

March 8, 2010

Over the past decade, your advisors at Roundview Capital have demonstrated that a disciplined investment strategy outlasts fads such as hot tech IPOs, secretive hedge funds, and can't-miss real estate deals.

The new century began with the promise of a technology boom and a popular belief that painful recessions were a thing of the past. Shortly after the champagne corks popped, cracks in the economy emerged. To ease the pain, the Federal Reserve aggressively loosened monetary policy helping to fuel the largest credit boom in history.

When the flood receded, many individuals and once-revered institutions like Lehman Brothers and Bear Stearns were swept out with the tide. At the end of 2009, late-night comic Jay Leno captured the dour mood of the financial sector and overall economy and when he quipped, *“President Barack Obama signed an executive order calling for the closure of Guantanamo Bay within a year. Actually, you know how he can close it faster? Make it a bank, okay?”*

The past 10 years have been dubbed the “Lost Decade”, as a period that appeared to be filled with promise ended in disappointment. For example, a \$100 investment in a Vanguard U.S. stock market index fund on December 31, 1999 was worth less than \$90 at the end of 2009. Over this period, economic output rose at its slowest rate since the 1930s, and there was zero net job creation.

Despite the negativity, the decade ended on an upbeat note as those who were brave when others were fearful were treated to a powerful stock rally. From the lows of March 2009, the U.S. equity market rose 65% without a setback worse than 7%. This strong rebound has been met with skepticism and unease. After witnessing the twists, turns, highs, and lows of the past ten years, many investors have arrived at the same conclusion as legendary newsman Edward R. Murrow, *“Anyone who isn't confused doesn't really understand the situation.”*

Roundview Capital's 2009 year-end letter reviews how we navigated the rough tides over the past decade by hewing to a value-based investment discipline. We re-examine a selection of our client letters during critical market turning points in 1999, 2002, 2007, and 2009. We discuss our current outlook, and review the opportunities and potential risks of converting your traditional IRA to a Roth.

RUNNING AN INVESTMENT PROGRAM

Your advisor navigates the uncertainties of short-term market movements by focusing on long-term asset values. A decade ago (when the two of us were running marathons instead of running after kids), we both read a book entitled *The Principles of Running* by Amby Burfoot. Burfoot, who was the winner of the 1968 Boston Marathon and editor of *Runner's World*, observed:

“The most important thing you need to know about running is the least well known and least discussed: Running is a mental activity, not a physical activity. Set a goal and a program for yourself, and everything else will follow.”

Like running, long-term success in capital allocation requires the consistent execution of a rational investment program.

Building on this principle, our programs are personalized to meet the long-term goals and objectives of our clients. The investment process consists of constructing portfolios through intensive bottom-up research and analysis. Investment opportunities are analyzed to determine their intrinsic value — the price a rational businessperson would pay to be the exclusive owner of the entire enterprise. Purchases are made when the market offers the opportunity to buy at discounts to intrinsic value. We sell when investments exceed their intrinsic value from price appreciation or deterioration in fundamentals. Most importantly, we seek to invest so that you can sleep well at night.

The emotions people have experienced over the past decade provide an illustration of why the average investor buys high and sells low. Without regard for the discipline of proper business valuation and analysis, the basis by which a person makes a decision about a company rests on the movement of the stock price. Under this framework, higher — not lower — prices generate excitement among buyers of equities. These same people will quit buying when the market is significantly off its highs. This is contrary to common sense. As an example, Howard is a big fan of the theater. He enjoys seeing lots of shows in January and February when the prices are low and better seats are available. When ticket prices in the summer are high, he lets tourists enjoy Broadway.

