MJB ASSET MANAGEMENT

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"Intangible things (such as feelings, circumstances, or beliefs) that get in the way."
– Definition of "baggage", Webster's Dictionary

Dear Clients and Friends,

Earlier this summer, my wife and I took a short vacation to "red rock" country in southern Utah where, among other things, we made the acquaintance of another vacationing couple from the New York metropolitan area. As it turned out, we hit it off and agreed to meet again "back East;" a few weeks later we spent an enjoyable afternoon with our new friends. Though we had some things in common and had shared some time together in Utah, there was something more that had made it so easy for us to connect. Then it occurred to me: we were in the high desert 2,500 miles from home, far away from conventional settings – e.g., work functions, charitable events, parent's night at school, etc. – in which various social impediments (real or imagined) might materialize. In effect, no one's "baggage" got in the way. I suddenly realized that: 1) baggage is a function of past experiences; and 2) you cannot erase the past but you can change your relationship with it. In other words, allowing "baggage" – those "intangible things" – to get in our way is a choice, a subconscious one at times, but a choice nonetheless.

Investors often choose to let intangible things get in the way. Their baggage is typically triggered by market volatility: no one likes to see their portfolio decline, even temporarily. I understand that well, as we navigate volatile markets daily. When volatility hits, many investors forget that baggage is a choice, i.e., that they can choose to stay relaxed and make reasoned decisions rather than suffer knee jerk reactions that lead to sub-optimal results such as selling low after a decline or piling in at the end of a bull run. Our goal at MJB Asset Management is to reduce the frequency of the triggering event, i.e., to reduce volatility and provide more consistent returns that allow our clients to relax. We do this in several ways:

1. **We utilize "absolute return" strategies that seek to make money regardless of which way the markets move.** These strategies typically have some type of hedge against market volatility that enables part of the portfolio to actually benefit from a market decline. As a result, these strategies do not follow the overall direction of the market (in market-speak, they have a "low correlation" with the market) and can provide a counterbalance to the ups and downs of the market. In effect, they seek to take the market out of the equation, helping to provide consistency and reduce overall portfolio volatility.
2. **We work to stay "in the present."** We invest based on current observations of the market, as opposed to getting stuck in the *past* (e.g., "every time since 1929 that we have had

declining interest rates, unemployment of 8% or more and a first term Democrat in the White House, the stock market has . . .") or lost in the *future* (e.g., "we expect corporate profitability to peak in the second half of 2011, Gross National Product to increase by 2.5% in 2010 and inflation to remain benign until the end of 2012, so we are investing in . . ."). Focusing on the present helps us to avoid the bubbles that occur when investors close their eyes to current valuations and follow the crowd into an overpriced asset. The most severe market downturns are frequently associated with a bursting bubble (e.g., technology in 2000 and housing in 2007); avoiding such bubbles can go a long way toward reducing portfolio volatility.

Turning to the present, and speaking of bubbles, I believe the U.S. Treasury market is in one. Treasuries are backed by the full faith and credit of the U.S. Government. Many investors – still fearful of anything that carries risk – have piled into Treasuries, stunningly willing to accept paltry rates of interest in exchange for safety of principal. (Baggage, anyone?) In addition, the Federal Reserve is driving interest rates lower by purchasing large quantities of government securities.[1] The buying pressure from those two sources has lifted Treasury prices to levels that do not offer attractive returns. I do not know what event(s) will eventually cause the mass rush to the exits, but I do not want to be holding Treasuries when the rush occurs. As such, we are avoiding them. In contrast to Treasuries, certain corporate bonds are attractively priced. Corporates lack the government backing enjoyed by Treasuries; when viewing them against the backdrop of the recent financial crisis, many investors believe corporate bonds are "too" risky. (Baggage again!) However, many such bonds are issued by high quality companies and have a minimal likelihood of default. Given that they are available at comparatively attractive prices, we are concentrating our fixed income holdings in funds that invest in such bonds.

Moving to equities, the stock market, as always, is impossible to predict. I believe the strongest potential for gains right now is in the common stocks of large, dividend paying multinational corporations that have repaired their balance sheets and have substantial cash on hand. Investors fearful of the stock market are leaving the prices of many of these companies at attractive levels, creating an opportunity for investors who are not as baggage-laden. Corporations with lots of cash typically do one of three things: 1) raise their dividend; and/or 2) buy back their common stock in the open market; and/or 3) acquire another company. The first two generally help boost a company's stock price; the third does not, but leads us to our next area of market opportunity: mergers and acquisitions. Companies flush with cash often seek to "buy growth" by acquiring rivals. Merger activity has picked up lately, most notably in the pharmaceutical and technology industries. To capitalize on that opportunity, we have added to our holdings in the merger and acquisition field, primarily through our positions in the Merger Fund, the AQR Diversified Arbitrage Fund and the Mutual Beacon Fund.

As the markets continue to move, we will continue to watch for changes that warrant any shifts in our allocation among stocks, bonds and absolute return strategies. In the meantime, the summer vacation season is winding down – it is an opportune time to put our baggage away.

Thank you for investing with MJB Asset Management. If you have any questions about your accounts or other areas of investing, please give me a call or e-mail me at rbregman@mjbam.com.

Respectfully,

Richard Bregman

[1] Interest rates and bond prices move in opposite directions as a mathematical certainty. By purchasing large quantities of bonds, the Fed pushes bond prices higher. As a result, the interest rate yield on those bonds drops.