April 30, 2012

First Long Island Investors, LLC

March 31, 2012

"We must build dykes of courage to hold back the floods of fear."
Martin Luther King, Jr.

Investment Perspective

We had an excellent first quarter for our equity based strategies, both defensive and traditional with gains as high as 17% (net) for our best performing strategy. This was accomplished despite widespread investor fears that continued to prevail from last year. For the most part, our strategies outperformed their respective benchmarks, and we believe we accomplished this while taking less risk, using no leverage,* and maintaining the utmost transparency. Our bond portfolios tracked at least as well as their respective benchmarks despite most bonds offering little return and not much value (in our opinion). Our private equity and real asset investments appear to be making progress as well.

Of great importance in being able to accomplish solid results despite ongoing fear, is deploying one's liquid net worth in a prudent asset allocation. One's carefully constructed asset allocation among our investment baskets in security; defensive equity; traditional equities; and private investments is the building of our dykes of courage. The floods of fear come daily from the many economic, geopolitical, and political challenges that we face. Our asset allocation seeks to protect us from the emotional decisions that investors often make that tend to hurt their performance.

* Only our Sterling Stamos strategies invest in funds that use leverage.

Our explanation for the first quarter's significant gains stems from a catch up to reflect last year's earnings growth, and the somewhat reduced fear emanating from last year's economic, political and natural disasters. The Japanese earthquake and related events, our budget debacle and subsequent credit downgrade, predictions of a Lehman-like financial meltdown in Europe, and a projected double- dip recession were digested/dealt with/or just didn't happen. Of course some challenges including structural and growing deficits, unacceptable levels of unemployment and anemic domestic growth need to be addressed with reasonable fiscal policy. But that will have to wait until after the election given the selfish nature of our politicians.

We at FLI believe that the economy is somewhat better than many pundits believe based on the financial strength of American business and the resilience and prudence of the American consumer. This is in spite of politicians who have chosen to bicker rather than promulgate constructive fiscal policies relating to addressing budget deficits, overdue tax reform, and impending difficulties with Social Security, Medicaid, and Medicare. This paralysis has contributed to a continued level of high unemployment as existing businesses are slow to deploy capital and hire new employees as there remains too much uncertainty. And overzealous government regulation in many industries including energy have hampered growth initiatives and subsequent job growth.

The unfortunate reality is that we face significant uncertainty from both unknown tax and healthcare policy which severely impact the domestic economy. Tax rates for almost all Americans are set to increase the first of the year as payroll taxes go back up and the Bush tax cuts expire. In addition, our new health care law is being challenged by 26 states before the Supreme Court. Their decision will impact virtually all Americans and most businesses. And by the way, imbedded in this new health care law are tax increases on all forms of investment income. The net result could be a huge headwind to the consumer and business depending on what happens at year-end (we believe some compromise will be made lessening the tax blow).

Meanwhile China's growth is still strong but somewhat slower than recent quarters. Europe's debt and banking issues are being dealt with but it is in a modest recession (thus far) resulting from austerity and tax increases (there is a lesson here). The good news is that the powers in Europe are looking to avoid a Lehman-like event. So far so good - and even headlines about Greece, Italy, Spain and Portugal don't really move our markets as much as they had. However, we continue to be concerned that steps taken to this point are still a temporary fix and include anti-growth austerity. This could present issues down the road. Other geopolitical hotspots in the Middle East could bring back volatility, especially efforts to stop Iran's nuclear undertaking.

The good news is the S&P 500 and other benchmarks are at much higher levels than three years ago, but not record levels. However earnings are higher for companies and we believe share prices therefore are more reasonable. This is especially the case given the historically low interest rates being paid on bonds. Corporate balance sheets are much stronger; however the pace of expected earnings growth has slowed. Dividend growth is robust and our Dividend Growth strategy yield is more than fifty percent greater than the ten year Treasury! Thus we remain comfortable in advising clients to have prudent but reasonable allocations to our defensive and traditional equity strategies. Too much money is in money market funds and bond strategies which we believe will provide negative real returns (after inflation) and will suffer losses if interest rates increase. Skepticism about the market's gains and ongoing fear continues to cause this outflow from stocks into bonds and cash. This we believe, as contrarians, is a positive factor.

Commodities are hard to call given the uncertainty of global growth. Gold remains more of an insurance hedge against inflation and global conflict now that financial collapse seems off the table. Real estate, if not overly levered and financed at longer term low interest rates while sporting a good cash on cash return, could be a worthwhile investment (not so easy to find, but we are looking). Private equity also is attractive if you're willing to endure long periods of illiquidity (you are generally paid for waiting).

The proverbial wall of worry described above should also include high energy costs and a housing market that continues to sputter along (we believe it will get better in the next year). Both particularly hurt the consumer who is still deleveraging. So why do we remain defensively optimistic? The answer is cash, fear, and progress.

The individual and corporate cash on the sidelines, both here and abroad, will ultimately find its way into investment, dividend increases, share buybacks, and acquisition activity. This will bode well for good stocks. The media-driven fear seems to be giving way to the animal instinct of greed. Apple at $600 and paying a dividend, Facebook going public at a hundred billion dollar valuation and old Big Blue (IBM) hitting $200 per share have made those risk takers richer. Given what we believe to be reasonable valuations for both Apple and IBM, even my older relatives would make that risk-on trade. Yet many remain on the sidelines still contemplating an entry point. They will slowly but surely commit as other asset classes provide little or no value and that also will be good for the markets. Despite the legitimate real life concerns that exist, progress is being made by companies in terms of earnings growth, market share gains and product innovation. And even politicians both here and abroad are starting to deal with structural issues that must be solved.

So stay disciplined and nimble by allowing us to work with you on a prudent asset allocation. In the current environment we generally recommend an asset allocation that emphasizes defensive equities, so volatility and fear doesn't shake you out of the equity markets. In addition, at this juncture we believe that our defensive equity strategies provide better value and yield than most bonds. At the same time you will also have a better chance to make a real return (after inflation) on your core capital. The balance of security (bonds and absolute return) on one side and traditional equities (growth, value and diversified) on the other side of defensive equities should give you a pathway to reasonable long term returns while taking on the level of risk you are comfortable with. Meanwhile you can watch events unfold on our wall of worry with fewer sleepless nights.

You will see from the results in the next section that having been diversified among our allocation baskets of security, defensive equity and traditional equities paid off handsomely this quarter while permitting you to sleep at night. We can't let fear dictate a policy of accepting below inflation returns.

Best regards,

Robert D. Rosenthal	Ralph F. Palleschi
Chairman and	President and
Chief Executive Officer	Chief Operating Officer

*The forecast provided above is based on the reasonable beliefs of First Long Island Investors, LLC and is not a guarantee of future performance. Actual results may differ materially. Past performance statistics may not be indicative of future results.

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