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## LETTER FROM THE PORTFOLIO MANAGERS

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September 2007

### **September Song**



Eric M. Kobren

The approach of September is a favorite time of year for many. The weather is starting to cool and the leaves will soon begin to turn. School has started and routines have resumed. Nobody's favorite college football team has lost yet.



Rusty Vanneman

Still, September historically hasn't been the friendliest month to stock market investors. Looking at the Dow Jones Industrial Average going back to January 1900, September has clearly been the worst month for stocks. While many investors initially guess that October is the worst month, it is actually September which has the largest negative average monthly return at -1.1% (October's average is +0.2% which qualifies it as the fourth worst month of the year). In addition, September is the only month that has had more negative months (58%) than positive months.

This just isn't the case looking back over the 100 plus years. This story also holds up over the last 20 years. Since 1987, September easily has the largest average monthly loss (-1.2%) and has been negative 60% of the time.

Why would September be such a rough month?

There are several theories, though none seem fully satisfying. One is that bills need to be paid. There could be some truth to that. Credit card bills containing summer holiday expenses need to be paid, as will new school year expenses. Another plausible reason is "window dressing" going into quarter-end. Window-dressing, which means selling losing positions and buying securities that have been performing well, is indeed practiced by many investment managers, particularly those who are often held accountable by a committee. Given that the third quarter tends to be the weakest quarter of the year, there could be some truth to that as well. "Profit-taking," which means to sell profitable investments before others sell the same position, is not a satisfactory answer. Why book profits and move to a notably more conservative portfolio position before the fourth quarter – typically the best quarter of the year?

Which brings us to this question – "Is September a good time to invest?" Our general answer is always the same. We believe, that for the long-term investor, it is always a good time to invest as the stock markets have an expected positive relative return to cash. Still, pertaining to the September time frame, and assuming that seasonal tendencies hold, adding to investment accounts this month may make even more sense than usual – stocks could be on sale!

Remember, seasonal tendencies are not certainties. In 2006, September was the second-best month of the year for the Dow Jones Industrials as it was up nearly 3% for the month. Only October was better last year as it was up nearly 4%.

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## We Have the Technology

The market has some well-documented issues right now. Then again, when doesn't it? As a saying we came across recently stated, "If you can't find things to worry about (in the markets), you lack imagination and a sense of history." Given the concerns in the credit markets, and the potential of continued spill over into the economy and markets, it could be considered reasonable to modestly trim overall portfolio volatility. We have done so in client accounts.

Nonetheless, there are always fresh investment opportunities to identify. One sector where we have recently, and modestly, added exposure is technology. There are several reasons why we are attracted to this sector.

First, technology is expected to grow earnings in 2007 by over 12%. The only sectors with higher expected growth rates this year are health care and telecommunications. Technology is also expected to show above-average earnings growth in 2008. But it isn't just about absolute growth rates. Another important consideration is whether earnings growth is accelerating or not. In this case, technology is expected to see accelerating earnings growth in both 2007 and 2008. No other sector, except for telecommunications, is likely to see such acceleration.

Second, valuations are considered to be more reasonable than they have been in recent years. While technology is still not cheap on an absolute level, its relative valuation to the broad market is expected to be lower than it has been in recent years. The anticipated contraction in relative valuation is supposed to be the largest of all sectors, with the exception of the consumer discretionary stocks.

Valuation can also be looked at relative to expected earnings growth. This is called a "PEG Ratio." In this case, technology is considered to be one of the cheapest sectors based on expected earnings growth. (Consumer discretionary and telecommunications also look cheap on this metric.)

Third, technology is one of the two sectors that have still not fully recovered its losses from the March 2000 market peak. Tech was still down 59% from the peak through 06/30/07. The average sector's return over that same period was +57%. While it could be argued that tech was wildly overvalued back in 2000, which we agree with, that doesn't mean that it has to remain in the doghouse forever.

Given the technology sector's expected earnings growth, relative valuations, and relative price performance so far this decade; this is a sector that could be poised to post above-average returns in coming years. *(For a frame of reference, technology currently represents about 15% of the overall market capitalization of the U.S. stock market. It was approximately 30% of the S&P's market's cap in 1999.)*

## Kaizen

Kaizen is a Japanese expression for “continuous improvement.” It is an expression often associated with the management practice of Ned Johnson who manages Fidelity Investments. The emphasis of kaizen is to eliminate waste, which means to remove activities that add cost but do not add value. While kaizen is not something we expressly embrace at Kobren Insight Management, it’s definitely central to our research culture. At the top of our internal on-line Research Library is this statement: “Our mission is to continually improve our investment process to efficiently manufacture effective multi-asset and multi-manager research and service.” Perhaps this mindset was developed because we have covered Boston-based Fidelity Investments for so many years and because so many of the individuals working at Kobren once worked at Fidelity.

That said, proper investment research can sometimes be messy. Not every avenue explored results in an actionable response, at least not a positive one (sometimes we learn what not to do!). Research also means to turn over as many rocks as possible so we can compare and contrast between multiple investment options. In this way, our current year-to-date pace of meeting with managers, listening to conference calls, and attending conferences is at a record level for Kobren Insight Management.


Good research also means that we continuously endeavor to innovate and explore new tools and approaches. On this count, it has also been a very strong year so far. While we have brought on a new sophisticated third-party tool, we have also added new internal tools. We have also conducted a variety of studies on portfolio attributes and how they might correlate with future relative performance. We have explored new investment products. Each of these has enhanced how we conduct money manager due diligence.

In sum, regardless of the season and short-term economic and market conditions, there are always opportunities to improve our investment processes and portfolios. Again, thank you for your confidence. If you have any questions, please feel free to contact us.

Sincerely,



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