

BRADY INVESTMENT COUNSEL LLC

# CORE GROWTH STRATEGY

2010 REVIEW AND 2011 OUTLOOK

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## MARKET AND LARGE CAP GROWTH STRATEGY REVIEW

The Brady Investment Counsel LLC Core Growth equity investment strategy gained 15.5% in 2010. We performed slightly ahead of the 15.0 % advance made by the S&P 500 Equity Index and trailed the Russell 1000 Growth Index's 16.7% gain.

The S&P 500 is our long-term, market performance benchmark and the Russell 1000 Growth Index is our investment style benchmark. Our long-term objective is to outperform the market as measured by the S&P 500. Our investment style benchmark is there to give us clues as to how we are doing over the short run.

The difference between Core Growth's 2010 performance and the style benchmark Russell 1000 Growth index was primarily a function of market capitalization. Even though the Russell 1000 Growth is employed by most all large cap growth managers as their style benchmark, the index typically contains a percentage of small and mid-cap companies.

In 2010, small caps significantly outperformed large caps. For example the Russell Top 50 Index, which measures the performance of the 50 mega cap companies, gained 9.5% in 2010. Solid but it becomes meager quickly when compared to the 27% advance made by the small cap, Russell 2000 Index. Small caps outperforming large is nothing new. In fact, over the past 10 years small caps have increased at a 6.3% annual rate versus a -0.5% average annual decline for large caps. There is nothing inherent to the diversion between large and small returns. The primary reason it happened over the past 10 years is large caps were extremely overvalued in 2000, trading at 2X our fair value estimate back then. For those who can remember 10 years ago the stock market was near the peak of the dot.com bubble. Because of the frenzied interest to own all things Internet, trader demand drove publically traded company share prices to altitudinous levels. Tech and telecom companies, that dominated large cap indexes weightings back then, experienced share price gains to an extreme where a long and protracted correction was inevitable.

Our current view is the large cap correction versus small caps is over. In fact, we will go so far as to label the domestic large cap growth space the single most attractive for the best long-term, risk-adjusted return potential. The large cap growth sector is to seriously under appreciated by the market. In December 2010 for example large growth caps mutual funds experienced \$4.2 billion in outflows while small cap growth funds realized \$750 million in inflows. It is almost as if holders can't sell large caps fast enough. Demand for small caps shows up clearly in the valuation differential between small and large caps. Small cap growth stocks trade at 22X earnings and 10X cash flow versus 16X

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and 8X respectively, for large caps. Given the large company advantages of scale and resources and all other things being equal, we believe large caps should trade at a premium to small caps.

As always we are investing right in line with our best ideas money where our best ideas are. We have trimmed our small and mid-cap positions in favor of large. Our top sectors picks as we begin the year are Healthcare and Energy. The environment for healthcare investments should improve visibly during the March 2011 quarter earnings season. The March quarter will mark the one-year anniversary of healthcare reform. As a result of the new legislation many healthcare were forced to take charges against revenues due to the higher cost of doing business after reform. The net impact was to lower earnings in 2010. However, once to/past the March 2011 quarter and with the healthcare reform understood, investors can again focus on fundamentals such as product pipelines and earnings growth potential.

The Energy sector is also a top pick for the next three-to five years. Recall, the sector was bid up significantly through 2007 by outperforming the market in five of the decade's first seven years. Today, we believe oil prices are sustainably higher than 10 year ago. Plus, energy company valuations are attractive relative to assets and expected growth. The emerging market demand for energy is well known. Over the short-to-intermediate term, we expect the U.S. recovery to support demand nicely.

The top companies that drove Core Growth's investment performance in 2010 were Chipotle Mexican Grill (CMG - \$213) and Caterpillar (CAT - \$94). Investments that detracted were Cisco Systems (CSCO - \$20) and real estate development company St. Joe (JOE - \$22). We added to JOE increasing the position prior to our annual portfolio rebalance and added to CSCO during our rebalance.

## **2011 Portfolio Rebalance**

Small and mid-caps were sold to fund investments in large cap growth companies. Out of the portfolio are well appreciated and highly valued companies like Ansys (ANSS - \$52) and Informatica (INFA - \$44) in the Tech sector and Industrial sector companies Stericycle (SRCL - \$81) and Expeditors International (EXPD - \$55). We also eliminated few large cap positions where short-to-intermediate term fundamentals no longer support share prices. Industrial sector company CAT and Tech company NetApp (NTAP - \$55) we sold with this in mind. Finally additional sales were made as we further concentrated the portfolio. Core Growth now holds investments in 33 companies versus 41 last year.

