



July 22, 2009

It is good to be back in the investment business and to be trying once again to grow clients' capital in a low risk way. We welcome new clients and the many former clients that have come aboard with us, and we thank you for your confidence and trust in our philosophy and methodology for investing in stocks and bonds. The timing may be terrific. Despite the Great Recession and government interference in the system to a degree not seen since the 1930's, it is still a largely capitalistic economy. This may be one of the most juicy investment opportunities in our history. Sentiment is terrible which is how investors should want it because it has produced low prices for stocks of some wonderful companies. Combine this with mountains of cash in money market funds and elsewhere, and an expansive Federal Reserve policy, and there could be a lot of upside potential in this market.

In this, our first letter to our clients at Llenroc Capital LLC, (Cornell spelled backwards, in case you are curious; our founder and Principal Managing Director, David Post, is a Cornell grad) we want to emphasize some of the points we make in our brochure and our website (www.llenroccap.com) describing our approach to investing. The collaborative research team at Llenroc, David Post, Michael Tannenbaum, and yours truly are dedicated to, first, preserving the integrity of your principal and, second, via a conservative growth strategy in the stocks and bonds of high grade companies, growing that capital in coming years.

We hope to be measured in these endeavors by our performance in absolute terms, as well as in relation to the S&P 500 stock index, to the extent that your portfolio is in common stocks. For the bond portion of your portfolio, we are not necessarily trying to obtain the highest yield for your funds. The goal is simply not to dent capital while receiving a decent return on corporate or treasury debt issues. Liquidity and safety are not to be compromised; they are more important than returns. Return OF capital is more important than return ON capital. We ask that our common stock investments be measured over a 3-5 year period, as we are long term investors by nature. (Until Congress gets around to taxing unrealized capital gains, long term investing is still one of the great legitimate tax shelters.) Our goal is to beat the S&P 500 with our stock investments over a 3-5 year period. We will not beat the S&P 500 every year; no one does that, not even Warren Buffett. But that is our goal.

We will not be fully invested in common stocks all the time, particularly when the market becomes extended, but we plan to be more invested in stocks with your capital when there are lots of values around, like now, for example, than when prices are full; that does not make us market timers, as the market is impossible to reliably forecast. We will let the market tell us, however, by the scarcity or plentitude of values in stocks as to when it is overpriced or undervalued. We will seek to build capital over time by being price disciplined; by not overpaying for a few outstanding companies' stocks, but by purchasing them when they are cheap or at worst at reasonable prices. Our watchword is Great Companies at Great Prices.

Your stock portfolios will contain roughly 15 stocks, give or take. Bond portfolios will vary in number of holdings depending on the size of the account. The larger the capital devoted to bonds the more diversified that part of the portfolio will be. Respecting common stocks, as you probably know by reading our material or if you have invested with us in prior years, we believe 5-10 stocks are probably too few and 20 or more are definitely more than is needed for adequate diversification. Diversification can be achieved with 14-18 stocks, carefully selected from different industries; usually no more than one company from a particular industry; once a portfolio has more than 14-15 stocks, the decrease in risk from adding one more stock is less than one percent. Our investment criteria are listed in our brochure and on our website, www.llenroccap.com. Two of our criteria are that our portfolio companies have a good, simple, clean balance sheet with little or no debt, and that the companies generate significant free cash flow (cash flow from operations minus capital spending), and therefore have the ability to self finance growth. These have been amongst our criteria for a long time; they have allowed us to avoid a lot of trouble; they are especially important now that credit availability is still somewhat constricted.

Your stock portfolios will have a core group of companies all of which we have been long familiar and wherein we perceive very little company risk. As described in our brochure and website, there is market risk, which is the risk that a weak stock market or other causes will make a security lose value; company risk has little to do with stock fluctuations, but has to do with the sustainability of the company's business franchise (and its competitive advantages) in the long term. In our judgment, our core group have the characteristics we require including the competitive advantages as well as the management to continue to grow in the years ahead. Presently, there are eight companies in that core group. Supplementing these core companies will be others, of course, some of whom we hope will become core companies someday. They have most of the criteria we like but may not be quite in the top category as yet. We are not so doctrinaire toward growth stocks that we do not on occasion include so-called value stocks or depressed stocks of some cyclical companies, when the price is right and we can see change coming.

One threat not immediately facing investors, but likely to become a factor in 2-3 years or so is inflation. In the near term, unemployment is too high and there are too many wage and hiring freezes for there to be much wage inflation. We had some temporary commodity inflation in the 2005-2007 period, but not wage inflation which continues to be muted by amazing gains in worker productivity to go along with the unemployment situation. We are planning that oil related companies will be a part of our portfolios going forward. We are believers in the proposition that the supply of oil coming from new finds, offset by declining volumes from depleting existing wells, will not keep up with the demand for oil once the world economy recovers. Gradually higher pricing should result.

Right now, our stock universe, from which we are creating your portfolio, consists of some great companies, which are experiencing growth in 2009, and those otherwise great companies not growing but whose future seems solid. These companies are therefore very likely to grow earnings in the future. Now is one of those rare times when some truly wonderful companies' stocks can be bought at historically low earnings multiples and/or low absolute prices.

Investors now face different challenges than those seen in the past 220 years of our U.S history. As Warren Buffett has said on several occasions, “The system can take a lot of abuse,” We do not know if he had in mind the kind of abuse the system is getting now with doubtless the most anti-growth, anti-business government in decades, and the rate of change in regulation, monthly, if not weekly, making it very difficult for businesses to make long term decisions. Nevertheless, as the man says, a still mostly capitalistic system is strong, as it is that economic system that is most aligned with human nature. That is, since it is in man’s nature to try, in the context of rational self-interest, to better himself, that is what he will seek to do. On a broad scale all this effort to better oneself by people all over the world is starting to engender multiple signs of recovery, not just here but overseas as well. Atlas is not yet shrugging. Thus, although we are not market forecasters, we are not bearish on stock and bond markets. Interest rates are still low which is good for business, and the price of oil is at levels good enough to encourage deep water drilling at least, but is way down from last year. At present, there is a cornucopia of very inexpensively priced stocks of first rate companies. Stocks are cheap historically, and there is an enormous amount of cash on the sidelines that is receiving abysmally low interest rates. With all this government spending, cash surely will be worth less in the future. Shall we remind you that the 1965 dollar is worth about a dime? There is a lot of fear around now, but the tides of greed are never very far away when there is all that cash.

At Llenroc, our perspective is that we only need to find three or four handfuls of outstanding companies that can carry the day through this challenging time in our history. During the 1930’s, there were quite a number of then moderate-sized American companies that made it through that decade such as DuPont, IBM, Dow Chemical, General Electric, 3M and Coca-Cola, that were profitable then, sold at moderate earnings multiples for much of that time, and proved to be very profitable companies for decades. Long term stockholders of such outfits had stores of value through those rough times and were amply rewarded for their patience subsequently. A modern version of that collection of great companies is certainly what we are seeking at Llenroc to find for our clients. Since there is a good deal of creative thinking in our research team, which boasts 85 years of experience in looking for just these kinds of companies, we are confident of our success. We have already identified some of these “evergreen” companies as long term investments in the past, and it is our intent to add to this list in the years ahead.

Please call if you have questions.

Most cordially,

Roland D. Underhill