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# J.L. BAINBRIDGE

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## & COMPANY, INC.

◆PROFESSIONAL MONEY MANAGEMENT◆

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### 2009 MID-YEAR REPORT

#### INVESTMENT RESULTS


For the first half of 2009, J. L. Bainbridge & Company, Inc. achieved a 4.6% rate of return on all monies managed in its equity investment program. In conjunction with returns in its equity program for 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007 and 2008 returns of 10.2%, 38.4%, 20.3%, 23.2%, 29.9%, 5.6%, 16.9%, -3.2%, -8.5%, 13.8%, 14.6%, 5.1%, 13.3%, 3.8% and -36.7% respectively, a January 1, 1994 investment of \$250,000 has grown to a June 30, 2009 value of \$856,183. This equates to an increase of 243% over the past fifteen and one half years or 8.4% compounded annually. These results assume reinvestment of dividends and are after transaction costs and our management fee.

#### INVESTMENT REVIEW

The first half of this year was the most tumultuous period since we began our service in 1981. January 1 thru March 9, 2009 the markets

dropped precipitously to the point where the amount of cash (CDs, Checking, Money Market and Saving accounts) exceeded the total value of the stock market. The only other time cash reached this level was in 1982 which marked the beginning of an eighteen year bull market. The panic selling caused all stocks to drop indiscriminately completely independent of their outlook and financial condition. In this environment, our focus on quality companies with proven growth records provided little protection against the malaise. This is in sharp contrast with our experience in the past when solid companies with strong cash flow and excellent financial positions resisted market declines. In our analysis the reason selling was indiscriminate is twofold: Firstly due to the credit crisis in the banking, brokerage, hedge fund and insurance industries, who's rampant speculation in collateralized debt and real estate, forced these companies to sell whatever they could in order to raise cash to meet margin calls and comply with government capital requirements.

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Secondly in this environment of credit market mayhem, even the healthiest companies financially began to hoard cash as a precaution. Consequently, the companies in our investment portfolio suspended their share repurchase programs which in the past were effective in propping up their stock price. In our view this was a unique period, and our philosophy of investing in established businesses with a proven earnings growth record and strong financial condition remains valid. In fact this approach was validated when the market turned on March 10, and our stocks recovered rapidly and closed the first half of 2009 ahead of both the Dow Jones Industrial Average and the S&P 500.

## **INVESTMENT STRATEGY**

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While our results for the first half are encouraging, the outlook for the remainder of this year as well as the longer term is all important to clients' financial success. The following is our thinking regarding the factors that will shape the investment landscape:

**RECOVERY FROM RECESSION:** The severity of the economic decline was a shock to the financial markets. The rapid economic decline was caused by two factors: Firstly the financial crisis and the decline in home prices dampened consumer spending. Secondly and the most important is accessibility to real time business information which enables companies around the world to quickly react by cutting inventory and reducing costs. This caused a contraction in business activity greater than the decline in end-markets. For example a distributor instantly sees orders falling ten

percent and reacts by cutting inventory by twenty percent. The manufacturers of these products instantly see their orders fall twenty percent and react by cutting orders to their suppliers by thirty percent. Consequently the economy falls more rapidly and deeper than in past recessions when information systems were less sophisticated. In addition, today companies react to a business decline by quickly cutting expenses which exacerbates both unemployment and creates a sharp decline in earnings because the expenses from cost cutting occur short-term while the savings show up later.

However there is a positive side to this in that as economic activity begins to improve, distributors, manufacturers and vendors will immediately see the improvement and quickly restock inventories which will stimulate more business growth. Furthermore earnings will increase faster because of the benefit of previous programs to reduce operating costs. Therefore, even a modest recovery, which is most likely due to the effect of high unemployment, slow consumer spending and the hangover from the housing boom, can result in significant earnings growth. Factors that will bring about a recovery are the worldwide stimulus programs and higher growth in the international markets in Asia, Eastern Europe, Middle East, Russia and South America. Thus our strategy is to own financially strong American companies with substantial exports as well as operating factories in these areas of the world. The key to a company's stock appreciation is strong earnings per share growth. The companies in our portfolio are well positioned to achieve strong growth in an environment of a modest recovery of the USA.

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**RISK OF INFLATION:** Due to deficit spending and aggressive expansion of the money supply, many pundits are speculating high inflation is on the horizon. High inflation and the resultant high interest rates are the most serious threat to the stock market, and we will continue to vigilantly monitor inflationary forces. However for at least the next five years, we do not expect a problem because the moderate economic rebound coupled with intense international competition will keep demand and prices in check. This does not mean inflation and interest rates will remain near zero because as the economy improves and the Federal Reserve begins to restrict growth in the money supply, rates will return to normal levels. Our opinion is inflation will run at a healthy two to three percent with interest rates a point or two higher.

**STOCK MARKET OUTLOOK:** Many market analysts conclude that the current evaluation of sixteen to eighteen times earnings is too high for a further rise in stock prices. But this analysis does not take into account the fact current earnings are artificially depressed by expenses being incurred to aggressively reduce future operating costs. Based on an analysis of our stocks using normalized earnings, the price-to-earnings ratio is slightly above thirteen. And as indicated earlier the sharp reduction in operating expenses and more rapid recovery in international economies could result in earnings over the next few years way above analysts' current expectations. Add the fact that the companies in our portfolio, which have proven earnings growth records and superior financial strengths, typically sell at a premium with an average PE ratio greater than twenty, the potential for higher returns is a reality.

## **CONCLUSION**

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In summary the stock market is modestly valued and a huge amount of cash remains on the sidelines. Therefore the stock market is poised to advance further as the economy recovers. Our portfolio is more modestly valued based on the historical premium placed on companies growing much faster than the economy together with an exceptional financial position and substantial excess cash flow. Furthermore, half of our portfolio is focused on worldwide infrastructure projects with companies such as Boeing, Eaton, 3M and United Technologies all of which derive well over fifty percent of their business from international markets. The other half of the portfolio consists of traditional growth companies such as Avon Products, Johnson & Johnson, McDonald's Corp and Proctor & Gamble which also obtain the majority of their business outside the United States. Since we expect international economies to lead the global economic recovery, we are confident our portfolio will outperform the stock market by a good margin. Consequently, we are well positioned to meet our overarching goal to build and preserve clients' wherewithal for an enhanced retirement.

*It should not be assumed that past results will be achieved in the future or that a loss could not be incurred. Furthermore it should not be assumed that future results will exceed market indexes.*

# ENHANCING CLIENTS' LIVES

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At J.L. Bainbridge & Company, Inc. our business is dedicated to “enhancing clients’ lives” by providing long term professional money management service totally focused on helping clients finance their children’s education, build and preserve the resources for an enhanced retirement and achieve a meaningful higher standard of living.

The foundation of J.L. Bainbridge & Company, Inc.’s business philosophy is based on the full understanding that our future and success is completely dependent on client satisfaction and delivering to clients a consistent long term investment service of the highest level of quality, competence and integrity.

Our commitment to “enhancing clients’ lives” is a guiding light that governs our professional daily activities and demands every decision and action be assessed as to exposure to investment risk as well as the long term benefit to clients.

**J.L. BAINBRIDGE**  

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**& COMPANY, INC.**

Managing more than \$200 million for over 800 clients nationwide.

VISIT OUR WEBSITE: [www.jlbainbridge.com](http://www.jlbainbridge.com)

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