YOUNG ENTERPRISE SHARES (YES)
PORTFOLIO REVIEW

First Quarter 2013

PERFORMANCE COMMENTARY

This quarter market valuation of the holdings in our portfolio finally started to respond to the inherent enterprise value within the portfolio. Hopefully, this recognition will continue to grow throughout the year. I say hopefully because last year we had a similarly strong first quarter but it did not continue. I have bullet pointed comments from last year's quarterly letters relating to small company shares:

Q1 - This quarter responded to a respite from negative headline news
Q2 - No one can predict when better sentiment will support more realistic valuations of equities
Q3 - Negative influences are prevailing once again upon the share prices of these young companies, notwithstanding better-than-usual enterprise progress
Q4 - The share prices of smaller highly innovative companies (categorically) went south, irrespective of better-than-usual enterprise progress

Small companies were out of favor. Investors focused on stocks with superior yields or strong cash flow and recurring revenue streams as concerns in Europe and the US election tempered investors' outlook. That was last year and we are forward looking investors. We are one year further into the recovery, which is no longer in doubt. Concerns now focus on the lack of speed of the recovery rather than will there be one. This is a favorable climate for enterprises of all sizes. For years the market has been indifferent to small companies irrespective of the unusually positive enterprise progress.

A slow recovery is beneficial to small company stocks as long as growth prospects are in place, and in health and life sciences those prospects are secure. Whether one gets caught up in the growth of Apple vs Android or the slowing of PC demand, what is certain is that the use of the web and demand for the delivery of voice and data grows unabated. The demand driver for personal health and a growing aging population will only increase spending on health care.

The performance results for the quarter were all about health care, both from an upside and downside perspective. **Biolase Technology (BIOL)** was up 115% in the quarter followed by **Nektar Therapeutics (NKTR)** +48%, **Vical (VICL)** +37%, and **Vertex Pharmaceuticals (VRTX)** +31%, with **Universal Display (PANL)** +15% the lone non-health care company in the top five contributors. **Mako Surgical (MAKO)** was down 13% and **Hansen Medical (HNSN)** was down 3%. We added **NeoPhotonics (NPTN)**, **Cytori Therapeutics (CYTX)** and **Senomyx (SNMX)** to the portfolio in the middle of March and all three retreated below our purchase price in the last weeks of March.

Biolase finally came through this quarter and still has a lot of upside ahead of it. Their diode lasers are used in dentistry for surgical soft tissue procedures. The lasers cut efficiently at low power and with considerably less heat and patient discomfort. BIOL has outstanding technology and has long been the leader in dental surgery. The struggle for the company has been marketing and the degrees of dental adoption rate. In February, the FDA cleared their 940nm Diolase 10 diode soft tissue laser for use in nineteen additional medical markets dealing mostly with soft tissue surgery including over eighty different procedures. This vastly increases the market for their lasers and disposables and accessories. BIOL also announced a product offering for veterinary applications.

PORTFOLIO COMMENTARY

The portfolio consists of companies with outstanding intellectual property and superior product offerings. All are growing in enterprise value and gaining product acceptance in the market place. We believe that finally their inherent value will be reflected in stock market valuations on either a one-by-one case basis or a generalized collective judgment.

We did make some adjustments to the portfolio in mid March. We took profits and trimmed back several positions to add four new businesses – two health related and two communication related. As we have more than doubled our money in **Cavium Networks (CAVM)**, **FEI Corp (FEIC)**, and **Morphosys (MPSFY)** and had a 20% profit in **Osiris Therapeutics (OSIR)**, it made sense to adjust accordingly and to invest in a few stocks we felt to be unduly cheap versus their prospective opportunities.

In the life sciences field, we increased our exposure to stem cells (and plan on continuing to do so going forward) purchasing Cytori Therapeutics (CYTX). CYTX develops cell therapies based on regenerative cells to treat cardiovascular diseases, burns, and other soft tissue injuries. Essentially, it takes stem cells from one's own fat and enables these to be modified and administered within several hours to rebuild tissue. This negates the risks of tissue rejection as these are one's own cell tissues. CYTX has approval in Japan and Europe for soft tissue procedures, such as breast reconstruction, as well as soft tissue wounds or fistulae associated with trauma, diabetes, ischemia, and radiation injury. The Company addresses open-ended opportunities.