New to the Core Growth portfolio in 2011 are Healthcare sector companies Celgene (CELG - \$59) and Quest Diagnostics (DGX - \$54) and Energy companies ExxonMobile

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(XOM - \$73) and World Fuel Services (INT - \$36). We also added to existing holdings such as Microsoft (MSFT - \$28), Archer-Daniels Midland (ADM -\$30) and Vulcan Materials (VMC - \$44).

## **OUTLOOK**

The market begins the year fairly valued according to our long-term equity valuation analysis. This means investors with a five year time horizon can reasonable target a 6%-8% annual return. Our 2011 S&P 500 yearend target is \$1,333. However, during January 2011 the market advanced a bit ahead of fundamentals putting it leaving it slightly overvalued. The DOW advanced 2.5% making it the best January since 1997. Combine this with the nearly uninterrupted 30% market advance from the July 2010 low and we believe a correction of 10% is likely sooner than later – say in the next 2-4 months. We currently counsel clients not to chase the market. Rather powder should be kept dry to take advantage of the correction.

The macroeconomic indicators point to the U.S. recovery continuing to gather momentum. The 2010 4Q GDP 3.2% annualized increase was impressive enough, especially after considering it was achieved as inventory investment shrank relatively. Lean inventories will support investment in 2011 which will be necessary to offset a reduction in government spending. Plus a well-controlled inventory situation will be supportive of corporate profit margins, which are currently impressive.

In addition, productivity, another key indicator, advanced 2.6% during the 4Q. Although below the three-year average the 4Q gain is still important. Productivity advances are an important element of the job creation equation. With employment hovering at 9.4% job creation will be necessary to advance and sustain our recovery.

The mountain of public debt and inflation are our major long-term concerns. Positively, the mid-term elections passed control of the House to Republicans and independents pledging spending cuts. We believe our U.S. senators got the message as well even though Democrats maintained a narrow margin. It is none too soon. This year's budget deficit is projected to be \$1.5 trillion, which is a ridiculous number. The level of U.S. unfunded liabilities are now greater than \$100 trillion. Unfunded liabilities include Social Security, Prescription Drugs Benefits and Medicare. The unfunded liability equates to \$1.0 million per U.S. taxpayer. If nothing is done, folks will figure things out quickly enough. They will be expected to pay higher taxes on benefits they will never receive. Human capital is mobile. It is conceivable this would be enough to drive people away from the country especially entrepreneurial foreigners considering moving here to pursue

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th American Dream. Take a look at Japan for an example of just how devastating a shrinking population is to economic growth.

As for inflation, there sure seems to be lots of potential to have a bunch of it. Our current view is banks with their collective and parsimonious lending have kept the lid on inflation. Remember inflation is a situation where there are too many dollars chasing too few goods. Inflation creation is a two-step process. First the Fed has to create the money by crediting member banks reserve accounts. Step two is banks to circulate the money into the economy at a rate faster than productivity growth by lending the new, Fed-created reserves.

We are concerned about the Fed's quantitative easing. First it creates the potential for inflation and second, it may signal the Fed is still concerned about the quality of banking system reserves. However, as long as banks hold onto to the new reserves and/or lend them out judiciously, the kind of runaway inflation that concerns some should not happen.

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	20-45
Target Portfolio Turnover	10%-30%
Current Yield	1.7%
BIC LLC Inception	March 20, 2003
Core Growth Composite Inception	March 31, 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

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Strategy has received three IIS Top Gun awards: For the three-month period ending September 30, 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 20-45 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>(After Deducting Management Fee and Trading Expenses. Including Cash. Ending 12/31/2010)</b>				
<b>(% Periods of Brady Outperformance)</b>				
<b>Brady Core Growth Equity Composite and Strategy</b>	<b><u>Brady Core Growth Composite</u></b>			<b><u>Core Growth Strategy</u></b> (Includes Prior Firm Results)
	<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	55%	61%	79%	100%
Vs. Russell 1000 Growth	60%	64%	81%	100%

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## PORTFOLIO CHARACTERISTIC (AS OF 1/31/2011)

\$ IN BILLIONS	CORE GROWTH COMPOSITE	S&P 500	RUS. 1000 GR. <small>(AS OF 12/31/2010)</small>
Number of Holdings	33	500	590
Median Market Capitalization	\$22.4	\$11.9	\$6.2
Largest Co.'s Market Cap -	\$422	\$420	\$376
Smallest Co.'s Market Cap -	\$1.1	\$1.7	NA
P/E Multiple			
Trailing – '10	19X	15X	18X
Forward – '11	15x	14x	15X
Growth Rates – Annual			
Dividend 5-yr. Historic	11%	0%	NA
EPS 5-Yr. Projected	13%	10%	14%