A DECADE IN REVIEW

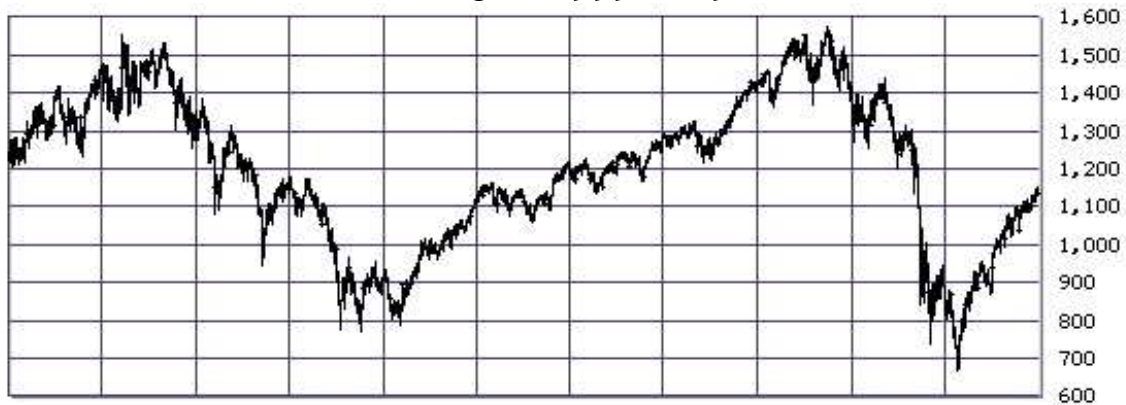
A review of our client letters over the past 10 years provides insight into our discipline. We avoided significant losses of capital relative to the overall market by focusing on value and the rational allocation of client assets. At times, we were early in our predictions and associated actions (which often led to phone calls). But in the end, our focus has added value for our client families.

We believe in eating our own cooking. Since our personal portfolios mirror those of our clients, we pay double the price for poor decision-making.

Excerpts from our client letters during four critical market turning points over the past decade in 1999, 2002, 2007, and 2009 follow:

1999: THE TECHNOLOGY BUBBLE

S&P 500: 1999-2009



1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009

In early 1999, we sounded the alarm on technology stocks as they continued to reach new highs. To be fair, we were early, and missed a good part of the rally that extended through 2000. When the markets began correcting in 2000, however, our focus on valuations helped shelter client capital as the Nasdaq fell about 80% from peak to trough. As we quickly found out, a lost opportunity is easier to recover from than a permanent loss of assets.

On August 15, 1999, we wrote a client letter with the heading, "A Train Wreck in the Making." We noted:

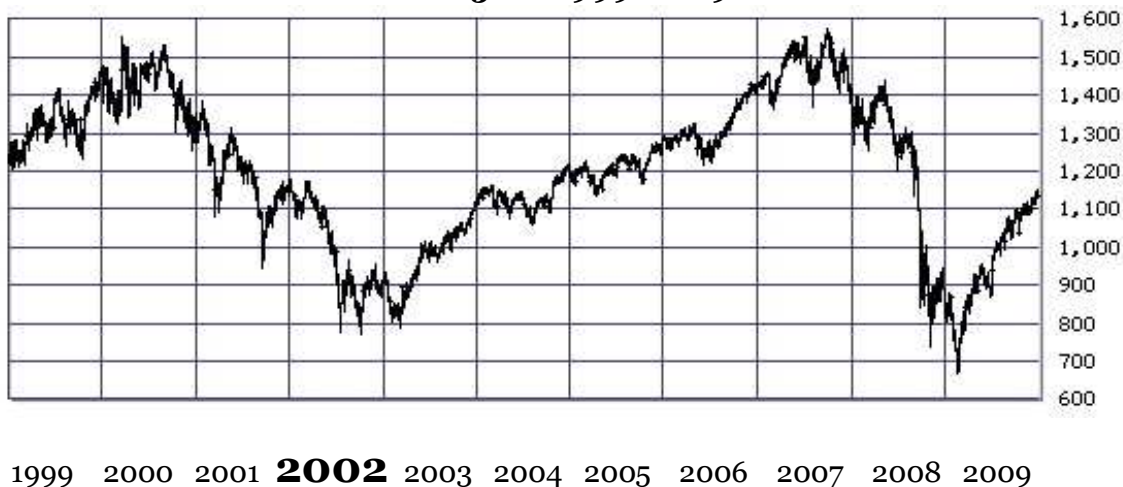
As we write to you in mid-August, the U.S. stock market continues to make new highs. Although the advance has broadened modestly, large capitalization growth stocks and technology issues continue to act like steroids – pumping up the major averages while creating a host of negative side effects. The most dangerous of these side effects is the dramatic speculative advance of a limited number of previously expensive securities fueled by short-term expectations of even more favorable price movements. With the appropriate credit to Oscar Wilde, investing has become a game where, "We know the price of everything and the value of nothing."

