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BRIDGEPORT
ASSET MANAGEMENT INC.

# Q4 2010
# Investment Commentary

Recently, BusinessWeek Magazine published an excerpt from an article entitled "The Long Haul: The U.S. Economy." We have reprinted part of the article here:

*"If America's economic landscape seems suddenly alien and hostile to many citizens, there is good reason: they have never seen anything like it. Nothing in memory has prepared consumers for such turbulent, epochal change, the sort of upheaval that happens once in 50 years. That may explain why so many voter polls, taken as the economy shudders toward the November election, reveal such ragged emotional edges, so much fear and misgiving. Even the economists do not have a name for the present condition, though one has described it as "suspended animation" and "never-never land."*

*The outward sign of the change is an economy that stubbornly refuses to recover from the ... recession. In a normal rebound, Americans would be witnessing a flurry of hiring, new investment and lending, and buoyant growth. But the U.S. economy remains almost comatose a full year and a half after the recession officially ended. Unemployment is still high; real wages are declining. At a TIME economic forum last week, forecasters predicted that U.S. growth would amount to only 1.8% this year..., about half the speed of a normal recovery. The current slump already ranks as the longest period of sustained weakness since the Great Depression.*

*That was the last time the economy staggered under as many "structural" burdens, as opposed to the familiar "cyclical" problems that create temporary recessions once or twice a decade. The structural faults, many of them legacies of the 1980s, represent once-in-a-lifetime dislocations that will take years to work out. Among them: the job drought, the debt hangover,...the real estate depression, the health-care cost explosion and the runaway federal deficit. "This is a sick economy that won't respond to traditional remedies," said Norman Robertson, chief economist at Pittsburgh's Mellon Bank. "There's going to be a lot of trauma before it's over."*

As it applies to the situation in the U.S. today, the thrust of the article is not surprising given the prevailing negative view of the U.S. economy.

What is interesting about the article though is that it was not written this past October before the midterm US elections as you may have presumed. Nor was it written anytime in the last decade.

The article was published by TIME magazine in September 1992, although it could just have easily been published at several other times over the last century.

On September 28, 1992 when the article was written, the Dow Jones Industrial Average stood at 3,276. Three years later, the Dow had increased by almost 80% despite the doom and gloom offered up by the media back in 1992.

By December 31, 2010, the Dow had increased over threefold to 11,577 from the time of the article and this growth includes the dramatic declines in the stock market in 2008 and early 2009.

The magazine excerpt is interesting because it illustrates (i) how the media repeatedly manufactures hysteria (either creating irrational exuberance or excessive pessimism) and (ii) the importance for investors of staying focused and not succumbing to extreme views of the future.

Since the Great Recession of 2008-2009, the media has convinced many investors of the merits of trying to "time the stock market." Investors are preoccupied with the idea of trying to figure out when to invest their money in the stock market and when to pull it all out. Not surprising, this strategy has produced disastrous results with many retail investors selling at the bottom and missing out on much of the recent rally.

Predicting the overall ups and downs of the stock market is extremely difficult. First, the market is highly volatile on a daily basis such that even missing a few days worth of investment returns can diminish long term portfolio results considerably as shown in the following analysis:

Source: Capital IQ

If an individual had invested $10,000 in the S&P 500 in 1990 and remained continually invested until the end of 2010, their portfolio would have been worth over $54,000. But if an investor missed even the best five days worth of returns over that 21 year period, their $10,000 investment would have been worth only $36,322. Missing the best 50 days over the same 21 year period would have resulted in the same $10,000 portfolio being worth only $5,505 at the end of 2010.

It also interesting to examine the degree of variability in annual stock market returns (as opposed to daily returns) as indicated in the chart on the last page of this letter. While long term annual returns from the stock market have averaged 8% to 10%, this is just an average return which obscures the great variability which exists between returns earned each year. Actual annual returns from the S&P 500 between 1924 and 2010 have been all over the map, with annual returns between 5% and 10% occurring in only eight of the past 87 years!

The stock market exhibited a similar degree of volatility throughout 2010, although patience was ultimately rewarded as a strong rally in December resulted in solid gains for the year.

Our investment approach at Bridgeport remains focused on investing in attractively priced stocks and bonds issued by companies with stable business models and solid results, as opposed to trying to time the overall market.

This does not mean, however, that we just buy individual securities and hold them forever. Nor does it mean that we will invest for the sake of investing if we cannot find attractively priced opportunities (in this case, we will temporarily hold cash).

An example of this discipline was our sale of common shares of J2 Global Communications at the end of 2010. The company had recently announced an acquisition, causing its share price to rise sharply. Because our financial analysis suggested that the shares had become overvalued relative to J2's future earnings stream and certain risks related to its business, we decided sell our position in the company and lock in a profit.

For our income oriented portfolios, we purchased several new high yield bonds and dividend- paying equities during the quarter which we expect will generate a steady stream of income going forward. We are particularly optimistic now about the potential for superior returns from both US bonds and equities given the high value of the Canadian dollar and the attractiveness of yields in the US relative to Canada.

We invite you to call us at any time if you wish to chat more about our investment approach or should you have any questions.

Yours truly,

John Fisher

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