

BRADY INVESTMENT COUNSEL LLC

# CORE GROWTH STRATEGY

2009 REVIEW AND 2010 OUTLOOK

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## **MARKET AND LARGE CAP GROWTH STRATEGY REVIEW**

Adopting judicious confidence, investors bid equities higher in 2009. By year end, the U.S. market would trade at only a slight discount to fair value. This contrasted sharply with the deeply discounted environment that existed at the start of the year. The S&P 500 Index gained 26.5% in 2009. The advance was broad, with all 10 S&P sectors recording an increase. The Russell 1000 Growth Index, our investment style benchmark, moved ahead an even more impressive 37.2%.

We attribute the market recovery to renewed faith in the global financial system. Strong support from governments and central banks around the globe gave investors assurance that banks could and would recapitalize on a low-cost, low-risk basis. In this environment, the Brady Investment Counsel Core Growth Equity Strategy (Core Growth) increased 37.3% after fees and trading expenses.

Core Growth's performance was driven by Consumer Discretionary and Information Technology stocks. Williams-Sonoma (WSM - \$21) and NetApp (NTAP - \$34) were our biggest money makers recording increases of 170% and 146%, respectively. Xyratex, Ltd. (XRTX - \$13) was the top percentage gainer, advancing an eye-popping 350%.

The year began with many once-in-a-career investment opportunities. Xyratex was an outstanding example. Back then, the shares were trading at a 40% discount to net cash value and three times our normalized forward earnings estimate. The market eventually recognized the XRTX's deep discount and the shares advanced well ahead.

Detracting from Core Growth's results were Financial Services and Materials stocks. Private Bank (PVTB-\$9) hurt results the most. PVTB's third quarter operating results, along with a surprise equity offering, caught the market off guard late in 2009. The additional shares, along with investor fears concerning the company's growth strategy, combined to cause the shares to weaken.

## **TRADING**

The Health Care and Consumer Staples sectors underperformed the market in 2009. However, the relative correction of these two areas provided many attractive buying opportunities. New Health Care investments were made in Abbott Labs (ABT-\$54) and Gilead Sciences (GILD-\$43). PepsiCo (PEP-\$61) and Clorox (CLX-\$61) were added to our Consumer Staples holdings. In our view, all four companies are well managed and have demonstrated impressive growth. Three of the four stocks currently have a dividend yield greater than 3%.

Consumer Discretionary sector holdings were scaled back or sold after making impressive gains in 2009. Eliminated were Harley-Davidson (HOG-\$25) and J.W. Nordstrom (JWN-\$38). Our Williams-Sonoma position was reduced as the reward/risk equation for holding a large position

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changed dramatically. WSM shares experienced rapid appreciation in 2009 while company fundamentals held stable. According to our analysis, Williams-Sonoma expected total return –or reward for investing - over the next three years was 50%. By comparing the reward for investing to the risk of owning shares of a retailer in a U.S. economy with the potential for a continuing 10% unemployment rate, we felt the sensible course was to realize enough profit to fully recover our investment cost.

We sold Private Bank late in the year to recognize a capital loss for 2009 tax purposes. No doubt our long-term view of the company was dented after the second equity offering. However, our conviction remains in PVTB's people and the company's large market opportunity. We added the position back to the portfolio after the 30-day Wash Sale Rule waiting period passed early in 2010.

## **OUTLOOK**

We are optimistic as we begin 2010 and expect the market to move higher over our three-five year investment horizon. We forecast the S&P 500 will reach the 1,200 level by year end, up from 1,115 at the start of the year. Our three-to five year projection is 1,530. The market's current dividend yield is 2%. The fact that the market offers record low dividend payout ratio relative to normalized earnings gives us hope that investors will be awarded above average income growth along with solid capital appreciation over the long run.