This has created a playing field where many good businesses with competent managements continue to be available at highly

favorable prices. Patient long-term investors have the potential to yield very satisfactory returns over the next three to five years in securities that are currently unloved and overlooked.

2002: THE TECHNOLOGY BUST

S&P 500: 1999-2009



In August of 2002, after the S&P 500 had fallen almost 50% from its peak, we became more constructive on investing in selective public companies. At the time, we observed that valuations were cheap and corporate insiders were significant buyers of their own company stocks.

This is the most important letter we have written to you in over a decade. There are several key points to highlight in this challenging period for common stocks, and we want to be focused and direct with our comments. This mid-year 2002 update highlights two key themes:

I) We'll provide you with context for the current bear market, an understanding of where we are in the cycle, our assessment of the market valuation, and some important information on future performance based on historical studies of market panics.

II) We'll share with you our strategy for selecting businesses and how we are preparing for an eventual market reversal.

CAN YOU BEAR THE BEAR?

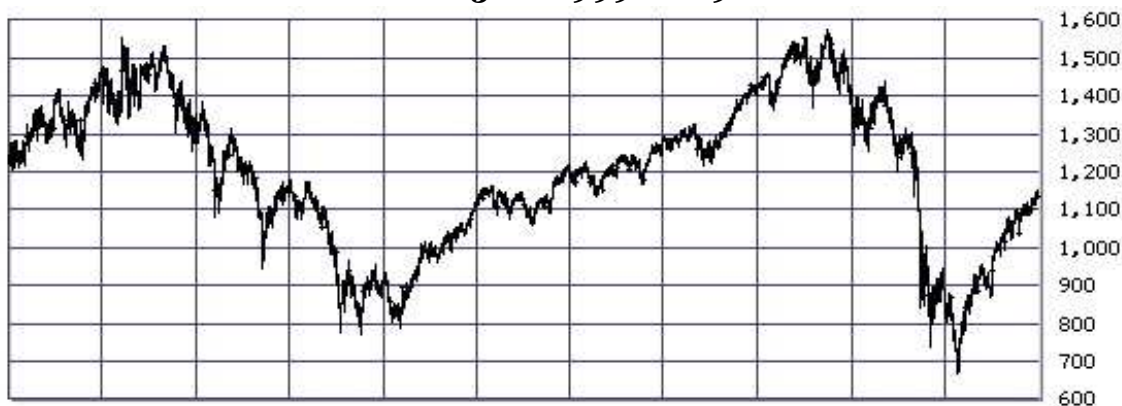
The S&P 500 and NASDAQ have now fallen approximately 49% and 76% respectively since reaching their highs in the spring of 2000 – the peak of the Internet bubble. Over this period, your capital did not feel any material impact from this falloff until June of 2002...

It is clear that stocks are cheaper than they were two years ago, but are they cheap enough?

Qualitative and quantitative indicators suggest that the recent market panic has brought about a fear-induced garage sale for great businesses. Despite the recent gloom, we highlight some reasons to be optimistic about the long-term returns that will be generated from a well-selected portfolio of equities in this environment.

2007: REAL ESTATE IS DRY TIMBER FOR A FIVE ALARM FIRE

S&P 500: 1999-2009



1999 2000 2001 2002 2003 2004 2005 2006 **2007** 2008 2009

At the end of 2007, we sounded the alarm on real estate by pointing out that housing prices had moved significantly beyond normal valuation metrics. It was our conclusion that a decline in real estate would have serious consequences for the overall economy.

Residential real estate prices in 2005-2006 marked a long-term peak. It is almost impossible for any investor to predict the depth, duration and all of the consequences of a decline from this high level. A contracting housing market has profound negative implications because:

1. Homes represent the largest single asset for most Americans.

Net housing wealth as a share of GDP rose from 60% in 1997 to about 85% in 2006 according to the Federal Reserve Bank of St. Louis.

2. Most Americans now view their home as an investment asset. It wasn't long ago that a house was simply a place to live and raise a family.

3. America remains the locomotive of the global economy and is responsible for between 1/4 to 1/3 of the world's goods and services.

Contraction in U.S. residential real estate will lead to a contraction in worldwide demand for goods and services.

