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November 25, 2009

Dear Client,

In my letter of March 26, 2009, I cautioned against abruptly exiting the stock market and potentially missing on market gains. My thinking was that when a rebound comes, it could be explosive. Evidence of a potential market rally was already brewing when, for the week ending March 13, the Dow advanced 597 points, or 9%. Missing out on too many of these days, as I wrote, can be detrimental to portfolio growth.

While I had no idea the market would rise at such a fast pace, I did suspect that the Dow would bounce above its 6,500 lows. As I noted in March, whether or not the recent market gains are the start of a recovery is impossible to say. What does seem probable is an environment offering sharp, unexpected gains in a short period of time. Long-term investors will not want to miss these gains.

Ibbotson Associates cautions against missing out on market gains like those of the last two and half quarters: "Although successful market timing may improve portfolio performance, it is very difficult to time the market consistently. In addition, unsuccessful market timing can lead to a significant opportunity loss."

Exiting the market entirely is normally not a prudent strategy. Instead, the more risk-adverse investor may favor a diversified portfolio weighted heavily in short-term corporate bonds and a mix of other asset classes, including gold, currencies, oil, and international holdings. Today, I believe investing one's assets entirely in U.S. dollars is an inferior strategy compared to maintaining a diversified portfolio that includes non-dollar-denominated securities.

Looking ahead, we are not as optimistic as today's stock market. Nor are we enthusiastic about the advance third-quarter GDP numbers. Here is what my dad wrote on the GDP uptick: "Dig into the fine print, and you'll see the inventory dump by private businesses. The dump actually added 0.94 percentage points to third-quarter GDP because liquidation was less than in the second quarter. So 27% of the good third-quarter news was simply a result of private business reducing inventory. I calculate that motor vehicles (distorted by Cash for Clunkers) added a whopping 47% of the total 3.5% third-quarter GDP gain. Add in the residential construction windfall fueled by one-time $8,000 first-time buyer tax credits and artificially low interest rates, and you have the guts of the hyped recovery."

Given our cautious outlook, we continue to make adjustments to portfolios. Trades are executed in a methodical and deliberate manner. We do not trade for short-term speculation, except to address concerns we have about the future and to capitalize on what we believe to be opportunistic long-term trends. Following is a review of our areas of particular interest.

Dividends and Interest

Not to beat a dead horse with my consistent emphasis of dividends and interest, but investing for cash flow is one of our primary goals. This year, we have made many sales in our Retirement Compounders portfolio (32 dividend-paying securities). In the period ahead, we suspect stock market gains will be difficult to come by. As a result, dividends will play an even more important role. Additionally, higher-yielding securities historically have been less volatile than lower-yielding ones. We strive for an overall dividend yield in the 5% range.

Short-Term Corporate Bonds

While the stock market gets all the attention, the credit markets are also causing investors trouble. Have you ever seen an uglier fixed-income environment? Richard C. Young & Co., Ltd. (Young), was founded in 1989 investing exclusively in U.S. treasuries. Today, we are not investing any new money in Treasury notes or bonds. The yields are too low. We are also shying away from new purchases on municipal bonds. States and municipalities are facing some of their most challenging times in decades, and the insurers that back them are also in a difficult financial position.

Our preferred securities positions are almost entirely liquidated. With the proceeds, we are concentrating on individual corporate bonds. Compared to preferreds, individual corporate bonds tend to allow for broader industry diversification and enable us to better control portfolio duration. Currently, we are targeting an average maturity of three years or less. Eventually, rates will rise. When interest rates rise, bond prices fall. The longer the maturity, the farther prices fall. We believe our current corporate bond portfolio will experience relatively little fluctuation (especially compared to preferreds, which are long-term securities) once rates begin to rise.