The U.S. economy has already demonstrated one impressive sign of recovery with fourth quarter GDP advancing a surprise 5.7%. Solid economic growth should continue at least through 2010's first few quarters. Better investment spending will be the catalyst. Housing is close to bottom and inventory de-stocking appears to have gone as far as it can. Our Technology sector contacts tell us that Chinese are ready to build inventories, which would also bolster exports. Further supporting our view on the economy are low interest rates, which certainly make investment that much more attractive at the margin. Finally, lenders we survey are actually talking about making loans again in 2010! New lending on productive investment is the cornerstone of a solid recovery.

Unfortunately we do not expect much from the consumer, at least in the early part of 2010. Do not discount this point, either. Consumer spending accounts 70% of economic activity. The consumer must be confident and spending for the 'things are less bad' expansion to continue much past the third quarter.

Positively, non-farm productivity continues to be impressive growing at an 8.1% annual rate in the third quarter of 2009. Productivity is a necessary ingredient for a sustainable recovery. We expect the most productive companies will hire workers in 2010. Keep an eye on temporary hiring too. Temps will likely be engaged until confidence exists to create permanent jobs. Hiring of any kind means improved employment though. Better employment will lift confidence, afford consumer spending and buttress the recovery's duration.

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There are risks to our optimism especially over the short run. The world has been a flooded with monetary stimulus. Fortunately banks didn't lend; instead, they hoarded capital. By not lending, banks limited money supply growth and put a lid on inflation. This has changed. Today banks and other financials are ready and willing to selectively make good loans. Releasing the monetary stimulus into the economy creates a real inflation threat.

We would prefer the Fed raise rates sooner than later. Zero percent short-term interest rates were necessary for banks to build balance sheets in 2009. The no-risk/capital-building arbitrage afforded to financials by the Fed is too generous at this point in the economic cycle. In fact, with GDP increasing 5.7%, we think the Fed's actions to rebuild the financial sector and avoid deflation appear extraordinary and misplaced.

Asset bubbles are already developing. Emerging equity markets, U.S. government bonds and certain commodities like gold and oil are a short list of examples. We have noticed examples of less traditional investments like fine art doing crazy things as well. A word to the wise on investing in bubbles: Use caution if heavily allocated to overbought markets. One thing is certain, bubble markets do not like rising rates, which are inevitable.

As always, there will be surprises throughout the year. The first has already occurred. In January 2010, the Obama administration proposed a double-barreled attack on financial companies. To us, taxing profits and limiting their trading activity seems an odd exercise given the efforts to prop up financials over the past two years. However, we are not politicians. We are investors. Therefore, you can count on us to remain focused on successfully executing our investment process with the ambition of achieving superior long-term risk-adjusted returns for our clients.

Please call with your questions and comments.

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## CORE GROWTH STRATEGY

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### PORTFOLIO STATISTICS AND ATTRIBUTES

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#### GENERAL INFORMATION

MINIMUM ACCOUNT SIZE	\$2,000,000
Standard Management Fee	50 basis points
Equity Holdings	35-45
Target Portfolio Turnover	10%-30%
Current Yield	1.5%
BIC LLC Inception	March 20, 2003
Strategy Inception	September 30, 1994

**Investment Manager:** David P. Brady, CFA, developed and manages the Brady Investment Counsel LLC Core Growth Strategy (Core Growth). Prior to founding Brady Investment Counsel LLC, Mr. Brady was lead portfolio manager of the Stein Roe Young Investor Fund (Young Investor Fund) from September 1994 through March 2003. Mr. Brady employs substantially the same investment philosophy and strategy to manage the Core Growth Strategy as he did to manage the Young Investor Fund.

**Investment Performance:** Our investment performance has been recognized as superior by leading sources. Between September 1994 and December 2003 the Core Growth Strategy was used to guide the Stein Roe Young Investor Fund. During that period the fund performed in the 16<sup>th</sup> percentile of the Morningstar large cap growth peer group. In addition, MONEY magazine recognized the Young Investor Fund as a MONEY 100 Fund for five consecutive years ending 2002, Mr. Brady's last full year as lead manager. The award recognized MONEY's Top 100 mutual funds in America.

