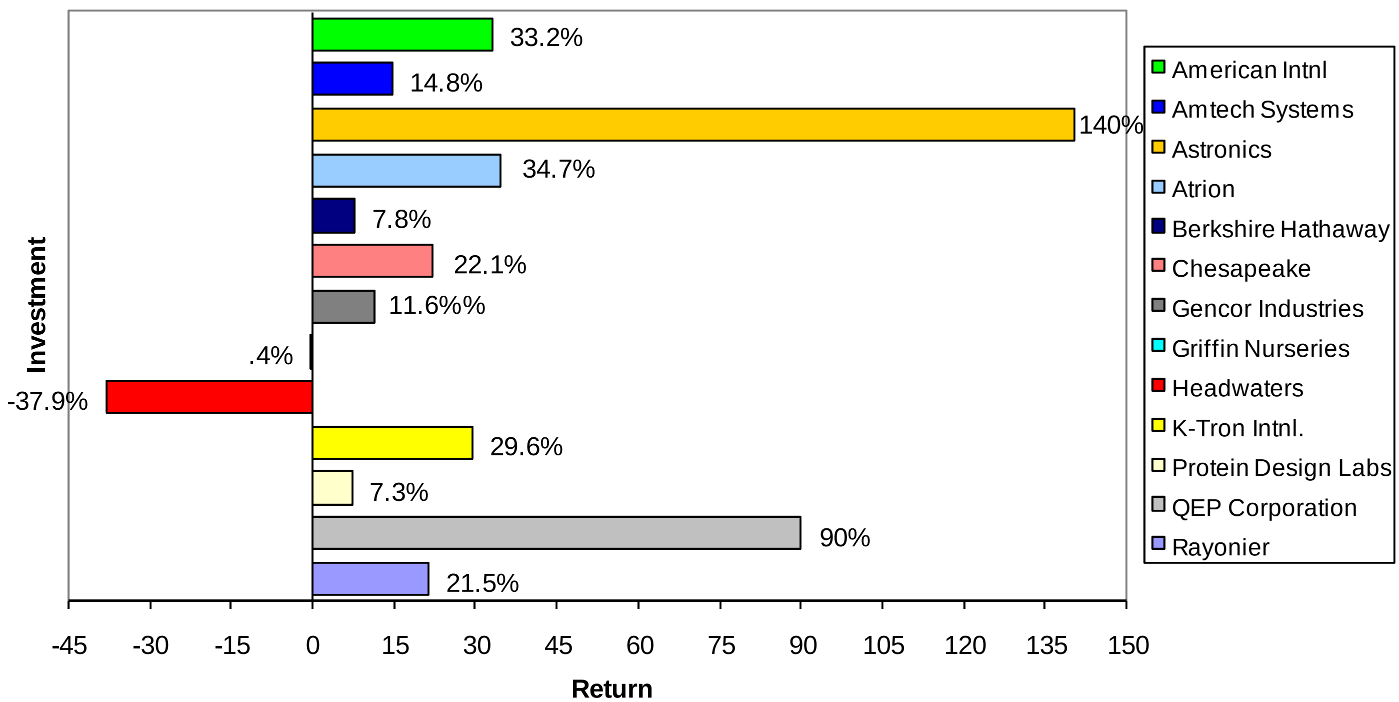
	2003	2004	2005	2006	2007
Investletter	30.1%	25.6%	18.6%	22.0%	45.7%
S&P 500	28.7%	10.9%	4.9%	15.8%	9.1%

Performance

With the Investletter Portfolio up 45.7% the first nine months of this year we have nearly outperformed the S&P 500 average over the past 45 months, the amount of time we have been publishing this newsletter. Over the past 45 months the S&P 500 average has returned 47%.

With Astronics in the driver seat our portfolio has surged to new highs again. Our Astronics shares are now up 140% through the first nine months. Many other companies currently in our portfolio are having very strong years. QEPC is up 90% in the short time we have owned it and we currently have shares in five other companies that are up over 20% this year. When a large position has returns of the magnitude that Astronics has provided this year (and last year), it has the ability to add quite a few percentage points to the performance of a whole portfolio. Without Astronics we would be having a good year, but not the spectacular year that this year has turned into. It only takes a few excellent investments to drive a portfolio to superior returns. If one in five investments turns out to surprise us, we expect to have good results on the whole. In the stock market, you are never forced to choose a certain percentage of poor investments. You have the option to choose the best and forget the rest. The best may vary from investor to investor depending on their experience, but you still can limit your choices in any manner you wish.

2007 Year to Date Return as of 09/30/2007



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