

November 1, 2012

First Long Island Investors, LLC

September 30, 2012

“In the business world the rear view mirror is always clearer than the windshield.”
Warren Buffett

Investment Perspective

Despite a lack of clarity and many issues to be concerned with, our clients and most long-term investors experienced significant gains in the third quarter (see Part II, Third Quarter Investment Results). Our traditional equity and defensive equity strategies made impressive gains. Bonds did reasonably well and private equity and real assets continue to show promise in recovering from the economic “decession” of several years ago. Almost all companies in our dividend growth strategy this year have increased their cash payouts on average by almost 9% (three remaining companies are expected to increase their dividends by yearend by at least 9% on average) demonstrating the free cash flow strength of the companies in our portfolio. Our FLI Partners Fund (dramatically outpacing its index) and core equity strategies continued to reflect the power of earnings growth and reasonable valuations. All in all, it was a strong quarter for those investors who committed their core capital to long-term investment strategies with varying degrees of risk. However, these gains came with the continuing anxiety and uncertainty that investors never get used to.

As Mr. Buffet so succinctly stated above, it is easy to now look in the rear view mirror and see those wonderful gains, but at the beginning of the quarter the windshield was not so clear. Investors were concerned then and remain concerned today with a significant number of economic, political, and geopolitical issues. The following are some of the issues that still cloud the windshield as we try to view our investment path down the road:

- A muddled economic recovery in the US and around the world
- Unemployment that continues at an unacceptable level
- Financial repression reflected in a zero interest rate environment
- Uncertain tax policies going forward

- Political paralysis and election uncertainty
- European Union financial and social strife
- High energy prices for gasoline and heating oil
- A growing unconscionable Federal deficit
- Financial weakness in Medicare, Social Security and municipal and private pension funds
- The fiscal cliff and the impact of Obamacare

Ok, the list is long and it makes looking down the road through the windshield seemingly difficult. However, this was pretty much the case at the beginning of the last quarter and the quarter before that. So, as investors we have never gotten used to being able to see through the windshield very clearly.

The answer to this in our opinion remains a prudent and responsible individualized asset allocation for each client. What is demonstrated over and over again is that a prudent asset allocation works over long business cycles to give clients reasonable returns. These returns can be interrupted by “black swan” events such as in 2008, but patience permits investors to return to compounding if they have smart asset allocations. One must remember that compounding depends on not getting badly hurt by the “rogue wave.” One can improve their chances of avoiding the big loss by having a prudent asset allocation that gives diversification a chance to somewhat insulate one from the unexpected or just a plain miserable economy.

We don't have a crystal ball. But if one invested with us in our Security and Defensive Equity baskets, a good part of the pain from the severe downturn of 2008 would have been mitigated. And by still having a reasonable allocation to traditional equities, with seasoned managers and quality companies, the recovery for those who held on was significant! Today, many companies continue to have strong balance sheets and growing earnings, housing is getting better, and emerging countries are still delivering reasonable growth. This is cause for some optimism.

So, let us make an analogy. One should view having a prudent asset allocation as the GPS system when you are looking through the foggy windshield and confusing road ahead. We believe it will guide you to reasonable returns over the longer term despite the uncertainty and queasy feeling you might currently have. We strongly believe that investing in bonds and cash with tiny returns will not help you overcome higher food and energy prices. So seeking a real return after inflation is critical and that requires having some faith in an asset allocation that departs from just the apparent safety of cash and bonds. Holding too much cash and overloading ones' bond allocation is a long-term prescription for a negative return after inflation. And with all of the currency (Dollars and Euros) being printed here and abroad, inflation must be considered a danger sometime down the road we investors are travelling on.

The foggy windshield represents the proverbial wall of worry that investors must overcome. Neither should deter an investor from trying to make real returns after inflation to preserve their wealth. As we have often stated, preservation of capital is key and that means avoiding, as best as one can, negative returns from market downturns or inflation. We at First Long Island Investors have investment strategies made up of great companies that have over time made our clients real returns after inflation. Long-term equity investing is not dead. Just ask the owners of *Apple*, *McDonald's*, *Occidental Petroleum* or so many others.

Finally, we are quickly approaching an important election, the aftermath of which we hope will bring Americans back together again. As a united people, our ability to see through the windshield will be even better. Whoever gets elected President, and those newly elected to Congress, owe us as much.

We will be holding a seminar on November 13th at the Garden City Hotel, with our guest, Senior Economist, Robert F. DeLucia, to discuss our view of the election as it relates to investing, as well as our strategy for investing in a zero interest rate environment. We hope you can join us. Also, as we approach our thirtieth anniversary next year, we are in the process of revamping our website and will invite you to visit it shortly. As always, we remain ready and willing to discuss our views on asset allocation, and how our investment strategies can play an integral part in your investment plans going forward. We also wish you a Happy Thanksgiving!

Best regards,

Robert D. Rosenthal
Chairman and
Chief Executive Officer

Ralph F. Palleschi
President and
Chief Operating Officer

P.S. Most of us have just endured a horrific storm. We have learned how cruel Mother Nature can be, and we hope that everyone's recovery is as speedy as is possible.

*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, 2012, 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.

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