Those who justify rapid real estate appreciation from 1998 to 2006 by referencing population growth, increased building costs, and low interest rates do not have history to support their argument. While all three factors contribute to price appreciation, they cannot explain most of the increase. U.S. population growth has been steady and gradual. Building costs — labor, lumber, concrete, and steel are also not out of line with long-term trends despite the recent spike in commodity prices. Central banks have cut interest rates many times in history, and such actions have never produced such concerted price appreciation.

2009: BUY WHEN OTHERS ARE FEARFUL

S&P 500: 1999-2009



By early 2009, investors were expecting the worst. The financial crisis drove valuations and sentiment to lows not seen since the Great Depression. As people became increasingly fearful, we turned more bullish in our March 2009 client letter when we advised clients that stocks on the whole were cheap:

In your Advisor's view— on a valuation scale from 0-10 with zero being extremely cheap and ten being the most expensive — we are currently between one and two. In fact, going back to 1870, the U.S. equity market has only been cheaper on four different occasions. History has shown that valuations can easily go from cheap to VERY cheap, and from expensive to VERY expensive. History, however, has also shown that investments made during periods of fear and low valuations have a high probability of providing fair returns over time. If you don't buy and own assets during periods of great fear and low prices, when do you buy — during periods of giddiness and high prices? Remember how great it felt to buy dot-com stocks in 1999, and real estate in 2005? Valuations do matter.

Currently, the relationship between long-term interest rates and stock market valuation as measured by the S&P 500 10-year rolling price-to-earnings ratio is back to levels last seen during Great Depression.

THE NEXT DECADE – NOT TOO HOT AND NOT TOO COLD

From our perspective, it seems like philosopher Friedrich Hegel was correct when he observed that the only thing we learn from history is that man can never learn anything from history. Is there any other reason that people continue to repeat the same mistakes?

Given severe market volatility over the past two years, many investors remain in their bunkers. We have observed that fear is quick to re-enter the market on any minor pullback.

Some may feel a need to continue hoarding cash waiting for “the right opportunity.” A careful study of history shows that typically the best course of action for most investors is to minimize shifts between cash and stocks since stock returns tend to occur in sudden spurts that are almost impossible to predict. For example, Ibbotson's Stocks, Bonds, Bills and Inflation shows that over 10% of market movements come in only 1% of the months. Another study by Birinyi Associates analyzed the results of \$1 invested in the S&P 500 beginning in 1966. \$1 would have grown to \$11.71 by the end of 2001. Without the five best days each year, the same dollar would have shrunk to \$0.15.

This said, the equity asset class requires a long-term horizon which necessitates the fortitude to withstand significant short-term shifts in the value of capital. We strongly encourage all client families to review their investment objectives with us on a regular basis to assess any material changes.

As we survey the investment landscape, we believe that most assets we track are within their respective ranges of fair value. For those who are very bullish for 2010, they are either betting on extraordinary earnings growth or an upside

overshoot that usually punctuates strong rallies. On the other hand, very bearish investors are largely forecasting a collapse in corporate earnings to justify their outlook. Your advisors are somewhere in between for the market in general, but are confident that the many seeds we are planting today will be fruitful over time.

WE WORRY SO YOU DON'T HAVE TO

As we survey the investment landscape, two of our major concerns are government debt and entitlement programs.

Here's a simple question that we have been asking ourselves: If some of the world's smartest business leaders could not prevent some of the world's most successful companies from failing during this last financial crisis, how much faith do we have that elected politicians and bureaucrats will have the ability to keep governments from experiencing similar problems?

We take heart that most seem to understand that difficult decisions will need to be made, and that fiscal discipline will require sacrifice. It will take political resolve to put the right policies in place.

There are many positives for the next decade. Continued innovation will improve our lives in ways we cannot imagine. A decade ago, we did not foresee that we would be able to see such a crisp image of a hockey puck flying around on a 60-inch high definition television for under \$2,000 (Steve is obviously watching Olympic hockey as this letter is being written).

Globalization is an overused cliché. Since we have not used it yet, now would be an appropriate time. Do not underestimate the underlying dramatic impact that the doubling of the global middle class will have over the next decade. We want to be on the equity side of businesses that will benefit from these developments.

