YOUNG ENTERPRISE SHARES (YES) REVIEW

Fourth Quarter 2012

For viewing in perspective, relative to years past and the unusual aspects of 2012, we refer to the page following showing the three categories of our strategies numerically and graphically for ten years. Last year was one of the most unusual, as it was suffused and confused with misgivings and contentiousness. The noise therefrom did not allow for proper hearing and comprehension of the steady hum of advancing business activity across most industries.

The general market indexes advanced, notwithstanding. The share prices of smaller highly innovative companies (categorically) went south, irrespective of better-than-usual enterprise progress. As described by indexes, the gains for the year ranked as follows: the Dow Jones +7.62%, the S&P 500 +13.41%, and the NASDAQ +15.91%. The wide disparity between Dow Jones and the latter two derives from the market cap weightings in the latter two, as contrasted with a simple arithmetical average for the Dow Jones Index. Furthermore, the latter two are heavily weighted in high-performing Apple, Amazon, Google, and financials that were still recovering from their earlier difficulties.

For inter-sector valuations, this was most unusual; and especially so for our selections, for which only one holding failed to meet expectations. Over half of the companies whose shares are owned came in with results very close to expectations; several companies exceeding by significantly better-than-expected results. Accordingly, the explanation for such an off year seems to be a market phenomena. Surely, this was not a circumstantial enterprise matter; from that standpoint, 2012 was one of the best years for this strategy. In our total universe of forty young company stocks (about twice the number owned by clients), only two failed to match growth expectations significantly. Surely, that is a better-than-customary incidence of matching expected progress.

Because the disappointing results were largely a market matter, this communiqué devotes more comments to the market than usual. Congressional-White House incompatibilities recurrently cast a blanket of risk apprehension across the entire landscape, compounded by several anticipated recessionary "double dips" and fear of a "fiscal cliff" (none of which were realistic, as events subsequently showed). Reportedly, some of the major computer-driven trading funds simplistically function as "risk-on/risk-off" in the deployment of massive sums for very short term gain expectations. Some managers specializing in short selling prefer small company shares that are highly responsive to an imbalance of buy or sell orders. If the aforementioned phenomena be summed, you have a jungle-like hostility to shares of fledging young companies, whatever their merits.

This challenging and sometimes hostile marketplace will not last, for this is too inconsistent with the American belief in the benefits of free and balanced markets. The evidence of destructive consequences thus far is sufficiently numerous to be compelling. Looking forward, the reduced contemporary valuations of so many young companies are such large aberrations to anything reasonably considered to be normal, prices for shares of many companies could increase by multiples (three to five) and still be attractive relative to tangible opportunities.

Characteristic American optimism is the sauce that flavors and energizes all enterprise endeavors and pervades the full spectrum of risk inherent in investing in marketable securities. Reasonable optimism is critically vital to the young, still-small enterprise sector; without such, there is nothing. For early commercial stage, products cannot be a solution looking for problems, but problems or opportunities looking for solutions sufficiently unique and effective to mitigate risk through differentiation of qualities. Those products also support profitable product pricing freedom for the providers. Those characteristics are essential in guiding our selection of shares.

As contrasted with the decades beforehand, the young still-small enterprise sector has been indifferently neglected since 2005, with the exception of the recovery year from the pits of 2008-2009. Revitalization therefrom lasted less than two years, having been dismissed by (1) the traumatized general attitude, (2) the concerns over the Greek-Ireland-Portugal-Spain-Italian sovereign debt affair (alias for banking profligacy), (3) the assumed fragility of the American economic recovery, and (4) the unwarranted fear of the "fiscal cliff". This aberration in pricing will probably be corrected by "catching up" (and then some) with an already deferred convincing general market uptrend, the potential for which seems to gain daily.

Considering the supportive influences from improving general economic circumstances, and from the extraordinarily low level of interest rates, the general market seems quite likely to respond with bold advances. These young company shares would then follow a general market sufficiently strong to elevate investor attitudes. Then, race to catch up and to value their superior growth prospects with a reasonable share of optimism. In the experience of this Firm, this category of shares has experienced three twelve-month periods when the advances in valuations doubled, or more. That took place during circumstances not so well sponsoring as contemporary circumstances. Thus, do not be surprised if valuations in 2013 much exceed a doubling.

There is no need to remind readers that surmises relating to the stock market are never to be counted on implicitly. Nevertheless, it is proper to advise clients that more than a doubling has a high probability rating from contemporary valuations for most of the shares owned. This only requires a normalization of capital markets.

Sincerely,

Jim Fitzpatrick

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