July 31, 2012

First Long Island Investors, LLC

June 30, 2012

"The key to making money in stocks is not to get scared out of them." Peter Lynch

Investment Perspective

Life has a way of injecting reality into our good time. The first quarter was a great period for investors, but one should never annualize investment returns after one good quarter. The second quarter ending June 30th reminded us that volatility caused by an ugly Europe, fiscal problems, higher unemployment, and political paralysis can appear at any time. Despite all of this, the quarter ended down only modestly for many equity strategies, overcoming an earlier sharp downturn. Of note, our dividend growth strategy achieved modest gains for the quarter, outpacing the general market that was down about 2.8%. Bonds also made modest gains in the quarter, but we remain skeptical about bond returns going forward. The important result is that our fixed income, defensive equity and traditional equity strategies are meaningfully positive thus far for the year!

At our recent seminar at The Garden City Hotel (please see our website (www.fliinvestors.com) for a summary) Jason DeSena Trennert, co-founder of Strategas Research Partners (a macro research, advisory and capital markets services firm), and Bob discussed, in an interview format, four big issues facing us as investors:

1. The European Debt Crisis (both sovereign and banking)
2. The upcoming elections (Presidential and Congressional)
3. The fiscal cliff (tax increases and mandatory spending cuts)
4. Investment strategies that make sense for the world we live in

We also touched upon the impact of China slowing as well as other potential problems including possible decreases in both corporate margins and productivity. Additionally we discussed Iran and its pursuit of a nuclear bomb as well as our chronic and debilitating unemployment situation.

The bottom line is that we still have a lot of unsolved problems, the solutions to which depend in some part on politicians here, and in Europe and China. This is not a pleasant thought. However, on the brighter side, American businesses both here and abroad have huge cash balances and very strong balance sheets. Our greatest resource just might be the strength of American business as well as the natural resources that remain abundant in our great country (especially natural gas and oil). Of course, we have to encourage the use of that cash and those natural resources, and that requires our politicians in Washington to remember who they represent. Consider that the cry for QE3 to help our economy is only a repatriation of excess cash away in terms of possibly putting to work as much as a trillion dollars. Both sides of the political aisle would have to cooperate and find a constructive way to put the money to use while also raising tax revenue from its repatriation. In our opinion, this will happen in time and that would be a positive for equities and our economy.

So not a lot has changed since our last letter except that those investors who stayed the course in our defensive and traditional equity strategies have maintained some real gains year-to-date after inflation to show for the risk they took. We believe that improved earnings and attractive valuations for many companies, (as well as low yielding bonds and cash), support the equity markets. All of our equity strategies are solidly positive for the year and outpaced bonds and commodities through the second quarter. In our dividend growth strategy, all companies that we expected to raise dividends did, and our performance improved versus the S&P 500 by posting a gain for the quarter. Since inception, this defensive equity strategy continues to beat the market despite being less risky than the market. Our FLI Partners Fund (also a defensive equity strategy) also had a good quarter. Prudent asset allocation with a defensive tilt continues to help us navigate the choppy and uncertain times that we live in, while helping us deliver to you a blended return that has more than outpaced inflation this year. Irrespective of the headlines, we focus on quality companies with attractive valuations and strong fundamentals.

Speaking of inflation, it still seems inevitable to us, given the amounts of money being printed here and abroad. However, velocity (circulation and use of that money) remains poor such that the money resides on the balance sheets of banks and in the treasuries of corporations without benefitting the domestic economy. At some point when greater velocity is achieved, we expect that inflation will increase and interest rates will trend up. Bond investments must reflect this possibility and those investing in bonds with long term maturities or buying low quality bonds will be subject to potentially meaningful losses. Of course, we don't know when interest rates will rise, however we remain cautious in our purchase of bonds and still believe that higher yielding large cap companies are currently a better investment. Our bond portfolios continue to concentrate on shorter duration and high quality.

The "wall of worry" continues to garner headlines each day. The problems in Europe continue to plague us and slow the pace of corporate earnings of large multinational companies. How soft the landing will be in China remains to be seen. The high unemployment in the U.S. is showing no signs of improvement. An 8+% unemployment rate is terrible and frustrates so many Americans as well as delaying the needed housing recovery. The continued increase in U.S. government debt is a ticking time bomb that must be addressed after being ignored for the last eight years. Health care also must be addressed through revisions to the new health care law that was just ruled constitutional. Providing care to almost all Americans is a noble mission; but it must be accomplished in a fiscally prudent manner. Finding a way to deal with Iran before it possesses nuclear weapons is essential. History is marred with madmen like Hitler and Stalin who used their weaponry to murder millions of innocent people. We can't let that possibility occur again. Thus there remains a boatload to worry about.

However, we remain cautiously optimistic because we do believe that the American people are resilient and are beginning to make it clear to our elected officials (at both the state and federal levels) that it is time to act responsibly on behalf of those they represent. The paralysis which has become Washington sport isn't acceptable, and everyone sees what's happening in Europe. The equity markets might just be signaling this as we still have good gains for the year reflecting a still growing global economy. And those who ventured into our defensive equity strategies (both Dividend Growth and FLI Partners Fund) have achieved gains (since the inception of the Dividend Growth strategy) that are much higher than their bond or money market accounts. We urge you to remain properly allocated among our four investment baskets. Remember, we assess your asset allocation each quarter and will continue to make suggestions to you to better position you for the long term.

So, hold onto your seats as we navigate the next six months. There will be both opportunity and volatility. We believe that quality and defensively tilted investing will reward us as investors while letting you sleep at night. Some measure of greater certainty will result from the upcoming elections and hopefully actions of Congress in the lame duck session. We look forward to it and we believe the markets will appreciate it as well. Please call us with any questions you might have.

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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