INVESTMENT OUTLOOK

March 31, 2007

A Look at International Markets

US equities were flat for the first quarter, as the market consolidated 2006's strong returns and cautiously weighed inflation fears and the potential fallout from expanding sub-prime mortgage delinquencies. This contrasts with foreign stocks, which continued their strong run of the last three years. While international stock markets averaged low-to-mid single digit returns for the first quarter, over the last three years developed and emerging market indices have produced annualized returns in excess of 20% and 30%, respectively. These overseas results, combined with the expectation of continued strong economic output from the so-called "BRIC" countries (Brazil, Russia, India, and China), have led to significant money flows into international stock funds at the expense of domestic investments. In this investment letter we analyze this phenomenon, contrast it with other periods, and explain how Saybrook has and will continue to approach growth prospects overseas.

At the risk of over simplifying, we highlight three distinct factors that impact international investing:

1. Growth of local markets: This is more than just analysis of the local economic climate. For companies that operate beyond their local borders, one must determine where their profits are attributed. Certainly, investors seek companies that sell their goods in countries with expanding markets, regardless of where they are domiciled.

2. Investment Sentiment: This is governed more by the location of the company's shareholders than their customers. A company's valuation can be impacted by the flow of funds into its home region. For instance, the performances of US-based and foreign-based consumer goods companies have recently diverged, despite similar global market profiles.

3. Impact of Currencies: Investing in companies operating or domiciled overseas has multiple currency implications, including the cost of raw materials and labor, the value of assets, the translation of foreign sales and profits into dollars, and, in the case of foreign-based companies, the actual dollar-converted worth of shares and dividends. In most circumstances, if the dollar weakens, US investors will benefit from any holding with international exposure.

Many investment strategists say that economic globalization has reduced country-specific diversification and left investors with a highly correlated portfolio of world markets. They point to the recent February 27 correction that began with an 8% sell-off in Shanghai and roiled stock markets with equal wrath as bourses opened around the globe. In fact, investors who take a longer view see that, while short-term shocks and exogenous events certainly do have global implications, over time stocks domiciled in different countries will experience various periods with diverse levels of returns, risks, and valuations. A review of the last 30 years reveals distinct multi-year periods of out-performance for the US, Japan, Euro-region, and emerging markets. Some even speculate that this phenomenon is increasing as globalization enables nations to specialize in industries where they hold distinct comparative advantages, so that their economy and market performance are most closely tied to the global market for their particular goods. Regardless of that hypothesis, we believe that returns from various countries and regions will fluctuate, and that, particularly for large and institutional-type investors seeking risk-adjusted returns, there is a benefit from such diversification strategies.

However, we would discourage investors from chasing returns in foreign markets based on recent past performance or speculating on developing markets in search of higher relative economic growth. As fundamental investors, we do not use momentum strategies, but we also cannot always rely on trends to quickly revert-to-the-mean. Instead we prefer to examine earnings multiples in order to value stocks of particular countries or regions. A review of world-wide P/E ratios reveals valuation multiples that are at 6-7 year highs in Latin America, China, India, and Asia ex-Japan. In a historical context, however, equities appear inexpensive in the US, Britain, Western Europe, and Japan. While this provides an inconclusive answer for the prospects of international investing as a whole, it hardly argues for an increased allocation to

emerging markets. As for the underlying growth of these economies and their locally-domiciled companies, population and productivity growth should certainly lead to higher future GDP growth in certain emerging regions. Yet, just like the divergence between fast and slow growing US businesses, this higher growth is well-known, is likely priced into markets, and is accompanied by the significantly higher risk that comes from high multiples, high expectations, and uncertain political and economic climates.

Saybrook Capital's strategy is to invest in superior growth businesses at undervalued prices. In 30 years of seeking such companies we have not restricted ourselves to a designated investment style, sector, or market capitalization. We have owned stock in some foreign, multi-national corporations in the past, most recently Vodafone (the world's largest cellular service provider), and we will likely do so again. But our investment style favors the access to senior management, transparent accounting standards, and high liquidity that the US markets provide.

It is no coincidence, however, that many of the companies in our portfolio have disproportionate overseas exposure. Certain industries, such as consumer products, shipping, financial services, and capital goods, must expand internationally to continue their high levels of growth. We are confident that companies such as PepsiCo, UPS, Goldman Sachs, and Emerson are reaping the full benefits of globalization and the high relative growth rates of key foreign markets. GE's latest quarterly results, for instance, highlighted their large exposure to infrastructure-spending in the developing world. Likewise, revenues that these companies earn in foreign currencies are worth even more in the event of dollar weakness. A recent addition to our portfolio is Schlumberger, a Houston-based company that has grown to be the world's largest oilfield services provider. With operations in 80 countries and approximately 75% of revenues coming from outside the US, Schlumberger is well-positioned to benefit from the world's thirst for petroleum. Meanwhile, Daimler-Chrysler (not one of our holdings) of Stuttgart, Germany counts on the United States for 42% of its worldwide revenues and 60% of its auto unit sales. While sentiment preferring European stocks could favor a company like Daimler for any given period, in terms of exposure to growing overseas markets, Schlumberger is the more "international" stock.

In closing, we concede that concentrating primarily on US-based companies can leave our portfolio vulnerable to near-term sentiment shifts when money chases the out-performance of foreign stocks. But our focus is on long-term investing, and we continue to seek companies that are enjoying growing markets, whether by expanding their products or enlarging their geography. We believe this strategy reduces our clients' exposure to a potentially weaker dollar while taking full advantage of these exciting global trends.