More recently, Informa Investment Solutions (IIS) has recognized our investment performance as Top Gun for being among the top 10 leaders in their large cap growth universe. Since founding Brady Investment Counsel LLC in 2003, our Core Growth Strategy has received three IIS Top Gun awards: For the three-month period ending September 30,

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2009; the three-year period ending and December 31, 2006 and the three-month period, ending December 31, 2006.

The Core Growth portfolio holds equity positions in 35-45 companies or exchange traded funds (ETFs). Our investment turnover ranges between 10%-30% in a typical year. Historically, our investment approach has worked well in achieving our goal of delivering superior long-term investment results. The table below demonstrates we have outperformed the market 77% of the time as measured on a net/net, rolling monthly five-year basis and 100% of the time on a rolling monthly 10-year basis.

## **BATTING AVERAGE**

<b>Rolling Monthly Net/Net Returns</b>				
<b>(% Periods of Brady Outperformance)</b>				
<b>Brady Core Growth</b>	<b><u>1-Year</u></b>	<b><u>3-year</u></b>	<b><u>5-Year</u></b>	<b><u>10-Year</u></b>
Vs. S&P 500	57%	64%	77%	100%
Vs. Russell 1000 Growth	60%	67%	83%	100%

## **PORTFOLIO CHARACTERISTIC (AS OF 12/31/2009)**

<b>\$ IN BILLIONS</b>	<b>BRADY CORE</b>	<b>S&amp;P 500</b>	<b>RUS. 1K GR.</b>
Number of Holdings	41	500	620
Median Market Capitalization	\$11.3	\$8.6	\$4.5
Largest Co's Market Cap -	\$272	\$324	332.7
Smallest Co's Market Cap -	\$0.40	1.06	NA
P/E Multiple			
Trailing – '09	20X	20X	20X
Forward – '10	17	15	16
EPS Growth Rate – Annual			
'10 Forecast vs. 3-yr Avg.	24%	4%	NA
Forward 5-Yr.	13%	8%	12%

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## AVERAGE ANNUAL TOTAL RETURN (%)

Ending 12/31/2009	<u>1-Yr</u>	<u>3-Yr</u>	<u>5-Yr</u>	<u>10-Yr</u>	<u>INCEPTION</u>	
					<b>BIC LLC</b> 03/31/2003	<b>Strategy</b> 09/30/1994
Core Growth, Gross	37.8%	-2.5%	2.6%	1.4%	11.8%	10.6%
Core Growth, Net	37.3	-3.0	2.1	0.9	11.3	10.1
S&P 500	26.5	-5.8	0.3	-1.0	6.2	7.9
Russell 1000 Growth	37.2	-1.9	1.6	-4.0	6.3	6.8

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## COMPOSITE AUDIT

(ANNUAL RETURNS EXCEPT 03/31/2003-12/31/2003) AS OF DECEMBER 31, 2009							
YEAR	GROSS- OF-FEES RETURN (%)	NET-OF- FEES RETURN (%)	S&P 500 INDEX (%)	RUSSELL 1000 GROWTH INDEX (%)	NUMBER OF PORTFOLIOS	TOTAL COMPOSITE ASSETS (\$000)	PERCENT FIRM ASSETS
2009	37.8	37.3	25.8	37.2	4	1,982	19%
2008	-34.1	-34.6	-37.0	-38.4	3	988	11
2007	2.0	1.5	5.5	11.8	2	1,041	17
2006	18.1	17.6	15.8	9.1	2	1,026	14
2005	4.0	3.5	4.9	5.3	2	880	15
2004	22.3	21.8	10.9	6.3	2	735	14
03/2003- 12/2003	52.7	52.4	32.9	31.2	1	313	7
09/1994- 03/2003	9.74	9.24	9.26	7.20	1	680,000	NA

