YOUNG ENTERPRISE SHARES (YES) REVIEW

Fourth Quarter 2013

PERFORMANCE COMMENTARY

The irrepressible advance in share valuations throughout 2013, attaining new high ground by year end, has been interpreted by both bears and bulls as supportive to their opposite orientations. The bears seem to have gained confidence owing to the fears of heights attained by general market indices, and an "I-told-you-so" confirmation in the January retreat. The optimists gain confidence believing the stock markets' advance is owing to the apparent increasing recognition that the American economy is on its way — moved by natural self regenerative forces, such as those that are commonly effective in growing societies. Moreover, there is a widespread causal effect from rising stock prices in elevating personal attitudes. Buoyancy of stock prices is the ultimate stimulative aspect of sponsored easy money. Under the circumstances of recent years, this effect has been rather constrained.

The dominant factors supportive to share price advances continue to be effective. The abundant liquidity that "floats all boats" will not disappear as the Federal Reserve System phases out its bond buying, for the American economy is generating adequate liquidity, and then some. Most conspicuously, this is evident in the consolidated corporate sector as cash positions continue to rise, allowing dividend increases and stock buy-ins, which return more cash to shareholders. This is also a way of showing that product pricing by-and-large among the well-run large enterprises has been so satisfactory as to swell cash positions and to sponsor the sending of money flowing towards the capital markets. Before 2004, corporations typically drew large total sums perennially from the capital markets to supplement their spending.

Furthermore, revenues and earnings obtained beyond the boundaries of America increase almost perennially. The recent-week flow of quarterly financial reports provides evidence of continuing satisfactory earnings. In concert with improvements in the chronic trade imbalance of imports exceeding exports, this acts in support of the American dollar and encourages capital inflows from other nations. When the eyes of citizens of other nations consider American shares in the context of alternatives, America's values appear more attractive than customarily.

