January 31, 2013

First Long Island Investors, LLC

December 31, 2012

"Time is the friend of the wonderful business. It's the enemy of the lousy business. If you are in a lousy business for a long time, you're going to get a lousy result, even if you buy it cheap. If you're in a wonderful business for a long time, even if you pay a little too much going in, you're going to get a wonderful result if you stay in a long time."
Warren Buffett

Summary Review

Our recent thought piece discussing performance for last year and our outlook for 2013 was mailed earlier in January and we hope you had a chance to review it. We believe it is worth again reviewing the "wall of worry" that we overcame last year to achieve strong investment results. These worrisome challenges included:

1. Slow economic growth
2. The Presidential election
3. European Banking and Sovereign Crisis
4. Stubbornly high unemployment
5. Fiscal policy uncertainty culminating in the "fiscal cliff" last minute deal
6. Geopolitical hot spots in the Middle East, North Korea, and South China Seas

Now on the plus side we have some significant positive developments or expectations as well:

1. Housing has bottomed and is on the rise rebuilding some lost wealth and helping employment
2. Auto sales are at robust levels and growing
3. Consumer debt is significantly down and deleveraging of consumers' balance sheets is slowing
4. Unemployment claims have dropped to below the 350,000 level
5. Corporations have strong balance sheets with significant cash and have borrowed at historically low rates to further bolster their finances
6. Corporate earnings remain strong
7. European banking crisis is being dealt with although not solved

8. Energy development is leading to not only potential U.S. energy independence, but is a catalyst to a manufacturing renaissance
9. We expect both institutional and individual money to flow into equities as the asset class of choice bolstering stock prices

Our guardedly optimistic outlook is tempered from lingering but real concerns about the following:

1. Unsustainable annual U.S. deficit and sixteen billion dollars of cumulative debt
2. Entitlement reform to reduce prospective deficits including sequestration
3. Unknown economic consequences from the Affordable Care Act (Obamacare)
4. Political paralysis in Washington holding back employment gains and energy development
5. A nuclear Iran and other global hot spots
6. The continued squeezing of the U.S. middle class
7. Unknown consequences when the Fed shifts to a less accommodating policy
8. Slow global growth and concerns about Europe

Our view of the investing landscape is reasonably bright, but any of the enumerated concerns could cause some turmoil and volatility. The net result is that we favor a higher allocation to defensive equity strategies (Dividend Growth and FLI Partners Fund) whose quality companies should participate in appreciating markets but be less volatile in market disruptions. At the same time, we continue to believe that concentrated portfolios (again) in quality traditional equities are prudent over the long term as part of one's asset allocation. However, here unanticipated volatility will do more damage in the short term. Both our defensive and traditional equity allocations will benefit from the continuing global growth driven by innovation (e.g., smart phones and payments by plastic) and an emerging middle class in other parts of the world. We also believe that the slow but sure healing of the financial system will benefit the entire global economy. Also, the slower global growth (particularly China and Brazil) has capped what had been highly inflating commodity prices. This continued slower global GDP growth and continued productivity gains should keep commodity prices somewhat subdued. As for gold, if inflation heats up in the future, or if there are regional outbreaks (e.g., the Middle East), gold could be a sound investment.

We remain cautious on bonds for fear of higher interest rates. We believe the bull market in bonds is at or near an end (see Exhibit 1). Better yields and growing income can be obtained from our Dividend Growth strategy (here the growing yield that we expect is a hedge against inflation). Therefore we continue to keep our bond portfolios with shorter duration through reasonable maturities. (Primarily no more than five to seven years on average, even if you plan to hold bonds to maturity.) We also believe that corporate, high yield, and emerging market debt have seen spreads contract. This limits the opportunity there as well.

Prudent individualized asset allocation among our four investment baskets should yield you the best road map to compounding your wealth at reasonable levels despite continued economic, fiscal and geopolitical uncertainty. And the reallocation of liquidity, if it occurs, should benefit all of our investment baskets excluding fixed income (security).

Please call upon us with any questions you might have. We wish you the best for this New Year and look forward to reporting to you at the end of April.

Best regards,

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