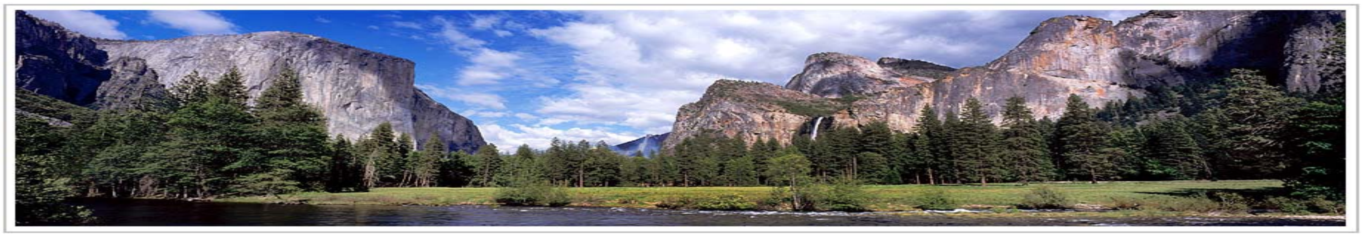

YOSEMITE CAPITAL MANAGEMENT

First Quarter 2012 – COMMENTARY

And then one day you find / Ten years have got behind you /
No one told you when to run / You missed the starting gun. – Pink Floyd

For tomorrow belongs to the people who prepare for it today. – African proverb

Successful investors act with the long term in mind, making portfolio strategy changes infrequently over the course of time when appropriate. They never make changes merely because the earth is at a certain point in relation to the sun or in response to market movements. The definition of "long term" for the vast majority of individuals is measured in decades. While this is easy to understand for an investor who is age 25 or 45, this is also generally true for a 65 year old because actuaries tell us this cohort has very good odds of living well into their 80's and even 90's. The continuing advances in medicine and the growing number of centenarians suggest that many more people could live to see their great-great-grandchildren. And for some, life expectancy is irrelevant because they have legacy plans for their assets to work for someone else long after they go to the Great Stock Exchange in the Sky.

All of this is to say that ***proper investing is a marathon that lasts decades and is not a series of one year sprints***.

This is why we have long advocated an investing approach that starts with a broad asset allocation between stocks and bonds that is appropriate to one's individual circumstances. This is a long term strategy that should only change very infrequently unless there is a significant change to the original circumstances. The natural process is to invest more heavily in stocks when in their 20's and 30's to take full advantage of time in the market, gradually decreasing exposure to stocks and more to bonds in the years approaching retirement, and further increasing exposure to bonds later in retirement to better assure income.

Within that broad allocation are various sub-classes (large cap stocks, small cap stocks, foreign stocks, commercial real estate, corporate bonds, government bonds, foreign bonds, etc.) whose weightings still argue for a multi-year approach but could, under some situations, benefit from periodic adjustments. But even tactical allocation changes are best done judiciously and relatively infrequently. Legions of exceptionally smart people armed with the most powerful analytical tools have not been able to consistently succeed at frequent tinkering.

This is easy to describe, but most investors have human emotions that tend to interfere with rational implementation. For many, simply getting to understand a multi-decade multi-asset class approach can be a huge step in improving their ultimate results. This change of attitude can allow them to understand that while any given current situation can seem dire, ***even large negative returns are that way for just moments in time and are <u>not permanent</u>***. Time has a way of making panic reactions ultimately seem foolish.

> Remember the Crash of 1987 when the S&P500 fell more than 20% in just one day? A mere blip on a long term chart.
>
> The Russian financial crisis of 1998 that caused the S&P500 to fall about 22% in less than three months? A minor interruption in the Great Bull Market.
>
> The panic of 2008 when the S&P500 ultimately fell about 57% from its high? The index has doubled since then.
>
> The many other recessions, crises, wars, inflations, etc. the United States has experienced within just the last century? 100% recovery.