## AVERAGE ANNUAL TOTAL RETURN (%)

	CORE GROWTH COMPOSITE			CORE GROWTH STRATEGY (INCLUDES PRIOR FIRM RESULTS)	INCEPTION	
	<u>1-Yr</u>	<u>3-Yr</u>	<u>5-Yr</u>	<u>10-Yr</u>	BIC LLC 03/31/2003	Strategy 09/30/1994
Ending 12/31/2010						
Core Growth, Gross	15.5%	1.3%	4.6%	3.8%	12.2%	10.9%
Core Growth, Net	15.0	0.8	4.1	3.3	11.7	10.4
S&P 500 Index	15.0	-2.9	2.3	1.4	7.3	8.3
Russell 1000 Growth	16.7	-0.5	3.8	0.0	7.6	7.4

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## COMPOSITE AUDIT

<b>ANNUAL RETURNS EXCEPT 03/31/2003-12/31/2003</b> <b>RETURN DATA PRIOR TO 3/31/2003 ARE PRIOR FIRM RESULTS</b>  <b>ANNUAL DATA ENDING DECEMBER 31</b>							
<b>YEAR</b>	<b>GROSS-OF-FEES RETURN (%)</b>	<b>NET-OF-FEES RETURN (%)</b>	<b>S&amp;P 500 INDEX (%)</b>	<b>RUSSELL 1000 GROWTH INDEX (%)</b>	<b>NUMBER OF PORTFOLIOS</b>	<b>TOTAL COMPOSITE ASSETS (\$000)</b>	<b>PERCENT FIRM ASSETS</b>
<b>2010</b>	15.5	15.0	15.0	16.7	2	1,096	7%
<b>2009</b>	37.8	37.3	26.4	37.2	2	947	10
<b>2008</b>	-34.6	-35.1	-37.0	-38.4	3	1,130	15
<b>2007</b>	1.9	1.4	5.5	11.8	3	1,584	19
<b>2006</b>	18.2	17.7	15.8	9.1	2	1,026	14
<b>2005</b>	3.9	3.4	4.9	5.3	2	882	16
<b>2004</b>	23.0	22.5	10.9	6.3	2	735	14
<b>03/2003-12/2003 (FROM COMPOSITE INCEPTION)</b>	52.5	52.2	32.8	31.2	1	317	11
<b>09/1994-03/2003 (PRIOR FIRM RESULTS)</b>	9.74	9.24	9.26	7.20	1	680,000	NA

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## SECTOR DIVERSIFICATION

<b>SECTOR</b>	<b><u>INVESTMENT COMPOSITE</u></b>  <b>BRADY CORE GROWTH (1/31/2011)</b>	<b><u>MARKET BENCHMARK</u></b>  <b>S&amp;P 500 (2/11/2011)</b>	<b><u>STYLE BENCHMARK</u></b>  <b>RUSSELL 1000 GROWTH (2/1/2011)</b>
CONSUMER DISCRETIONARY	11%	10	16
CONSUMER STAPLES	11	10	7
ENERGY	10	13	12
FINANCIALS	10	16	6
HEALTH CARE	28	11	9
INDUSTRIALS	3	11	13
INFO. TECHNOLOGY	14	19	29
MATERIALS	4	4	1
TELECOMMUNICATIONS	4	3	0
UTILITIES	2	3	0
OTHER	0	0	0
CASH	4	0	0

## TEN LARGEST HOLDINGS (1/31/2011)

<b>NAME</b>	<b>SECTOR</b>	<b>% INVESTED ASSETS</b>
Chipotle Mexican Grill	Consumer Discretionary	6.1%
ExxonMobil Corp.	Energy	4.5
St. Joe Corp.	Financial Services	4.2
Cisco Systems, Inc.	Info. Technology	4.1
Becton Dickinson & Co.	Health Care	3.9
Pepsico, Inc.	Consumer Staples	3.9
Vulcan Materials Co.	Materials	3.8
Avon Products	Consumer Staples	3.8
AT&T, Inc.	Communications	3.7
Quest Diagnostics, Inc.	Health Care	3.6

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## HYPOTHETICAL INVESTMENT GROWTH



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

Brady Investment Counsel LLC claims compliance with the Global Investment Performance Standards (GIPS®). Performance prior to March 31, 2003 is of The Stein Roe Young Investor Fund (the Fund). The Fund's past performance has been presented 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.

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

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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 presented before management fees but after certain expenses of the Stein Roe Young Investor Fund (the Fund). The Core Growth net investment results are presented 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-date opinion on Brady Investment Counsel Core Growth Composite GIPS Compliance. The value of an investment may decrease as well as increase, an investor

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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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