**Weathering the Current Market Turmoil**
**Some Thoughts from Marble Harbor**
**August 8, 2011**

Driven by fears that the global economy might stumble back into recession, the stock market had a poor week. This means that the market is down 3.5% year to date, after appreciating more than 15% in 2010 and more than 25% in 2009. With the economic challenges in the world, this is not particularly remarkable. However the rollercoaster ride that has gotten us here has been something else. The recent performance of European-based stocks is more dismal. For example, the British market (FTSE 100 Index) is down more than 12% since July 1st, with stress on several European economies igniting debate about the viability of the Euro as a single currency. Given this recent turmoil, we wanted to share our thoughts with you about how your portfolio is structured to handle today's challenges. Please understand that any of these topics could easily consume several pages of discussion – and in fact they are all ones we've discussed with you in the past and in our quarterly letters. So, here we'll be brief. If you would like to discuss any of these issues at length, please don't hesitate to follow-up with us.

A weak economy and poor stock markets are resident around the globe, albeit for different reasons. An incomplete list would include a devastating tsunami, grossly indebted nations, declining consumer confidence and of course, political gridlock. It would be safe to say that the European Union's problems first became apparent in Greece, but it was soon recognized that these issues also encompassed Spain, Italy, Ireland and Portugal. An excellent, longer discussion of these problems is in last month's *Ruminations*. In sum, Europe's economic disparities are proving too immense to overcome, and an EU restructuring or break-up is possible. These issues also weigh on the US economy and thus, our markets.

As we've discussed in the past, the weak employment picture, accelerating inflation and a declining housing market, all present challenges to the US economy. However the recent debt ceiling debate has shaken the all too fragile confidence that many had in our progress. It is becoming clear that the apparent recovery earlier in the year was really the by-product of a variety of short-term band-aid packages such as the American Recovery & Reinvestment Act, the Troubled Asset Relief Program and the Federal Reserve's massive stimulus effort (colloquially QE2). Last Friday night's credit downgrade of our Federal debt is exacerbating these near-term fears. So, what does this mean for your portfolio and how are you positioned to withstand these stormy seas?

Stepping back from the news headlines and market volatility, we prefer to focus on what you actually own in your portfolio. As our Advisory Board member Brad Perry never fails to remind us, a company can be analyzed with a considerable degree of logic. We can study a company's products, services, markets, competition, financial trends, management and long-term history. This helps us make solid investment decisions based on the underlying economics of the business rather than short-term blips. And by paying close attention to valuation, i.e., not succumbing to popular group think, or flavor-of-the-month trend-following, we have built for you a portfolio of financially strong companies that generate sustainable, high rates of profit.

You'll recall our perhaps monotonous concern over the economy, debt levels and unemployment in past letters. This risk-aversion has importantly informed the companies that we own for you. These leading businesses have far better than average profitability, strong balance sheets, and operate in attractive industries around the world. Perhaps best of all, they generate prodigious cash, trade at a discount to the market and pay you a healthy – and rising – dividend income. As owners of pieces of these businesses, we are happy. In the short-term, we are as frustrated as you are by the dithering in Washington and the volatility of markets. But the value of the *businesses* that you own do not change simply because the market moves up & down. Rather, to once again quote Brad, "bear markets are really a long-term investor's best friend. They provide the best opportunity to buy high-quality companies at truly attractive valuations." This is where we are today. Viewed from a longer-term perspective, your stocks are on the bargain table.

We suspect that the market will continue to be rocky in the near-term. Emotions and fear are running high. You'll note that we have continued to be positioned defensively for you. This conservative bias has paid off. With the challenges in the world, we continue to cast a Gimlet eye toward markets. We demand much of our companies in exchange for ownership. Your companies are delivering on their long-term promise. Eventually the markets will as well. In the meantime, we can sleep at night knowing that as long as people all over the world eat, stay clean, go to work and strive to improve their lot in life, your companies will grow and prosper.