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## SECTOR DIVERSIFICATION

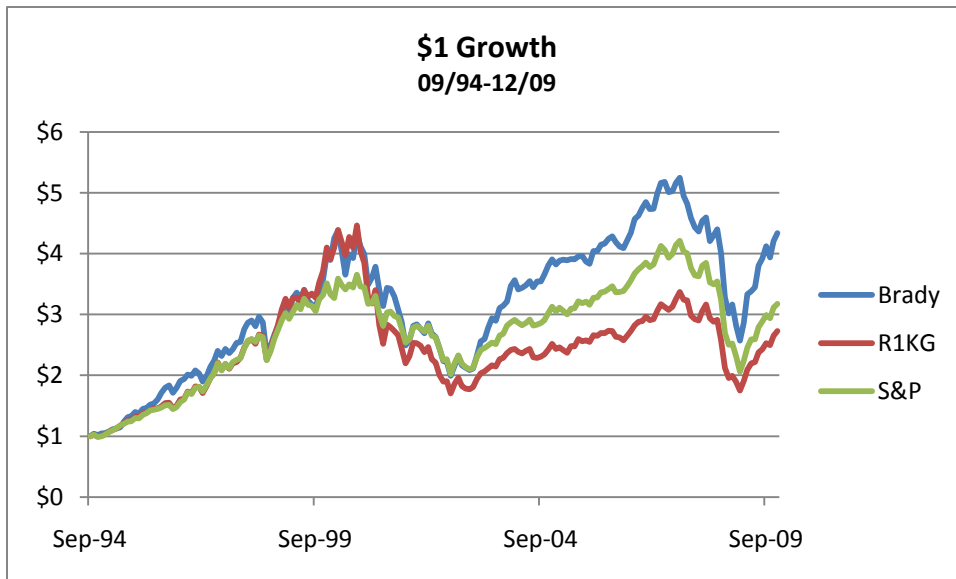
	INVESTMENT STRATEGY	MARKET BENCHMARK	STYLE BENCHMARK
% AS OF 12/31/2009	BRADY CORE GROWTH	S&P 500	RUSSELL 1000 GROWTH (9/30/2009)
CONSUMER DISCRETIONARY	14.6	9.0	10.3
CONSUMER STAPLES	13.0	11.7	16.1
ENERGY	4.7	11.2	4.2
FINANCIALS	5.4	15.4	5.1
HEALTH CARE	18.0	13.4	16.8
INDUSTRIALS	10.8	9.9	10.1
INFO. TECHNOLOGY	23.2	19.0	31.7
MATERIALS	3.5	3.4	4.0
TELECOMMUNICATIONS	0.0	3.1	0.6
UTILITIES	3.0	3.8	1.0
OTHER	2.4	0.0	0.0
CASH	1.2	0.0	0.0

## TEN LARGEST HOLDINGS (12/31/2009)

	SECTOR	% INVESTED ASSETS
Cisco Systems, Inc.	Info. Technology	3.1
Gilead Sciences, Inc.	Health Care	3.0
Excelon Corp.	Utilities	3.0
Pepsico, Inc.	Consumer Staples	3.0
Abbott Laboratories	Health Care	3.0
Paychex, Inc.	Info. Technology	3.0
Amgen, Inc.	Health Care	3.0
Walgreen Co.	Consumer Staples	3.0
Medtronic, Inc.	Health Care	3.0
Stericycle, Inc.	Info. Technology	3.0

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## HYPOTHETICAL INVESTMENT GROWTH



### Additional Product Information, Disclosures and Compliance Statement:

Brady Investment Counsel LLC has presented this report in compliance with the Performance Presentation Standards of the CFA Institute (formerly AIMR), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS®). The CFA Institute has not been involved in the preparation or review of this report. Performance prior to March 31, 2003 is of The Stein Roe Young Investor Fund (the Fund). The Fund's past performance has been linked to the Core Growth Composite performance for supplemental evaluation purposes only. Linking returns is not GIPS compliant. Mr. Brady was lead manager of the Fund from September 1994 to March 2003. He employs substantially the same investment strategy managing the Brady Investment Counsel LLC Core Growth Composite as he did managing the Fund. The Stein Roe Young Investor Fund data were provided to Brady Investment Counsel LLC by Columbia Management Group, the Fund's advisor. Brady Investment Counsel does not warranty their accuracy.

