THE VIEW FROM PRINCETON

Market Commentary ♦ September 10, 2010

Morose Meditation on the Sullenness of the Summer, 2010

The Economy Strengthens as it Slows

The double-dip fantasy (OTC Ticker Symbol: DODI if there were such) paraded once again during the summer. In our commentaries throughout many months, we recurrently designated as major influences upon prices of financial assets the rhetoric derived from the sour, and so often venomous, state of public commentary — in broadcast, publishing and extreme remarks of both analysts and politicians. We comment yet again because the confusion from such background noise has led to the high frequency of significant mispricing of common shares of enterprises that have clear opportunities for sustained growth. It is doubtful if any one can remember a time when attitudes and commentaries have been quite so negative, sour, and untowardly dissentious. It is abundantly apparent that there are very many people who do not care for the world as it is. Yet, can you ever remember a time when the world was as you wished it to be? The traumatizations from the financial debacle of 2007-9, the persistent high unemployment, and the impatience with the slow pace of economic recovery charge the mix of emotions into a situation that can be exploited by those who care to do so.

Take for instance the broadcast and publishing media. Stirring anxiety, disapproval and anger for the sake of attention toward selling merchandise (a timeworn tactic) is often the name of the game, simply because revenues are essentially derived from the merchandise they sell. Whatever it takes to enlarge audiences in order to sell products motivates whatever they present, or so it often seems. Contemporary negativeness, however, goes beyond all former, seemingly establishing a new low point in our state of self-regard. Accordingly, many Americans look despondently down and inward, not upward into opportunities that are proliferating in so much of the rest of the world. Quite recently, attitudes became tuned and suffused with the catchy thematic phrase "double-dip" in economic activity. The continual monthly outflow from domestic equity mutual funds appears exemplary of this retreat state of mind.

Surely, under current circumstances, another dip can be created if, FIRST, we can convince ourselves that another is inevitable. Such expectations can be sufficiently widely held to be self-fulfilling. That is a noteworthy worry of the moment. This cannot be supported from fundamental circumstances — which, if one cares to observe, are showing persisting improvement — not across the board but generally persisting. Indeed, it should be said that the present pace of economic recovery, disappointing as it is, follows closely to the best that could have been reasonably expected, following the depth and breadth of recent year financial disasters. The boost from restocking (nearing completion) of inventories from the deep reductions of 2008 and 2009 was characteristically a temporary matter. All things considered, the recovery not only seems to be approximating reasonable expectations, it also supports expectations of durability until such time when acceleration takes over, probably in the forepart of 2011.

The "double-dip" concept (with barely enough circumstantial evidence to provide credence and partial probability) sometimes seems promoted as a means to attain the objective of stalling and reducing President Obama, implying that getting rid of the President would be more than worth another recession. This appears as a vile counterpoint to the equally vile objectives attributed early to this White House team to the effect that the opportunities in the devastations from 2008-9 should be used to destroy the viability of the GOP. Using the aggravations of adversity for an alternative purpose, whether it is to sell merchandise or to force political change at the polls, seems quite unworthy of an honorable nation. Some of such is always present, to be sure, but we have not seen the likes of recent years, particularly when the genesis of the difficulties is writ so clearly in the excesses of the financial world. And, if the financial industry in America is successful in restoring its financial privileges and licentiousness formerly allowed, you can bet another financial bust will cascade within a few years from such a similarly irresponsible use of such privilege. Europe is leading the way in bringing a vitally needed discipline to the industry.

The puzzling challenge for investors is that of determining what will dispel this attitudinal malaise that envelopes markets at this time. No one can foresee. It might await the time when share prices move upward from other considerations in a way that restores confidence in expectations of happiness resumed. It might come from some change for the better in people's understandings of political posturing, or from other factors, such as rising awareness that the present sad state of spirit is at cross-purposes with what is best for us. We need broadcasters who program for balance, not extreme leftist and extreme rightist commentators spewing their own definitions and opinions with venom and assertiveness that has that "getcha hook" within. It might be that the talking heads on television will tire their listeners to a state of resignation. It might come from revulsion to some of the many occasions when panels of four or more are all talking at once in elevated voices — and the TV channel is permanently turned off in preference for web-based news and the "oldie goldies" of Netflix movie discs. Or, just possibly, from further depths of thorough disgust for ourselves, when, desperately, seeds of the American spirit will sprout in revival.

