Colbert Investment Management

Annual Letter to Clients
December 31, 2012

Fabulous Four
Our clients had a fabulous year in 2012, with fixed income (bond) and equity (stock) portfolios all posting excellent returns. Our Core Equity Portfolio Composite increased 21.78% (net), while the S&P 500 Index (with dividends) gained 16% (gross). Although we were down 15.09% in 2011, our performance over the last 4 years has been good, even when compared with the Standard & Poor's 500 Index.

	2009	2010	2011	2012	Annualized Returns	Value of $100 after 4 Years
CIM Core Equity Composite	65.54%	25.15%	-15.06%	21.78%	20.98%	$214
S&P 500 Index	26.46%	15.06%	2.11%	16.00%	14.58%	$172

I chose the last 4 years not to cover the fact that 2008 was a dismal year, everybody knows that already. The last 4 years were chosen as an illustration of why investment returns are usually better when expectations are low.

Expectations are a key component of future investment performance. Because expectations in 2009 were extraordinarily high that a depression was nearly inevitable, prices of stocks were driven to extraordinarily low levels. Hence the very high returns obtained in 2009 when the predicted depression did not materialize. Just because things stopped getting worse, not necessarily much better, prices rebounded strongly.

> *"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."~Mark Twain*

We started out 2012 with low expectations: the Euro had nearly imploded in late 2011, Spain's deficit was worse than expected, and, emerging market economies were slowing down. Many pundits were forecasting a recession in the USA, and a crash landing for the Chinese economy. Yet businesses were making record profits in many cases, while their stock prices reflected the negative news headlines.

Here is what we said one year ago:

> *"Where does that leave us? Perhaps in one of the more fertile investing environments in years."*

Markets are full of optimists and pessimists. Optimists do what optimists do, the Stevie Wonder way ("Don't you worry 'bout a thing!"). Pessimists do what pessimists do, the Mose Allison way ("I don't worry about a thing, 'cause I know nothing's gonna be alright"). Having started 2012 with low expectations (and low stock prices), when things turned out to be not as bad as advertised, prices increased to more rational levels.

Economic Cold War

I can't remember such a long period in the last 25 years during which there has been a persistent drumming about unresolved economic problems facing many nations. The US, Europe and Japan have various chronic ills, so chronic that I have compared it to a sort of Cold War. This economic "cold war" may end up lasting a decade or more, a period during which we may not get an "all clear" signal. A period during which many businesses will have thrived, taking their shareholders (and our clients) along on an enriching ride.

While any trip may be expected to have some bumps along the way, after experiencing bad times, expectations for more bad times are often excessively pessimistic. This means probably better times ahead for selected investments. Although neither I, nor anybody else, can predict the future, here is my toast to four more good years!

Best wishes,

Karim Armand
President

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