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Brady Investment Counsel LLC Core Growth Composite performance represents time-weighted rates of return for a dollar-weighted composite of that portion of all fully discretionary taxable and tax-exempt accounts managed in accordance with the Firm's Core Growth large cap growth equity strategy whether focused or diverse. Accounts greater than \$200,000 are eligible for inclusion. Performance is calculated monthly in U.S. dollars on a total return basis. Composite Creation Date: March 31, 2003. Gross returns are time-weighted; include cash and a return on cash, and after deducting trading expenses. Net returns are gross returns after deducting our maximum 0.50% (fifty basis points) management fee accrued monthly. Carve-out portfolios were eliminated from the Composite beginning March 31, 2008.

Prior to March 2003, the Core Growth gross returns are linked to the investment returns before management fees but after certain expenses of the Stein Roe Young Investor Fund (the Fund). The Core Growth net investment results are linked to The Fund's net returns after deducting the maximum Brady Investment Counsel management fee of 0.50%. David P. Brady was the lead manager of the Fund between September 1994 and March 2003. Mr. Brady employs substantially the same investment strategy of buying high quality growth stocks at a market price below their intrinsic value managing the Firm's Core Growth Strategy as he did while managing the Fund. The Fund's investment returns are given as supplemental information only. The Fund performance numbers were provided to Brady Investment Counsel LLC by Columbia Management Group, the Fund's advisor. Brady Investment Counsel does not guarantee their accuracy.

The Russell 1000® Growth Index is a subset of those Russell 1000® Index securities with a greater-than-average growth orientation. Companies included in the Index tend to have higher price-to-book and price-earnings ratios, lower dividend yields and higher forecasted growth than value securities. The index is unmanaged and does not hold cash, reflect transaction costs or management fees and other expenses. Unlike the index, a portfolio is actively managed and may include substantially fewer securities than the number of securities comprising the index. Investors cannot purchase interests directly in an index.

The S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the US economy. Unlike a portfolio, the S&P 500 Index is market-weighted and focuses on the large-cap segment of the market. Returns reflect the reinvestment of dividends. The index is unmanaged and does not hold cash, reflect transaction costs or management fees and other expenses. Unlike the index, a portfolio is actively managed and may include substantially fewer securities than the number of securities comprising the index. Investors cannot purchase interests directly in an index.

**Past performance is not indicative of future returns. Past GIPS Compliance does not guarantee future compliance.** Contact Brady Investment Counsel LLC for their up-to-

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date opinion on Brady Investment Counsel Core Growth Composite GIPS Compliance. The value of an investment may decrease as well as increase, an investor may not receive the amount initially invested, and income, if any, may fluctuate. The value of an investment may be affected by a variety of factors, including economic and political developments, interest rates and foreign exchange rates, as well as issuer-specific events. Performance records of any accounts and composites presented herein reflect the particular guidelines, cash flows and timing considerations applicable to that account or group of accounts. Careful consideration should be given to the potential differences between any account opened in consideration of the information contained in this presentation and the results of any accounts shown herein. Tracking and calculating investment performance is cumbersome and inexact. Brady Investment Counsel puts forth its best effort when calculating performance. This notwithstanding, unintentional mistakes can be and are made. Brady Investment Counsel LLC reserves the right to change previously reported performance numbers without notification and free from liability should the firm discover a computational inaccuracy that leads to a change or changes in previously reported performance. Contact Brady Investment Counsel for the firm's most up to date investment performance data.

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