January 15, 2011

Dear Client:

Along with an improved macroeconomic picture worldwide, the global market ended 2010 with a strong push forward in the fourth quarter, ending the year with a double-digit gain. What a strong contrast from investors' sullen sentiments just six months earlier.

Hopefully, we all have learned a few lessons from the Great Recession which can help us avoid similar mistakes in the future. From an investment viewpoint, markets proved not to be as efficient as many previously believed (a good reason to favor active over passive investment). Growth rates of economies and markets tend to move towards the mean (in this respect, a contrarian investment approach often leads to better long-term results). Finally, long-term investors who do their homework typically produce better risk-adjusted returns than short-term speculators. From our own viewpoint, we have reaffirmed how important good communication is with our clients in the midst of difficult markets.

During 2007 and early 2008, many investors blindly jumped into the emerging markets, commodities, and real estate, while we continued to focus on fundamentally solid companies with high earnings visibility. At the time, we seemed to be in the minority and some clients questioned our approach. We believed that these asset classes were historically cyclical, unpredictable, volatile and could be prone to extreme price inflation.

In early 2009, before the markets turned around, and again in mid-2010, when many investors were concerned about a potential double-dip, we had clients who wanted to liquidate their portfolios and we made dramatic changes to our portfolios. Admittedly, we acted more timidly than we otherwise would have as we were being sensitive to our client's reception to some of our contrarian moves.

This current cycle confirms our firm belief in long-term investment in high quality companies with high earnings visibility, sustainable above-average growth, no or little debt, and ability to generate strong cash flows.

Over the past five, ten, twenty and thirty year periods, the world economy has consistently grown approximately 3.5% compounded annually. While advanced economies have grown 2.6%, emerging economies have grown 4.5%. Looking forward, the International Monetary Fund has projected 2.5%, 6.6% and 4.5% growth,

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respectively, for these categories for the coming five years. Emerging economies, as a group, could grow 2.5 to 3 times faster than the advanced economies. Furthermore, emerging economies account for 47.6% of the gross world product in 2010, up from 30.9% in 1980, and could grow to 52.5% in the next five years. The importance of emerging markets should not be ignored.

As such, there should be little doubt that investors want to benefit from the secular trend of emerging markets' strong growth. Many have been buying into this theme for a decade or two. However, few have found a comfortable and consistently successful way to invest in the emerging markets, not to mention the right asset allocation. Unfortunately, many investors randomly chose Exchange-Traded Funds (ETF's) without knowing what the composites represent nor how they work, or rush into investments being touted by their favorite "television" investment analyst. ETF's can be a very effective investment tool when used properly.

Policy risk is often a big factor in emerging markets. Accordingly, country selection is a very important factor with respect to successful investing in emerging markets. Passive investment through ETF's should be an option when considering these markets. In our opinion, however, investment in top-quality global companies offers the better option.

Typically, as emerging markets mature, their consumption power strengthens. These consumers are generally brand-conscious, which should have a positive impact on global companies in the Western Hemisphere. This trend will benefit those top-quality multinational corporations where a growing portion of sales comes from emerging economies.

Many of these companies have been developing their businesses in these emerging markets for decades. They have learned to build solid business models to succeed in different social and regulatory environments. They know local economies much better than most of us do. For example, Caterpillar, the largest heavy equipment manufacturer in the world, is well-positioned to benefit from emerging demand for new infrastructure in emerging markets. Approximately 70% of Caterpillar's sales come from outside the U.S.

Another example is Nike. As one of the world's most widely recognized brands, Nike wields significant pricing power. The firm has established a solid foundation in key markets across Africa, China, Latin America, Eastern Europe, and the Middle East. Nike's overseas sales accounted for approximately 58% of its total revenues in 2010 and continue to expand quickly. Other world famous brands in our portfolios include Disney, PepsiCo, American Express, Google, etc.

Last but not least, the valuations of many emerging markets have already outrun those of developed markets. Today, many – though not all – multinational companies offer better value than their rivals in emerging markets.

We are often asked the best way to invest in China and similar markets. In response, we typically question the person's risk tolerance and express a number of our concerns regarding investment in China. China remains a dictatorship versus a democracy; its economic data is not fully transparent; most of the largest Chinese companies are state-owned; and the central bank is controlled by the Communist Party, just to name a few concerns. Being Chinese, I understand the risk better than many and believe that we should not ignore the investment opportunities in China. However, I also fully understand the need to do our homework rather than get hyped on the headline news or exaggerated investment analysis.

Fixed Income

Treasury yields on longer maturities have risen quickly in recent weeks in response to higher inflation expectations, recovering economic growth and the Fed's abundant purchase of Treasuries. In many ways, this is a good sign as investors show their confidence in the economic development. The question is, how long will the bull market for bonds continue?

From a longer-term viewpoint, the yields for the 10-year Treasuries have slid for three decades (see the Chart 1 below). Fortunately, there is little room for yields to continue to slide. As such, common sense dictates that yields should rise or could remain low for the immediate future. In other words, with extremely low yields and potential capital loss, the bond market is not currently attractive.

Chart 1. 10-Year U.S. Treasury Yield

Source: Federal Reserve Bank

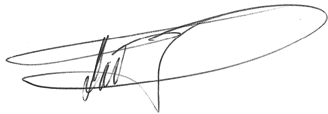
From a short-term viewpoint, if there is a strong economic recovery in the U.S., there is pressure on inflation, and thus yields, to rise. However, this is a big "if." If the economy remains sluggish, the Fed may continue to keep the yields "artificially" low.

From either a long-term or short-term angle, the bond market is not very attractive. Although the yields have risen recently, it may only help lessen the pressure for a short time period. As long-term investors, we favor equities more than bonds.

One final point. Our focus is and will continue to be on research and service. Consequently, we spend less time and resources on sales and marketing and instead rely on referrals from our clients and friends. In fact, one measurement of our success is retention ratio and number of referrals. If you are satisfied with us, please consider telling your friends. As always, we appreciate your feedback and encourage you to contact us should you have any questions.

Wishing you and yours a happy, healthy and prosperous 2011!

Sincerely,



Joseph Lai, CFA
Chief Investment Officer

Our most recent Form ADV, Part II is available upon request