



TEALWOOD E-DIGEST

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NAVIGATING THE OBSTACLES — *ASSESSING THE IMPACT OF THE EARTHQUAKE, UNREST IN THE MIDDLE EAST, AND AFTERSHOCKS FROM BOTH*

Financial markets opened down sharply this morning and we feel the need to check in with an update in light of the complicated news events that have impacted stocks and bonds.

Before we weigh in on the financial implications of the Japanese earthquake and its multiple complications, let us first say that we feel for the people of Japan in this moment of tragedy. While natural disasters leave a trail of heartbreak, we know from their historical example that the people of Japan have a remarkable capacity for resilience. We expect that their abilities for hope and recovery will serve them well in this crisis.

Many investors are still hurting from the pains of the recession and financial crisis and layering these complications on this budding recovery feels like salt applied to an open wound. As directly as we can say it, here is what we think:

Q: Will events ranging from Japan to the Middle East drag us back into recession?

A: No

Q: Will these events have a “dampening” effect on the global economy?

A: Yes

Q: From an investment perspective, how do we adjust for the changes being thrust upon us?

A: *In this environment, it becomes dramatically more important to be selective about what you own; these developments favor stock and bond pickers over market investors.*

THE GLOBAL ECONOMY

We believe these complicated events will marginally slow the rate of economic expansion, but not return us to a period of economic contraction. Thinking in terms of the impact on profits, the current consensus earnings estimate for the S&P 500 Index for 2011 is \$96 (which represents all time record profits for the index!). In the interest of risk management, let’s make a “margin of safety” assumption that this estimate comes down to \$90.

VALUATION AND THINKING A YEAR AHEAD

On a historical basis, the S&P 500 Index has traded at an average multiple of 16.4X the trailing 12 month earnings. If this market were to conform to that average, that would project to 1476 for the Index on the adjusted \$90 earnings assumption. This would represent an advance of about 200 points or an increase of over 15% from today's close of 1275.

If we haircut the valuation assumption down to 15X trailing 12 months to adjust for a period of risk and uncertainty, then that projection works out to about 1350 on the index or an increase of about 5.9%. In calendar 2010, the S&P 500 Index traded in a valuation range of 13X to 15X 2010 estimates.

If we were to repeat the valuation range from last year, that would take us from a low end of 1248 to a high end of 1440 (on the \$96 earnings forecast), a range that projects to a 2011 performance of -2% to +13%. Using the "haircut" \$90 estimate, that range projects from 1170 to 1350, from here those numbers work out to -8% to +6%. Not the most exciting of results, but by no means the stuff of another collapse.

VOLATILITY ALONG THE WAY

This **"thinking a year ahead" perspective** does NOTHING to lessen volatility along the way. The acquired wisdom of decades of experience is that getting there is half the pain. If you seek a predictable path, invest in the bonds of our *Defensive Fixed Income Portfolio*. Otherwise, even when the outcome is constructive, the route is RARELY predictable. There is a Warren Buffett quote that goes like this, **"At Berkshire, we prefer a wiggly 12% to a linear 5%."** We think the year ahead will resemble something close to that example, and we are invested to capture a wiggly reward.

SELECTIVITY, SELECTIVITY, SELECTIVITY

Tealwood portfolios are differentiated from the market. We are not trying to capture a market rate of return; we are working to add value by being very choosy about valuation, quality and opportunity. In this environment, for both stocks and bonds, we love the advantage of being able to differentiate. **As has been the case over the last two years in this impatient, tactical, anxious atmosphere, we believe the reward conferred to patient, strategic investors will continue to be meaningful.**

HUMILITY AND THE CRAFT OF INVESTING

All this "navigating the obstacles" can be very humbling. At the beginning of the year we could have easily provided you with a list of our top ten concerns, and we can assure you that neither popular uprisings against Middle Eastern dictators with oil supply implications or the fallout from an earthquake in Japan, would have made our list. **It is ALWAYS dynamic:** We have not set a permanent course; we are navigating the obstacles as we see them. We want you to know we will stay alert to changes and will adjust accordingly. Ongoing vigilance to a dynamic world is our charge. There is never a scarcity of humbling events in our business.

It is very important to us to communicate with you. Please know we are thinking of you through these developments and invite you to contact us with any questions you may have.