In the health care field, an increasingly overweight population and diabetes are of growing concern. Senomyx (SNMX) seems to understand taste bud receptors as no other to enhance or diminish sensory responses. Their present focus is on sweet, savory and salt flavors and bitter taste blockers. They are licensing flavor ingredients on an exclusive or co-exclusive basis and have entered into development agreements with several large food companies. As they proceed, these licensing agreements should generate a very high margin recurring revenue stream.

In the physical sciences, the demand for communication of voice and data continues to grow. NeoPhotonics (NPTN) products enhance cost-effective, high-speed connectivity and agility in allocation of bandwidth over communications networks. NPTN is a components provider selling product to network equipment vendors on a global basis. Their components enhance operating efficiencies enabling companies to address the ever growing demand for the communication of data.

Numerex (NMRX) is designer and manager of machine-to-machine twenty-four-seven communication systems. Whether it is the remote monitoring of health care devices through telehealth or managed care providers, security monitoring of facilities for commercial or residential property, monitoring pipeline pressure flows and possible leaks, tracking transportation logistics, or government tracking of equipment and troops, businesses and governments need to track or monitor data as new devices are utilized and usage for them is developed.

MARKET COMMENTARY

Earlier we posited that this year might be different from last in that renewed interest in YES holdings would be sustainable and valuations would continue to rise. As patient investors, we continue to be optimistic in terms of investing. Slow and steady are key descriptive words, and both are supportive to equity investing. There is ferment from the Mediterranean eastward that is beyond prediction, and there are attitudes toward America and possible strikes against America that are sobering to say the least. But these do not have the mass nor the influence to take down the improvements that are going on in Central Europe, in Eastern Europe, in Russia, in China, in the western hemisphere, and throughout the huge continent of Africa, to say nothing of the exporting nations of Australia, New Zealand, Indonesia, Malaysia, the rim of Asia, and others. The pieces of the world are ever more moving coordinately together, though at times rose-colored lenses are needed to see this.

Here at home, all things considered, the economy has moved into a period when it is self-sustaining, self-regenerative, and moving ahead. The fundamental factors sustaining growth are prevailing over concerns, and months ago the American economy attained the normal commercial evolvement of synergistic interactive regenerative relationships. If stripped of ulterior or personal prejudice, the landscape can be seen as highly supportive to equity valuations, helped – not diminished – by the gains of last year. Improved visibility and changed attitudes will allow more relevant observations in world changes beyond the range of parochial financial attitudes. These are fundamental and as pervasive as air and water; too huge and too omnipresent to attract attention.

One of the more conspicuous supportive influences for equity valuations is seen in the increase in merger and acquisition activity. Already, 2013 is off to a massive – possibly record – year. Prices have been at substantial premiums to quoted market prices, showing that these professional purchasers think the selected shares are cheap. This cross references like opinion to other shares as the reinvestment of money paid for purchased shares usually flows into other shares. As additional support, announced share buy-ins and dividend increases exceed prior experience.

Moving from the vastness-vague of universal concepts to industry-by-industry, we would cite several radical significant changes expected in America pertaining to energy, employment and jobs, health and relateds, and especially infrastructure. Investors should be sure that in each of these designations, the changes for prospective years are fundamentally — even radically — different from years past.

I. For energy, following decades of price increases for fuels, there is now a broadly embedded downtrend of long duration in the prices of liquid fossil fuels, and correlatively across the broad fuel-related and chemical-related spectrums. The decades-long uptrend that was created out of our national policy has ended. What could be more radically different than this? A long downtrend in the cost of fuels has more pervasive social sponsorship than a tax reduction. Everyone and every industrial entity benefits from a lower cost of fuel (except fuel providers, of course).

   Support for these surmises is made evident almost wherever you look. It was part and parcel of our national policy to constrain drilling at home, to build inventories in the salt domes of the southern Gulf States, and above ground in Cushing, Oklahoma. National policy could be summarized as keep our own reserves, import from others, and raise prices as we go. That attitude is reversing, coincident with market forces from huge new discoveries of oil (especially under sea water) and from the discovery of available natural gas through hydraulic fracking, not so far from major population centers of America. Expectantly, this extends by 30% or more the total available American reserves of natural gas. Rarely has anything of this scale ever happened. Moreover, the means of delivering natural gas allows it to be shipped over waters as never before in increasing scale, which means that natural gas becomes more nearly an international commodity rather than accessible largely through pipelines.