Switzerland

The World Economic Forum ranked Switzerland as the most competitive economy in the world in 2009. According to the Tax Foundation, the combined corporate income-tax rate in Switzerland is 21.17%. That’s lower than the Organization for Economic Co-operation and Development’s average of 26.29% and the U.S. rate of 39.54%. *The Economist* magazine ranked Switzerland as the least risky country in which to do business in 2009. The Swiss city of Zurich has the highest take-home wages in the world. Switzerland is the ninth most economically free country in the world, according to The Heritage Foundation’s *2009 Index of Economic Freedom.*

Switzerland is home to four times as many Fortune Global 500 companies per capita as the United States. Fortune Global 500 companies based in Switzerland include Nestlé, UBS, Credit Suisse, Roche Group, Novartis, ABB, Zurich Financial Services, Adecco, Alliance Boots, Petroplus Holdings, Xstrata, Migros, Holcim, Swiss Re, and Tyco International. Five Swiss brands were included in Interbrand's Best Global Brands list, which includes the world's 100 best-known brands. The Swiss brands that made the list were Nescafé, Nestlé, Rolex, UBS, and Cartier.

Currencies

Currencies are often an overlooked asset class. History shows that adding a currency component to a portfolio of stocks and bonds can lower risk and increase return. Also, foreign currencies can act as a hedge against inflation and a declining U.S. dollar. Since February of 1985, the value of the dollar has declined by over 50% against the currencies of the nation's largest trading partners.

Water and Electric Utilities

Historically, this group has worked well for conservative investors and income seekers. Nothing fancy, but that's the point. When you buy water utilities, you should not be looking for much in the way of capital appreciation. Instead, you are seeking reliable dividends and the prospect of modest dividend growth. Water utilities are unremarkably simple and predictable. There is no competition because water utilities are, of course, monopolies. Connecticut Water Service (CTWS) and Middlesex Water (MSEX) are two names recently purchased. Both have current yields in the 4% range.

Electric utilities, especially those concentrating on alternative energy sources, continue to be of interest to us. At present, we achieve broad utility exposure through the exchange-traded fund SPDR Utilities (XLU), with a current yield of 4%.

Agriculture

As the world economy expands, many countries, including China and India, will experience rising wealth levels. With increased income, the populations will demand more protein-rich diets, significantly influencing meat consumption. Meat consumption in China, for example, tripled in the last 20 years as per capita income grew, and consumption is expected to continue to grow.

According to data from the United Nations, in 1960 there were 1.1 acres of arable farmland per capita globally. By 2000, that number had fallen to 0.6 acres. And the CIA's *The World Factbook* estimates that only 10.57% of the earth's surface is arable land.

Companies that own agricultural land stand to benefit from the long-term supply and demand differences in food markets. The USDA has reported that "sustained biofuel demand and strengthening global food demand after the current economic slowdown provide a major impetus for long-term projections of strong farm income." In our view, elements are in place for a long-term boom for most things related to agriculture, including farmland, fertilizer, and farming equipment.

At Young, our investment strategy has always been focused on diversification and patience. We do not follow a buy-and-hold strategy. We focus on long-term secular trends and attempt to profit from them. At the same time, we do not want to reach for returns. Today, we are interested in reducing risk and moderating volatility. Counterbalancing is a large part of our strategy, as is diversifying away from U.S. dollar risk. As always, we are interested in cash flow in the form of dividends and interest.

Have a good month, and, as always, please give us a call at 800-843-7273 if your financial situation has changed or if you have questions about your investment portfolio.

Warm regards,

Matthew A. Young
President and Chief Executive officer

P.S. Of the four BRIC nations, we feel Brazil offers the most promise as an investment destination. Unlike other emerging-market countries, Brazil does not appear to be overly dependent on commodities or exports. Its economy is highly diversified, with personal consumption expenditures accounting for 60% of GDP and exports accounting for only 14.3% of GDP. Brazil is the world's seventh-largest manufacturer of automobiles and the fourth-largest manufacturer of airplanes, and it is endowed with an abundance of natural resources. In the months ahead we plan on seeking positions in Brazilian bond and equity securities.

