November 1, 2011

First Long Island Investors, LLC

September 30, 2011

"Making money doesn't oblige people to forfeit their honor or their conscience." Baron Guy de Rothschild (renowned banking magnate)

Investment Perspective

The third quarter was very difficult with many factors contributing to both uncertainty and fear. The result was a significant downturn in equity markets (S&P 500 -13.9%), and a flight to safety in both U.S. Treasury bonds and gold. However, thus far in the month of October equity markets have rallied sharply (S&P 500 +13.7% as of 10/28/11) and bonds have retreated. (Our defensive equity strategies and bond investments have done well as of this writing for the third quarter and year-to-date.) In addition, social and political strife, reflecting a loss of hope by some, has made its presence known in the Middle East, Greece, and most recently on Wall Street and other major U.S. cities.

The cause of much of this fear and uncertainty can be attributed to the following factors:

1. European debt crises resulting in concerns about global banking and sovereign defaults
2. Economic pundits predicting another domestic recession reflecting continued deleveraging
3. Political paralysis in Washington relating to our deficit resulting in the downgrade of U.S. debt
4. Concerns about the pace of growth in China
5. Fears about domestic inflation
6. The growing economic plight of our middle-class

7. High domestic unemployment and under employment
8. New domestic regulations that continue to hamper business expansion

There are probably others, but these seem to be the most troublesome. However, there continue to be some very favorable factors as well:

1. U.S. domestic corporate profits continue to grow and have reached record levels!
2. Domestic corporate balance sheets remain flush with cash and lower levels of debt
3. In our opinion, valuations for many domestic companies are cheap (11 to 12 times 2012 earnings) assuming there is no double-dip recession (continues to be our view)
4. Dividends for many quality blue-chip type companies continue to grow
5. Our banking system continues to get stronger despite headwinds
6. Retail sales and industrial production continue to improve despite slow GDP growth

The above positive and negative factors are highlighted daily in the press leading to a schizophrenic equity market. Short term investors, high frequency traders, and hedge funds are exacerbating the market volatility. Seemingly knowledgeable market experts speak of recession and market declines adding to investor fears. Some renowned hedge fund managers are down 30% to 40% thus far this year. The multi-hundred point intraday swings in the stock market have once again led to outflows from equity markets and abnormally high cash on the sidelines earning virtually nothing. However, in our view this continues to represent an opportunity for long term investors, who can wait out the uncertainty, and take advantage of certain company share prices that we believe are on sale. Some of these bargain priced companies have dividend rates twice that of the yield of a ten year treasury bond.

We recognize that at a time when politicians are failing to address serious economic and social issues through meaningful compromise, it can be frightening to investors. Demonstrators and liberal politicians want to make us feel that making money is not only not noble, but greedy and dirty. However, it would be a mistake to forget that one can invest with conscience as well as a goal of making money, as Baron de Rothschild suggested. We believe that much of the monies we invest support growing businesses with innovative ideas, new products and hopefully contribute to improving employment. As investors, we must recognize that despite being criticized for being wealthy as well as facing a potential higher tax burden, we could face another threat, inflation. This threat requires us to withstand market volatility and make sound investments to ultimately make enough money to maintain our standard of life and financial security. It is true that stock market returns have been unkind over the past decade, however there are numerous examples of companies whose stock prices have thrived despite the many uncertainties we have discussed (McDonald's and Apple as examples). In addition, there are numerous companies whose share prices have languished, but have increased dividends on a yearly basis giving us a growing cash return (e.g. Microsoft). At the same time, despite talk of deflation, core inflation continues to modestly rise. We must stay ahead of that, especially given the money printing that has been used to avoid the recent threat of financial Armageddon.

So, how do we invest in this deleveraging and confusing environment yet still sleep at night? We would be foolish to suggest that the European debt crisis, high unemployment, political paralysis, and consumer and government deleveraging is going to just fade away. We can, however, somewhat insulate ourselves from these legitimate concerns by directing you to defensive equity strategies that we believe will result in reasonably good returns over time as a more meaningful part of your asset allocation. This is particularly appropriate for us as wealth managers whose first priority is to preserve your capital (while outpacing inflation). It also permits us to participate in equity returns when some of the black clouds dissipate and investor flows return to stock markets. We continue to believe that more of your asset allocation should take advantage of our strategy that benefits from growing dividends, from strong mostly global companies that successfully build market share. Many of these businesses are benefiting from evolving countries where there aren't debt problems and boast a surging middle-class representing new customers for the companies we invest in.

Our relatively new Dividend and Growth strategy (growing dividends), continues to dramatically outperform its respective benchmark by over nine hundred basis points respectively on a net basis as of September 30. As of this writing Dividend and Growth has a net return of slightly more than nine percent. The strategy is in our defensive equity category, providing a lower risk way to invest in equities. This strategy invests in companies with consistently growing dividends and reasonable earnings growth. It relies in part on a cash earnings stream as part of its overall return. If equity markets turn much higher, it won't do quite as well on a relative basis. However, this type of strategy has demonstrated an ability to preserve capital during severe market downturns. We believe it makes more sense than keeping large sums of money in cash (earning a negative real return) or crowding into an overvalued bond market where any inflation leading to an increase in interest rates will result in a loss of "real" capital. And for those investors who have too much exposure to traditional equities, you should feel more comfortable allocating to a defensive equity strategy.

These are difficult and confusing times for investors. But we believe we can offer you reasonably safe and diverse ways to make an honest, liquid and transparent return while still focusing on preservation of capital. And despite fear, political paralysis, and policy uncertainty, we believe we can still find an honorable way to protect and grow your net worth with a clear conscience. Asset class diversification with a bias towards defensive equity strategies is called for in this troubling economic and geopolitical environment. And, as contrarians, we believe there are still investment opportunities for those conservative investors that are patient, selective, quality-oriented and don't give in to the herd mentality following the constant noise of media.

We look forward to working with you to craft your asset allocation to navigate these troubled investment waters. Our goal remains preservation of capital with appreciation above the rate of inflation while minimizing risk through greater emphasis of defensive equity strategies and overall diversification. And yes, we know this will help you sleep at night as well. Please call upon us.

Best regards,

Robert D. Rosenthal
Chairman and
Chief Executive Officer

Ralph F. Palleschi
President and
Chief Operating Officer

Merge documents/Lisa/Website Letters/FLI 3rd Qtr 2011 report on funds part one for website

*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.

Disclaimer: The views expressed are the views of Robert D. Rosenthal and Ralph F. Palleschi through the period ending September 30, 2011, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.