THE \$3.5 TRILION QUESTION

There has been a revolutionary shift in retirement planning, and your Advisor wants to work with you to make the best choice possible.

To Roth, or not to Roth? This is the question facing owners of approximately \$3.5 trillion of assets in traditional IRAs. Beginning in 2010, the \$100,000 income limit for individual Roth conversions disappears so everyone can consider whether or not a Roth makes sense for them.

A Roth IRA is a very powerful retirement and estate planning tool. After investors meet certain holding period requirements, all withdrawals can be made tax-free.

Converting to a Roth IRA requires significant personalized analysis. For starters, all pre-tax contributions and earnings will be taxed immediately as ordinary income with the promise that the assets will never be taxed again in your lifetime. For 2010 conversions, the taxes can be deferred evenly between 2011 and 2012,

but if you elect to defer the tax to those years you are subject to the prevailing tax rates of those periods.

There are two main reasons to look before you leap: 1. Some tax professionals do not believe you should pay taxes until you absolutely have to. In the case of traditional IRAs, taxes are not due until investors start taking required minimum distributions at age 70½. At that point, 4-5% of the account balance will be withdrawn each year and that portion will be treated as ordinary income, and 2. Tax rules can change. Social security benefits were once excluded from federal taxation and this was regarded as ironclad. This changed with the passage of the 1983 Amendments to the Social Security Act which made these entitlements subject to taxes.

So should you do it? Thinking through the conversion question reminds us of Albert Einstein's observation about taxes, "*This is too difficult for a mathematician. It takes a philosopher.*" There are indeed many variables to consider, and the conclusions are not always black and white.

For starters, the best conversion candidates are those who can afford to pay taxes from assets outside of their retirement accounts. In addition, there are four variables to consider:

1. **Tax Rates:** A conversion today makes more sense if you do not expect your overall tax rate to decline substantially in the future.
2. **Time Horizon:** The longer your investment time horizon, the more beneficial it is to convert .
3. **Spending Needs:** You do not expect to use your retirement funds during your lifetime and plan to bequeath them to others (translation: you have some very lucky beneficiaries).
4. **Large Estates:** If your estate is subject to taxation upon death, a conversion may be beneficial since marginal estate taxes are higher than marginal income taxes and your heirs will not be taxed on distributions for your Roth IRA.

As you think through a possible conversion, it's important to understand that it's not an all or nothing proposition. You may convert part of your traditional IRA assets to hedge your bets or slowly convert some assets beginning in 2010. The IRS even gives you a money-back guarantee. If you're not satisfied with your conversion, you have until October 15th of the following year to "recharacterize" your converted Roth IRA back to a traditional IRA.

Please contact us to discuss the Roth conversion. We believe it is an important matter.

CONCLUSION

The past decade has highlighted the importance of maintaining a disciplined investment strategy. Our core team has successfully navigated the difficult waters, and we now share over seventy-five years of experience managing money.

As we look forward, we continue to grow to meet the needs of our client families.

During the second quarter of 2010 we will relocate our offices to downtown Princeton on Nassau Street. Fear not, we are not taking on additional expenses. We have capitalized on the current weakness in the commercial real estate world to upgrade our office space without upgrading the cost. All of us are very excited. One of us is worried because his office will be overlooking one of the best ice cream establishments in town!

We have been on the hunt for talented people to add to the Roundview team, and we found a future star in Andrew Lieu. He will be joining us as a Director who will be responsible for research and business development.

Andrew attended Princeton as an undergraduate, was captain of the tennis team, and was very involved with the religious community on campus. Andrew meets all of our basic filters. He is family-oriented, honest, smart, modest and hardworking. His analytical abilities are only matched by his people skills. He has already made a pilgrimage to Omaha for a Berkshire Hathaway meeting. In addition, his spouse Bonnie is truly his better half, and that is saying a lot given how much we think of Andrew.

That is all of our news for now. Please let us know how we are doing, how we can get better in meeting your individual needs, and any material changes in your financial life which would lead us to make changes to your investment policy.

We have included a copy of our ADV Part II for your review and additional policies and procedures are available at www.roundviewcapital.com.

We will write to you again in the third quarter with a mid-year update for 2010. In the interim we look forward to speaking and meeting with you. Until then, we wish you good health and the joy of family and friends.

Sincerely,



Howard



Steve