P.P.S. Canada also continues to be a favored investment destination of ours. As Canadian prime minister Stephen Harper told Larry Kudlow on *The Kudlow Report*, "We [Canadians] have, I think, the only banks in the western world where we're not looking at bailouts …We haven't got any TARP money …We don't have a Fannie Mae or Freddie Mac equivalent mucking around in the system." One of our favorite securities from up north is Bank of Nova Scotia, which is among the best-capitalized banks in the world and has an attractive current yield of 4.4%.

P.P.P.S. Acts of terrorism can have major macroeconomic impacts. The destruction of the World Trade Center on 9/11 resulted in a 12% drop in the S&P 500 and was partly responsible for the 2001 recession. A single terrorist attack plugging the Strait of Hormuz in the Persian Gulf could trap 40% of the world's seaborne oil. The effect of a blockage could be catastrophic. At Young, we look to craft investment portfolios that consider many different risks, including terrorism. We purchase assets including gold, foreign currencies, and common stock in countries that we believe are less likely to be targets of radical Islamic terrorism, including Canada and Switzerland.

The Analyst’s Corner

Even after jumping 143% from its September low (Chart 1), natural gas is cheap. The commodity is down more than 70% from its all-time high and 66% from its 2008 high. Long-term, natural gas appears to be a winner. The fuel is clean, cheap in relative terms, and now available in abundance in North America. Thanks to improvements in drilling technology, vast reserves of natural gas that were once unrecoverable are being unlocked. The Potential Gas Committee estimated recently that technically recoverable natural gas reserves increased by 35% from year-end 2006 to year-end 2008.

At current rates of consumption, the U.S. has 90 years’ worth of natural gas supply. The current depressed price of natural gas is a result of soft industrial demand and excess supply. The supply-demand imbalance could drive natural gas back to its 2009 lows in the near-term, but a rebound to much higher prices is very likely. The current cash cost of production is north of $6. And in relative terms, natural gas should be your energy commodity of choice. Chart 2 shows that natural gas is currently a steal versus oil. Oil and natural gas prices can diverge for short to intermediate periods of time, but over long periods, consumers and businesses will change their behavior to favor the cheaper fuel.

Chart 3 shows that natural gas is also cheap versus coal. With a new friend in the White House, the “Environmental Industrial Complex” (you saw it here first) is pushing hard for a cap and trade bill. Gas is cleaner than coal and it emits less carbon. Gas should trade at a premium to coal in a carbon-regulated economy.

Chart 4 shows gas in terms of the only true hard currency, gold. Natural gas is on its back versus gold.

Jeremy Jones, CFA
Chief Investment Officer

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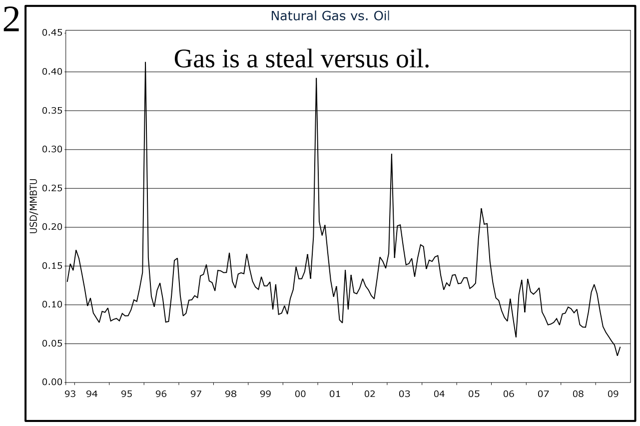

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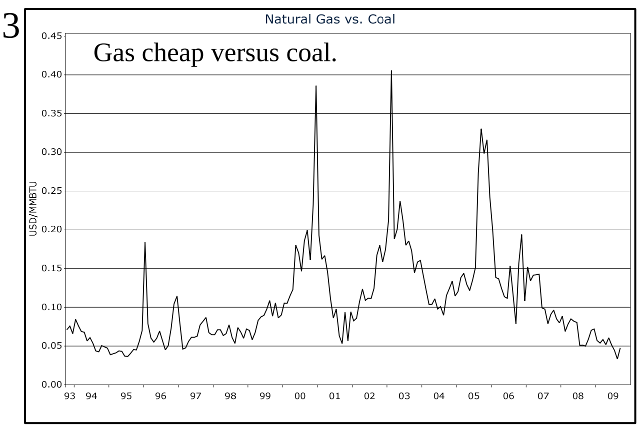

