Madison
WEALTH MANAGEMENT

Highlights of Selected Investment Manager Views – Tweedy, Browne Company

Tweedy, Browne was founded in 1920 by Forrest Berwind Tweedy, a dealer in closely held and inactively traded securities. The firm's 86-year history is grounded in understanding undervalued securities, first as a market maker, then as an investor and investment advisor. Today Tweedy, Browne manages over $13 billion in client assets, including about $585 million of the firm's owners and employees' personal assets that is co-invested alongside their clients. According to Tweedy; "We have always owned what our clients own." (At Madison, we share this view and also own what our clients own.)

Managing Directors - Left to right: Will Browne, Bob Wyckoff, Chris Browne, Tom Shrager and John Spears.

Tweedy, Browne's shareholder letters are among the most thoughtful and insightful letters written by any mutual fund manager. While many managers primarily focus on the United States, Tweedy takes a global view. What follows are some highlights of Tweedy, Browne's most recent shareholder letter dated April 24, 2006. While the writing is Tweedy's, we concur with the thoughts expressed.

On market results: "The past year, as measured by various worldwide indexes, has been something of an anomaly. Generally, world markets move in closer correlation to each other. This was not the case last year. Foreign markets significantly outperformed the S&P 500. In 2005, the US economy grew at a healthy rate of 4%. Rising interest rates are still on the lower side of their long-term levels, unemployment is near an all-time low, and some parts of the US are experiencing worker shortages. On the other hand, the larger economies in Europe eked out gains in Gross Domestic Product ("GDP") of less than 2%, unemployment has stubbornly held in the range of 9% to 10%, and there are riots when governments propose even modest labor law reforms. And although there is much wailing about the size of the US budget deficit, the budget deficits of France, Germany, Italy and Japan as a percent of GDP are greater. In addition, the US economy is growing at a faster rate than the deficit as a percent of GDP. The same cannot be said for the major economies of Europe or Japan."

Global Social Security problem: "Looking ahead to the greatest future problem confronting every free world country - social security retirement benefits - at least the US is discussing the problem. The problem is far more serious in Europe and Japan. While all countries are facing the ticking time bomb of the imminent retirement of the baby boom generation, the US is one of the few countries experiencing any population growth. Europe and Japan are showing fairly significant declines in population, which further exacerbates their social security problem."

It's not different this time: "Indeed, as the cover story of the April 17, 2006 issue of BusinessWeek magazine reports, large-cap US stocks have been suffering through one of their worst periods of relative performance despite strong earnings growth. During the past year or two, small and mid-cap stocks have been the best performers. However, one has to ask whether the money flows into small and mid-cap mutual funds created a self-fulfilling prophecy just as money flows into tech funds did in the late 1990s. Stock markets have a way of over-shooting themselves both on the upside and on the downside; i.e., they go to extremes of overvaluation and undervaluation. The relatively smaller market

capitalization of small and mid-cap stocks means they are less liquid. This can be great when money is chasing small and mid-cap stocks, but potentially disastrous if sentiment changes and investors head for the door. While we hear statements that this time it's different, we have heard such statements many times in the past with subsequent grief for investors."

Not following the herd: "The same can be said for funds that invest in foreign stocks. They have been the darlings of the investment world. And the riskiest markets have been the best performing. Like small and mid-cap US stocks, international stocks were relatively cheaper than large-cap US stocks for many years. However, this difference is quickly being arbitraged away as new money flows into the sector. These inflows are what we would call "top down." Investors have decided they want to invest in these sectors with little or no knowledge of whether there is any value left. They want to participate and, therefore, send their money into international funds, which then feel compelled to put the money to work. The inflows drive the stock prices up, which only attracts more inflows. It is an axiom in investing that money flows to those sectors or styles that have performed the best most recently. This sequence of events makes life for true value investors difficult. Stock prices rise to a level where there is little or no margin of safety. And because we are unwilling to follow the herd, we underperform indexes that track what the herd is buying."

A difficult life for value investors: "The spread in valuation between the most expensive stocks and the cheapest stocks went from its widest to perhaps its narrowest in our investment careers. The valuation compression, the difference between the valuations of nearly the entire market, is now complete. This is a most unusual phenomenon. Usually, small and mid-cap stocks are perceived as "riskier" than so-called blue chip companies, and, therefore, carry lower market valuations. However, this approach leads to a lot of "babies being thrown out with the bath water," which is where value junkies like us come in. We hunt for the jewels among the rejected. Like the guy with the metal detector walking along the beach looking for lost jewelry, we forage through the stock tables looking for mispriced stocks."

Thoughts on risk: "Defining risk is a highly subjective and personal exercise. What one investor thinks is risky may be completely different from what another investor perceives as risky. Some investors measure risk on a daily basis, while others look at it from a perspective of years. Some see it as the possibility of losing 1% on a particular investment while others are willing to bet the ranch. Merely assigning some mathematical ratio to a particular investment as its "risk measure" may be fine for academics but it is probably of little, if any, use to the average investor. Moreover, many forms of risk are not even identifiable. Natural catastrophes, terrorist attacks, stock market crashes, etc. can all happen, but can anyone seriously put a number on their likelihood? The fact that something happened doesn't mean it was likely, and the fact that something didn't happen doesn't mean it was improbable. Improbable things happen all the time, just as likely things often fail to occur."

Belts and suspenders: "We diversify our investments both in terms of the number of issues and the number of industries in which we invest. No matter how rigorous your research is, and no matter how confident you are in making predictions about future prospects, errors can be made or unforeseen events can occur that will render your judgment incorrect. Diversification seeks to protect us from such non-foreseeable events. Our rule of thumb is generally no more than 3% of assets at cost in any one issue. Three percent is an arbitrary number. Many of our peers would say this is too extreme. It may well be, but we prefer wearing "belts and suspenders" in the stewardship of your money and ours."

Pearl of wisdom: "Our focus has never been to outperform in any short-term period, but to consistently adhere to a set of investment principles that have worked in the long term and have been successful."