Combined with the upgrading of gas and oil to chemicals and other products, exports will supplant imports big-time, further assured by the significantly more conservative use of fuels and the subsidized sponsoring of alternative sourcing of fuels. You might hope Congressional representatives would factor these considerations into fiscal planning which are many times more important than their vacant, heated bickerings.

II. Another new national policy is evolving that is also a radical reversal in the form of infrastructure repair and building. References to the decaying bridges, the insufficiency of roads, and the insufficiencies of some other public works is compellingly apparent. This would not be net costly in social terms; rather, it would provide net savings. Imagine the time and dollars that would be saved when you can traverse metropolitan areas at more than 15 mph, or stalled with engines running. Or, the airplanes waiting on the runways to take off, or those being held up from landing by runway congestion. These will entail billions of dollars of saving. And, when you look at our public transportation system, it is so inadequate for us; and, many of those who visit from afar, think of us as some sort of a backward nation. So, public transportation is also in for a boost as an alternate to delays on the surface through private vehicles.

III. The exportation of jobs to less developed nations and to Asia is slowing dramatically. Our interest rates no longer give Asians a several-hundred basis points or more advantage (as in decades gone by) in high-capital, low-labor-ratioed manufacturing such as semiconductors, textiles, electronic end products, and even automobiles. Dissimilar taxes and subsidies will come under increased scrutiny, and the unevenness reduced. Also, there is likely to be less immigration than the astonishing quantities of very recent years, which, in effect, take jobs from persons who have been citizens in this country for years. Expect, also, a new emphasis on infrastructure spending to be combined with job opportunity sponsorship. The foregoing will all be interactive and mutually regenerative.

IV. Another, to be sure, reversal of trend will be a reduction in military expenditures. The retreat will be more conspicuous in spending beyond our borders. Yet, a large portion of military expenditures will come under a new analysis for justification. This will release human and financial resources toward infrastructure here at home where it is so badly needed for having been neglected for so many years.

V. Also expect a slowing of population growth in America, some reduction in the birth rate while the demographic bulge of elderly will be going on in increased numbers. Meanwhile, we have large industries that experienced little or no recession, owing to underlying self-sustaining forces. Most note worthily it is the healthcare realm – huge and ever increasing. Medical care will be made more available throughout the world.

VI. Agriculture, broadly considered to include all related aspects and support services, is our largest single industry, by far. It faces ongoing years of increasing output and is ever America's trump suit.

The sourcing of energy from a variety of technologies and discoveries is more dynamic than in the memory of any of us, for its breadth and totality of expenditures. Lodging, travel, entertainment goes on as though there is a fundamental demographic affinity that crosses national borders and runs throughout our large domestic economy.

This simplest and easiest sponsorship that our national government can give in financial leadership is simply to guarantee the credits of revenue bonds issued by state and local governments to improve their facilities for transportation, for education, for improving health facilities, and other aspects where government participation is important and welcomed, and use is regionally confined. While Federal expenditures will be constrained, expenditures by state and local governments will be rising. If the healthcare program were run differently, there could be perhaps a trillion a year saved. If the military were run differently, there could be perhaps a trillion saved. If we conduct our energy conservation appropriately, we perhaps could save another trillion there. And, Americans do not have to wring their hands in anxious wonder concerning where the money is coming from. The money is already sitting idle in huge amounts. A trillion dollars held by corporations overseas is locked over there because of tax considerations. It is pretty easy to find a way to bring that home.

Repeating, with all things considered here at home, the economy has moved into a period when it is self-sustaining, self-regenerative, and moving ahead. Slow and steady are key descriptive words, and both are supportive to equity investing.

For several years, our views have been highly divergent to much that we see and hear elsewhere. As always, change is the name of the game – especially so now, as relief ensues from the traumatized years. Rarely does it pay to bet against the vigor and endemic growth of America.

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