Ah, but what about the fact that the S&P500 is still below where it was 12 years ago? According to the Wall Street Journal's MarketWatch, on Friday March 24, 2000 the index had its then-all-time closing high of 1527.46 and on Friday March 23, 2012 (almost exactly 12 years later) the index closed at 1397.11 for a loss of 8.5%. Surely that is a long time period that demolishes the benefit of a long term approach? And isn't that even worse for those approaching retirement?

There are several key flaws in making this argument, to which we respond with four points.

First, comparing closing prices only takes into account the price change and does not include the dividends which are the major component of total returns in periods when markets ultimately do not move much. Using data from Morningstar, a $10,000 investment in VFINX (a Vanguard mutual fund that replicates the S&P500) during the above time period returned $11,313 for a total cumulative return of 13.13% which is annualized to 1.03%. While these are low returns that are far below the long term average, the point is that the returns are actually positive and not negative as portrayed in the claim. Investors must ***beware of overly simple "analysis" because such presentations are often not complete or thorough and frequently have hidden agendas***.

Second, this is only one cash flow, and not only that but one made at the absolute peak of the S&P500 in 2000. Virtually all other investment contributions since then have had positive returns which have compounded to increase a portfolio's size over these 12 years. This demonstrates the benefit for investors who are saving for a long term goal such as retirement to ***continuously feed their portfolio with regular periodic contributions no matter how the markets are behaving at any given time***.

Third, the S&P500 should not be anyone's complete portfolio. A well-diversified portfolio would likely include some amount of bonds, small-cap stocks, emerging markets stocks, and commercial real estate. According to data from Morningstar, during the aforementioned 12 year period every one of these asset classes had total returns that trounced those of the S&P500 as typified by investing in index funds that mimic those areas:

		TOTAL RETURNS, 3/24/00 to 3/23/12	
FUND		**CUMULATIVE**	**ANNUALIZED**
VFINX	Vanguard 500 Index	13.13%	1.03%
NAESX	Vanguard Small Cap Index	87.98%	5.40%
VBMFX	Vanguard Total Bond Market Index	102.09%	6.04%
VEIEX	Vanguard Emerging Markets Index	177.82%	8.89%
VGSIX	Vanguard REIT Index	299.62%	12.24%

The returns that any investor actually gets in their portfolio depend on the mix of asset classes. But over this time period a broadly diversified portfolio would have done significantly better, even if not great, than the claims of negative returns in a "lost decade". The lesson for investors is to remember that ***when the headlines and talking heads freak out about the stock market going down, they are <u>not</u> shrieking about <u>your</u> portfolio***.

Fourth, since the S&P500 should not be anyone's complete portfolio, this is especially so for someone just a few years away from and certainly well into retirement. Usually bonds become a significant portion of a portfolio for someone close to or in retirement because income and stability are more important than growth. A portfolio that is constructed of 40% or 50% bonds, for examples, means that a decline in the S&P500 has a much smaller ultimate impact, which further means recovery to positive portfolio returns is even sooner. The lesson for investors is that ***portfolios must be structured to match their particular objectives, time horizons, risk tolerances, etc. and revised as their circumstances change over the course of time to prevent unnecessary risk***.

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The financial markets have been fairly calm in recent months, so this is why we chose this time to remind investors of these lessons since most human beings have a difficult time remaining calm when everyone around them is in panic mode.

We can't know if the secular bear market that began in 2000 died in 2009 or is still alive. We can't know if the markets are about to take another leg down, whether in response to the economic mess in Europe or the slowdown in China or the still fragile domestic economy or anything else. The financial markets likely will have declines at some point to some extent in the future, if for no other reason than because ***periodic declines are normal*** and facts of life.

But we can suggest that we are fortunate to live in a time and place where business is dynamic and people continue to innovate. Ultimately growth will resume globally and domestically. History demonstrates that investors who are ready for that eventuality, whenever it occurs and in spite of whatever happens in the short term, will be well-served in the long term.

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The S&P500 Index is designed and maintained by Standard & Poor's (a division of The McGraw-Hill Companies), is a free-float market capitalization weighted index that includes 500 leading companies in leading industries of the U.S. economy, and is intended to be an ideal proxy for the total market. This index is calculated on a total return basis with dividends reinvested and is not available for direct investment.