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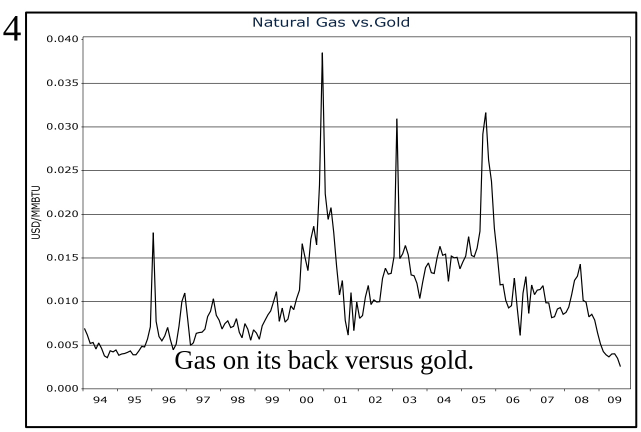
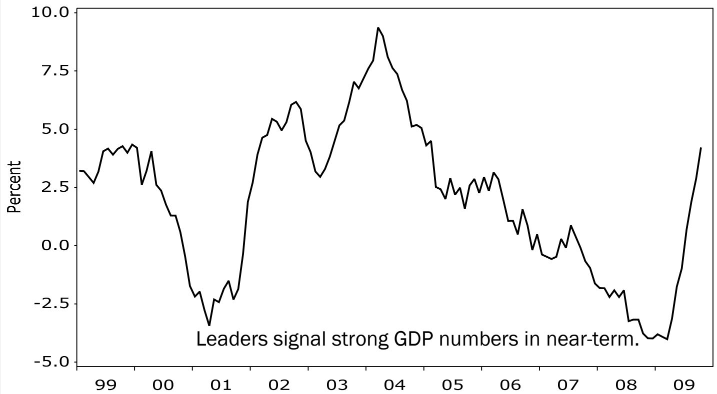
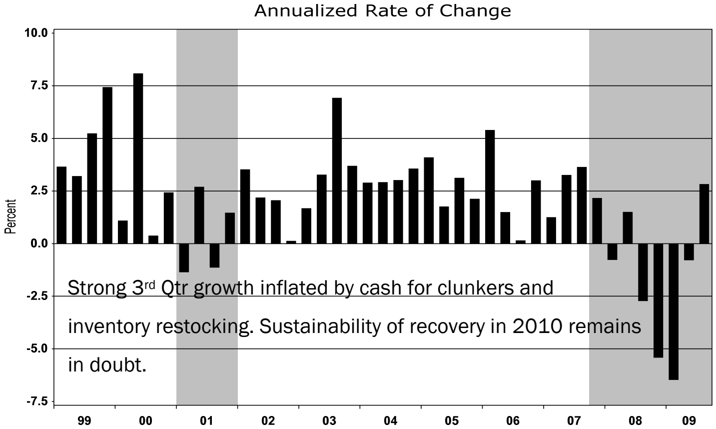


