HUTCHINSON
CAPITAL
MANAGEMENT

October 2009

INVESTMENT PERSPECTIVES

<u>Our Investment Process: Why We Are Different</u>

Our approach to investing is similar to that of the patient batter who Warren Buffet, an avid baseball fan and a great investor of our times, describes as follows:

> "In baseball you can be ruled out for not swinging at three hittable pitches. With investing, there are no called strikes. The market can lob you fat pitches all day long and there is no penalty for not swinging. You can stand at the plate all day long, all week, month, year or decade, and not swing and not be called out. You can wait for the fat pitch when the fielders are asleep and hit it out of the ballpark." (1)

A major reason for our investment patience is a result of the expectations of our client base. A notable distinction between our firm and larger, institutionally focused firms is that our client base is comprised primarily of individuals and families. While each client relationship is unique, a common characteristic is that many of our clients are nearing retirement or are already retired. As a result, the majority of our clients do not have the ability to re-create their wealth and therefore preservation of capital is of paramount importance. We make this point because while we expect our investment results to be measured relative to appropriate benchmarks, we also hold ourselves accountable for achieving acceptable <u>absolute</u> returns for our clients. In other words, in our investment decisions we are focused on both return <u>on</u> capital and return <u>of</u> capital.

A second reason for our investment patience is our long-term time horizon (three to five years) versus a short-term time horizon (the next three to four quarters). There are a lot of bright, hard-working people on Wall Street but due largely to inherent flaws in incentive plans and compensation structures (which are heavily influenced by the professional's short term performance results) we believe their overriding orientation is on short-term behavior and results.

Additionally, we are different from many other investment firms because our client assets are not always fully invested. If the overriding aim is to keep pace with or beat a designated benchmark on a short-term basis, holding cash can be detrimental. By contrast, in our value-oriented, contrarian approach, we invest for the long-term in high quality companies and will delay initiating new investment opportunities until we see compelling valuations. We are comfortable holding cash as an alternative if potential new investment ideas do not meet our strict valuation parameters. In our experience, patience rewards long-term, value-oriented investors who strive to consistently invest only at what they consider to be outstanding long-term valuations.

We believe that our approach is similar to that of Seth Klarman, a professional value investor whom we greatly respect. His approach, called *absolute-performance oriented investing* [(2)], is based on the principle that you should buy a stock only when the investment meets absolute standards of value. Absolute return investing is focused on long term investments, not short term trading. The approach allows you to look at all investment opportunities in all sectors, whereas relative performance investors must invest a certain percentage of their investments in specific sectors in order to closely match a benchmark.

Seth Klarman further elaborates on this by stating the following:

> "Remaining fully invested at all times certainly simplifies the investment task. The investor simply chooses the best available investments. Relative attractiveness becomes the only investment yardstick; no absolute standard is to be met. Unfortunately the important criterion of investment merit is obscured or lost when substandard investments are acquired solely to remain fully invested. Such investments will at best generate mediocre returns; at worst they entail both a high opportunity cost – foregoing the next good opportunity to invest – and the risk of appreciable loss."

We believe that absolute performance oriented investing differentiates Hutchinson Capital Management from many other investment counseling/money management firms. We do not mean to imply that other processes are inadequate, we merely are attempting to explain why we believe that our process is different.

As we have stated above, our primary goal is preservation of capital. To achieve this goal, we concentrate on two specific areas of investing. The first is to invest in stocks of the best companies at very low prices; quite simply, we look to invest in the twenty best companies that we can find. Our research process gives us the framework to identify, investigate, and finalize stock ideas without "swinging" at every pitched ball.

The second is to invest in high quality bonds laddered over eight to ten years to provide current income and stability in the portfolio's total performance. This approach enables us to smooth out fluctuations in the bond market without trying to guess which way interest rates are heading.

We focus on return as a measure of gain or loss on the money that is invested. However, Wall Street managers tend to focus on how well they have performed versus a benchmark, since this is how they are compensated. For example, if they lost 25% but the index lost 30% they will have outperformed and may receive a generous bonus! We measure ourselves both in absolute terms *and* against a benchmark index. Since our primary focus is on preservation of capital, we attempt to determine (using a variety of measurements) the most that a stock will decline before buying a position. If we believe that the downside is "manageable", we will then look at the stock's potential long term value.

In ancient Rome, builders often stood under the arches they had constructed as the scaffolding was removed. They took pride in their work and wanted to prove it in no uncertain terms. In a similar fashion, we select the same investments in our retirement plan that we select for our clients.

We are very proud of our consistent approach to investing since June of 1995 when we formed this company. There have been numerous occasions when we could easily have foregone our approach but instead "stuck to our guns". Two classic times were during the phenomenal technology boom of the late 1990's and the 12 to 18 months prior to the top of worldwide stock markets in October of 2007.

Our research process is rigorously followed in all of our investment decisions. We believe that consistency is imperative for a well thought out and disciplined process to have a chance of delivering sound results. This is true for success in all vocations and avocations! This consistently applied process enables us to deal daily with the massive amount of data that confronts us as we investigate or monitor our investments. Sorting out what is and what is not relevant is much easier if you utilize good filters in your process. (A summary of our Research Process may be found at our website **www.hutchinsoncapital.com** in the "Research Library" section.)

We firmly believe that a portfolio of high quality stocks bought at mediocre or overpriced levels will not provide satisfactory long term returns. Buying intelligently is mandatory for sound long term results. We will continue to be patient batters and to follow consistently our proven investment approach over the coming years.

(1) From "Warren Buffet Wealth" by Robert Miles

(2) From Seth Klarman's book Margin of Safety   Risk-Averse Value Investing Strategies for the Thoughtful Investor

HCM's investment decision making process involves a number of different factors, not just those discussed in this document. The views expressed in this material are subject to ongoing evaluation and could change at any time.

Past performance is not indicative of future results, which may vary. The value of investments and the income derived from investments can go down as well as up. It shall not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities mentioned here. While HCM seeks to design a portfolio which reflects appropriate risk and return features, portfolio characteristics may deviate from those of the benchmark.

Although HCM follows the same investment strategy for each advisory client with similar investment objectives and financial condition, differences in client holdings are dictated by variations in clients' investment guidelines and risk tolerances. HCM may continue to hold a certain security in one client account while selling it for another client account when client guidelines or risk tolerances mandate a sale for a particular client. In some cases, consistent with client objectives and risk, HCM may purchase a security for one client while selling it for another. Consistent with specific client objectives and risk tolerance, clients' trades may be executed at different times and at different prices. Each of these factors influence the overall performance of the investment strategies followed by the Firm.

Nothing herein should be construed as a solicitation or offer, or recommendation to buy or sell any security, or as an offer to provide advisory services in any jurisdiction in which such solicitation or offer would be unlawful under the securities laws of such jurisdiction. The material provided herein is for informational purposes only. Before engaging HCM, prospective clients are strongly urged to perform additional due diligence, to ask additional questions of HCM as they deem appropriate, and to discuss any prospective investment with their legal and tax advisers.