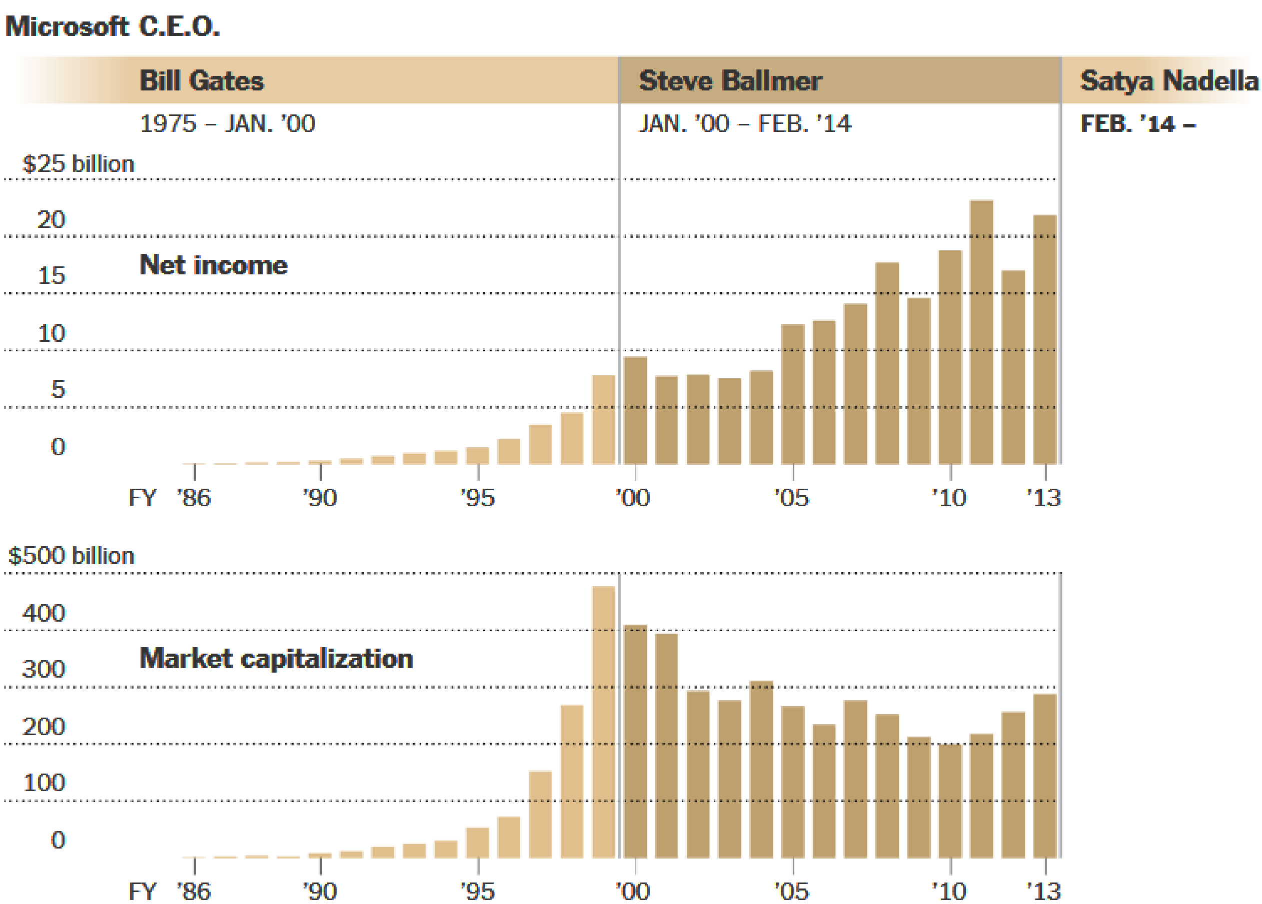
For leading American enterprises, shares are historically cheap on the metrics commonly used, and cheap relative to their prospective prosperity. The relative cheapness of the mighty blue chip companies accounts, in large measure, for the advancing markets' having shrugged off distractive aspects of politics. The market also seems to show incipient tendencies toward again preferring shares of young, smaller companies whose rates of growth are enhanced by new products. Such change in preference is long overdue. For more than a decade, small company shares have not been favored on a risk-considered basis, in part owing to alternatively competitive unusual cheapness of highly respected mid-sized and larger enterprises.

The graphics as shown herein from the *New York Times* for February 5, gives provocatively bold testimony to valuation changes for Microsoft. Acknowledging that Microsoft is not a typical company, this plotted change in valuation for twenty-three years is nevertheless illustrative of many prospering large companies, and of similar patterns for small innovative companies. Our selection of young companies have met growth expectations unusually well; but, categorically, success has been disregarded by market valuations. This plotting for the market valuation of Microsoft trended downward for eleven years from a 1999 peak. While this occurred, revenues advanced more than threefold, earnings also advanced about three times, and net working capital more than doubled to exceed $70 billion, equivalent to more than twenty percent of the market's capitalization of the Company's worth. The generality of such reductions in valuations seems to be of central importance.

The New York Times Wednesday, February 5, 2014

A New Leaf for Microsoft

Satya Nadella will be only the third chief executive in Microsoft's history. The first, Bill Gates, led the company through a period of rising profits and stock prices. The next, Steven A. Ballmer, more than doubled annual net income, but investors have cooled to the company as it has been outmaneuvered by rivals.



Source: Bloomberg

PORTFOLIO COMMENTARY

The unusually large price advances during 2013 among young enterprises of our earlier selections were registered by FEI, Morphosys, Osiris, and MAKO, which was purchased by Stryker for cash at almost double the market price. Among shares purchased during the year, Sangamo BioSciences and Senomyx led the price increases. OCZ Technology Group crashed and was sold, and shares of Vical suffered on a disappointing trial test. This is a significant setback for Vical. Other Vical products at various stages of trials led us to hold these shares on a wait-and-see basis. We sold our position in late December to offset some of the gains taken earlier in the year. Other enterprises owned seem to be progressing toward realizations of exceedingly pleasing commercial success. Especially noteworthy, Cytori, a leader in the use of stem cells, formed arrangements with the Malaysian-based enterprises of Mr. K.T. Lim in November that will carry product development and marketing costs for commercialization in Asia, nearby suzerainties, and Australia. We added to our position on the news of this development.

