Marble Harbor Investment Counsel, LLC
Excerpt from
First Quarter, 2011 Letter

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"How do I love thee? Let me count the ways." ***Elizabeth Barrett Browning***

Investors continued their love affair with riskier assets in the first quarter, with the market sprinting ahead at a strong pace. Like the subject in this classic poem, it seems that there is no news, even death, so alarming that it shakes investors' love. Against a backdrop of rising interest rates, regime change in several Middle Eastern countries, civil war in Libya, financial distress in a number of European Union countries, rising food and oil prices, an earthquake and Tsunami of biblical proportions in Japan, not to mention the resulting nuclear disaster, the imminent end of artificial economic stimulus by the Federal Reserve, large and rising debt loads for most governments and the Red Sox being off to their worst start since 1945, the market continues upward. This phenomenon is often referred to in investing circles as "climbing a wall of worry." Perhaps less charitably, we see this as playing a game of chicken with structural risk.

If we ignore all of the "bad stuff," we see many good things at our companies. Those we own for you are performing quite well, with continued sales and earnings growth, increased geographical reach and strong cash generation. All this is being achieved with excellent balance sheets and frequently with generous and rising dividends. This pattern largely held true even during the worst of the financial crisis.

For many other companies having near-death experiences during the financial crisis, their growth in profits has been stunning. Of course, movement from loss to profit looks great if you are willing to ignore the deterioration in the balance sheet and the structural weaknesses in the underlying business. With our approach as long-term owners of our companies, we *care* about the underlying attractiveness of the businesses in which we invest: Long-term fundamentals matter more than the short-term optics showing spectacular growth off of a depressed base.

Most companies are growing, and global economies in general are improving. But to presume this means that everything is hunky-dory is to dismiss the litany of concerns we've cited. We agree with pundits who say that should current trends persist, we will grow our way out of our fiscal problems. That is simply the inevitability of the math. If our debts grow more slowly than our profits, eventually we'll pay off our debt. However, at today's rates of growth, that may be a very long time from now. More troublesome than slow growth is the new fragility in the system. If anything has been proven over the past dozen years, it's that no one can reliably predict what misfortunes will befall the world and how they will affect the economy. We do know that as

each calamity has struck, governments have stepped in to cushion the blow. This now leaves us with little margin for error. The reserves in our economy, created through years of prudence, are now spent, making us more brittle and more vulnerable to unwelcome surprises. This doesn't necessarily spell disaster or mean that economic progress will stall. It does mean that the "Great Moderation" we enjoyed from 1980 until 2000 is likely over. This may signal a more volatile time and a harsher environment for companies. Well capitalized companies will gain market share in the tough patches as poorer businesses struggle. Innovators and companies who generate consistent and growing profits will thrive as also-rans and cash-users wither. With these prospects, we like the businesses that we own for you.

We've never felt comfortable ignoring reality in pursuit of chasing fashion. This current love affair with risk seems short-sighted. While Browning's lover may feel content knowing, "I shall but love thee better after death," we invest with the goal of ensuring that we live to see another day.

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