Composite Index of 10 Leading Indicators
Year-to-Year Rate of Change

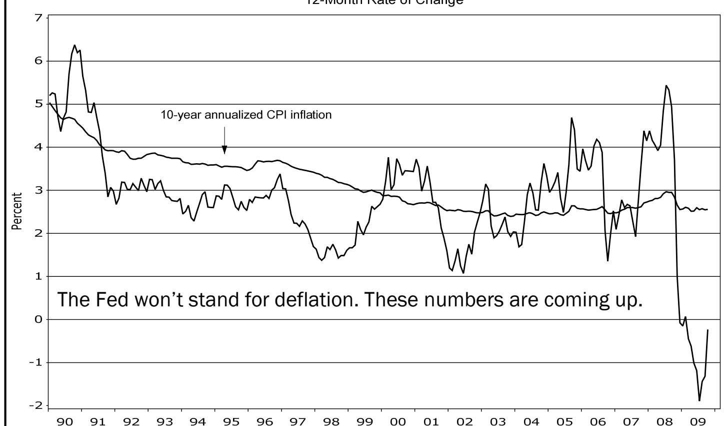


Gold Spot

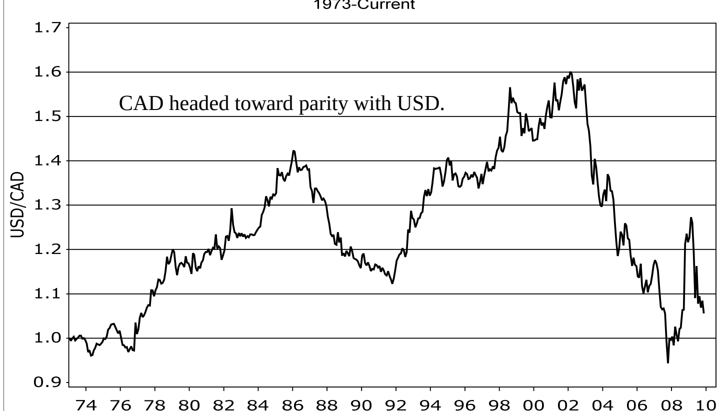
Gross Domestic Product
Annualized Rate of Change



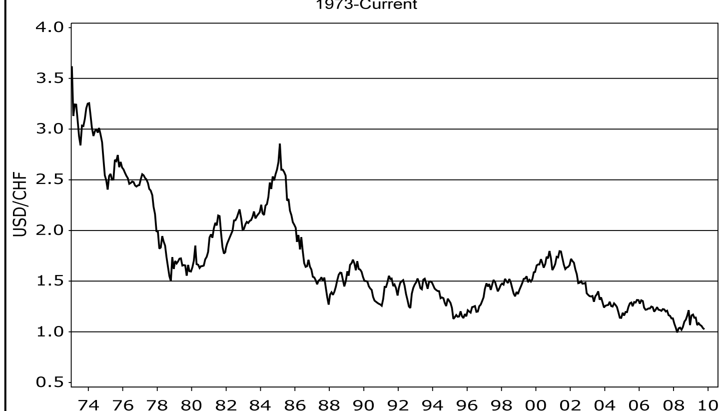
Consumer Prices
12-Month Rate of Change



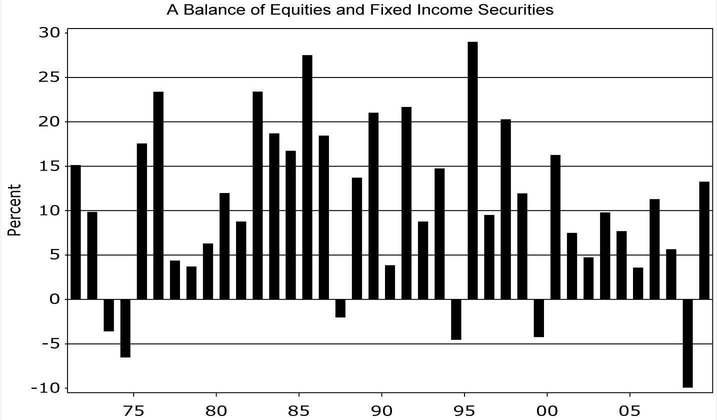
Number of Canadian Dollars One U.S. Dollar Buys
1973-Current



Number of Swiss Francs One U.S. Dollar Buys
1973-Current



Vanguard Wellesley Income Fund Annual Returns
A Balance of Equities and Fixed Income Securities



Risk
Dividend Payers vs. Non-Dividend Payers
(Standard Deviation over 36-month period ending 12/31/08)