PORTFOLIO ACTIVITY

In this quarter IPG Photonics (**IPGP**), which has been a home run for us, continued its run up 38% while BioLase Technology (**BIOL**), which has had recurring ups and downs this year, was up 49%. Senomyx (**SNMX**) and Sangamo BioSciences (**SGMO**), which we added to the portfolio in the first half, were both up 43% and 32% respectively. In what was a very strong quarter we had no disappointments from an enterprise perspective, yet Maxwell Technologies (**MXWL**) was off 14%. RF Micro Devices (**RFMD**), Hansen Medical (**HNSN**) and NeoPhotonics (**NPTN**) were down between 9 and 3%. All in all, these price declines are not of meaningful concern.

MARKET COMMENTARY

If expectations for share valuations take into account the evident (and the potential) flow of investible funds, and the comparative attractiveness of many a share valuation, there would seem to be due support for discreet fully invested positions. Last year's unusually large advance seems to increase the probability for successively more, albeit of reasonably smaller magnitude.

When summarizing surmises for 2014 in broad sweeps, we visualize an overall score similar to that of last year; yet, within the mix, look for changes of major import:

1. Interest rates will continue a normalization of which getting the ten-year Treasury rate up to 3% is a big first step. Normalization will be manifested in a widespread, international notching higher — important for the universality of the advance, more than for the extent. There should be no fear from expectations of a persisting bold uptrend that would be hyper competitive to shares.

2. America's balance (a.k.a. imbalance) of trade with the rest of the world would improve, giving support to the dollar, and in turn, encouraging inflows of investment capital, adding to the native American abundance of liquidity. Recent evidence of such is in hand.

3. Expect widespread price weakness in fuel costs, centered on liquid fossil fuels as among the most significant of changes. The effectiveness of political pricing of past decades is over. The price of a barrel of crude ranged in the low teens of dollars before our first Gulf war in 1991. Much of that rise since (scaling beyond $120 per bbl) will disappear owing to new sourcing of natural gas, huge development prospects for oil under the salt seas, and in all directions (it seems) from the Caspian Sea, alternative sourcing of energy from sun and wind, and increased conservation in use. The folly of ethanol from food-grade starch (to run through internal combustion engines) will diminish or disappear. Ethanol produced from byproduct biomass or from waste can be sustained. The world is entering the other side of former political sponsorships, and of politically driven pricing. Such a prospective reduction in fuel costs would comprise a vast pervasive boost to spending for other things, in comparative effectiveness beyond that of a great tax reduction. Except for the providers of oil, this would be a widely spread stimuli to persons and to industries (especially in lower-cost feed stocks for chemicals).

4. The automobile-producing industry that has so spectacularly improved designs and elevated production schedules cannot be expected to bring another such incremental boost to economies. If current output can be sustained throughout the new year, that would continue to help and match best expectations. Auto sales have large unfilled prospects in Asia, Latin America, Russia, and a few smaller nations.

5. Expect increased spending for infrastructure improvements in all aspects of transportation, that could compensate for slacking spending for automobiles.

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advisory fees over time on the value of a client's portfolio. As an example, the deduction of investment management fees would reduce the annualized return for the five years ended December 2013 from 22.0% to 20.4%. Actual investment advisory fees incurred by clients may vary.

The **S&P 500 Index** is an unmanaged index generally considered to be representative of the US stock market as a whole.

The **Russell MicroCap Growth Index** is an unmanaged index that measures the performance of the microcap growth segment of the US equity universe. These indices are unmanaged and include the reinvestment of dividends and earnings. Individuals cannot invest directly in any of these indices.

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