The Law of Unintended Consequences

Though it is not apparent how change will manifest itself from the troubled, muddled retreat from reality of the past few months, yet all can know that this is a wide aberration from what Americans have grown to consider themselves to be in spirit. Also, lessons from experience advise that political tactics as well as some of the commercial tactics tempt activation of "the law of unintended consequences". This universal law, though not written in ink, is inscribed firmly in recollections of social and political conduct. This law could begin to pertain without much warning, and prevail for nearby years.

The writer remembers a private report after President Clinton's Democratic party lost so heavily in the midterm election (1994) of his first term. He was asked, "Mr. President what do you plan to do about it?" With a pause that feigned reflection, President Clinton said, "Nothing." "Nothing Mr. President?" "Yes, I don't have to do anything, Newt Gingrich will re-elect me." That strategy out of the mouth of President Clinton is especially exemplary of the law of unintended consequences, as it pertained to Mr. Gingrich's intentions. Political opposition to proposals that are constructive as well as to those that are bad will ever have exposure to unintended consequences.

Look toward leading corporate entities in America and elsewhere for reliable guides

Reasonable alignments in market values of financial assets according to apparent opportunities and inherent valuations are not likely until America first clears its heads and its hearts. That is the fundamental issue in which all are trapped at this moment. The antidote is present in day-to-day life, where the essential drive in the conduct of business enterprises requires the vigor and the attention that disregards grumbling. This is the curative that is at work always for investors, and will eventually act to dissipate this current malaise of spirit. If attention is paid to the corporate reports as these have been announced this summer, faith would find support in the evidence that revenues are rising, and earnings rising more, in most instances. Who could ask for more under the circumstances? Continuation is to be expected, although there is a slowing of pace that began in the summer months. As important as a national attitude is in forming valuations of financial assets (and the course of economic activity), it is quite unnecessary at this moment for one to be either bullish or bearish. That is not appropriate terminology to use now. For those who must rely on animal characteristics for description, the preferred mascot should have the discerning disposition and quiet temperament of cats, rather than the unstable animus of bulls and the periodic somnolence of bears.

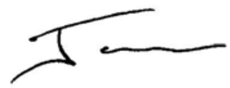
Knowing that clients prefer direct language to equivocal surmises, this writer's compliance with unhedged comments is often irritating to colleagues. Just a few days ago, one asked how could I appear so confident that a double-dip is unlikely. This was answered by saying, look no further than ourselves. We are a small service company functioning as a partnership under the radar of government surveillance so far as tallying national income and product is concerned, a category containing tens of millions of other models like us in our Nation. Our billings and revenues have moved into new high ground, as have assets under management. With very few exceptions, valuations of client holdings have advanced to new highs, and for all, progress underway in those companies selected for clients has never seemed to have been so uniformly positive. Now multiply our model of one small service company by the many tens of millions of others prospering, and you will find significant support to the surmise that the recovery is gaining in durability, though not yet in acceleration. Meanwhile, the reporting and affairs of large enterprises are especially supportive.

Additionally, assurance for long-term investors is conspicuously seen in prices of equities. Generally, these are unduly cheap by all metrics, by prospective opportunities, and by comparison to lower yields on high quality debt. What greater verification is needed beyond the recent corporate acquisitions in several industries that paid premiums over market prices of 34%, 45%, 50%, and in a bidding war 60% and 200% for strategic purchasing of intellectual property. Interest rates are nearly zero at short term, and lower than in many years throughout most maturity ranges for high quality credits — and should remain so owing to the high levels of unemployment resulting from the contractions in residential construction and the automobile and financial industries. Significant support is also to be expected from a growing flood of mortgage refinancings, as this will be releasing household interest payments for other uses.

Someday employment in the construction industry will experience an enduring revival. It is not so certain that it will for many years in the financial or the automobile industries. So, investors can quite easily avoid these three industries just mentioned, not one of which is of the scale of prosperous agriculture, healthcare, and electronics (as broadly defined from consumer electronics to industrial electronics to communications electronics). These three major industries, with spotty weakness only, are doing quite well and show reasons to continue so. As these industries grow, strength will gradually be communicated to others, as already seen in tourism, and certain aspects of entertainment and home repairs. As a confident friend remarked, there is enough money — real money — to be made within immediate months and for months thereafter to deter dispositions toward increasing risks in selecting securities. Instead, maximizing rates of return should be attempted by full positions in selected issues of thriving enterprises. There are surely enough for everyone.

With all good wishes,

Sincerely,



James Fitzpatrick

PRINCETON CAPITAL MANAGEMENT, INC. • 47 Hulfish Street, Princeton, NJ 08542
Phone: (609) 924-6867 • FAX: (609) 921-9502 • www.pcminvest.com