

**Equity Investment Corporation**  
**2009 Second Quarter All-Cap Value Commentary**  
**July 10, 2009**

After a precipitous decline in 2008 and Q1, 2009, US stocks rallied strongly (about 45%) from their March lows. For the second quarter, this resulted in gains of 15.9% and 16.8% for the S&P 500 and Russell 3000 Value (R3000V) indices, and 17.9% (gross) for our All-Cap Value Composite. Taking 2009's first two quarters together, the S&P 500 rose 3.2% but the R3000V fell 3.1%, while our All-Cap Value Composite rose 2.9% (gross). For the trailing 12-months, our All-Cap Value Composite fell 17.3% versus 26.2% and 28.7% for the S&P 500 and R3000V indices.

Just as 2008's *fear-filled* statements regarding the "collapse of the financial system" were exaggerated, 2009's *hope-filled* proclamations of "green-shoots" will likely prove unfounded, and equally misleading. The surprise, we believe, will instead be the difficulty of achieving and sustaining a broad recovery. That is why our investment posture remains largely unchanged, focused on owning quality companies that can not only profitably withstand difficult times, but grow. In certain market segments, we feel current prices more than compensate for the uncertainty of the times and offer attractive opportunities. However, we remain concerned that prices of cyclical companies for the most part do not reflect the changed circumstances they face.

The financial mess so apparent around us (from foreclosures and bankruptcies to bailouts) is in fact a symptom of a more deep-rooted ailment, namely, poor consumer balance sheets (i.e. inadequate income and equity to support debt). This was created by *years* of overspending (relative to income), encouraged by government policy, enabled by over-lending from banks and Wall Street, and now exacerbated by asset price declines. The gradual savings needed to restore consumer balance sheets to healthier levels will likewise take years, delayed by the feedback loop from slower growth, and a more restrained spending psychology.

**The Last Decade**

Over the past 10-years, a dollar invested in our All-Cap Value approach grew to \$1.56 (4.5% per year, net of management fees), versus \$1.02 (0.2% per year) if invested in the R3000V, and fell to \$.80 (-2.2% per year) if invested in the S&P 500. During those years there were times when our short term results were below the market, because we actively steered away from high risk areas experiencing strong momentum. For example, to track the indices in 2003-2006 required ignoring the unsustainability of earnings in financial, building, and capital-sensitive stocks, while tracking the indices in 1998-1999 meant ignoring the risk of high prices of large-cap and technology stocks.

Our concerns and avoidance of these risks can be seen in the excerpts of our quarterly commentaries posted on our website at: [www.eicatlanta.com/presentations.htm](http://www.eicatlanta.com/presentations.htm). Investment risks play out over long time-frames that have little to do with the calendar. The past decade highlights the importance of independent thinking, resisting momentum of the crowd, confidence in a valid framework of beliefs, and patience as risks play out.

**For Financial Professionals Only**

### **The Importance of Beliefs**

The investment business constantly tests one's beliefs against unfolding reality. Long-term success requires a willingness to let beliefs be challenged by events, yet a commitment to certain principles even when unsupported by short-term events.

*One of the core assumptions fueling the financial bubble, especially in sub-prime excesses, was that investors get paid to take risk.* This is also a core viewpoint supporting "modern portfolio theory". When combined with the belief that the market is "efficient", it can lead investors to disregard the risks being taken with their money, or even worse, to seek higher risk investments to achieve higher returns though leverage (private equity & hedge funds), volatile investment "satellites" in an equity portfolio, etc.

At one time, looking backward, these views may have appeared valid. But they can be irrelevant when living forward, and undermined if investors are not diligent in weighing the risk of loss against potential return. By definition, *most* people who take higher risk experience more losses, not higher returns. In this sense, theory runs counter to experience. We believe we increase our chance of making money when we reduce our risk of losing it. Both our recent and long-term experience has affirmed this belief.

### **Portfolio Review**

During the quarter the portfolio changes were relatively few. We began a new position in Brown-Forman, producer of Jack Daniels whiskey among other alcohol brands. Brown-Forman is a high quality, well managed and stable company that normally sells at the high end of our valuation range, so we rarely get to own it. Typically, such opportunities show up during crisis periods like today and work out well. Also during the quarter, Suncor offered to purchase Petro-Canada, which was one of our holdings. While the merger proposal was beneficial to the price, the combined firm will be more exposed to the risk of tar-sands than we thought wise, so we sold Petro-Canada and replaced it with Encana, a firm focused on natural gas production. In addition, in response to the strong results experienced by our energy companies (up about 36% for the quarter), we reduced our overall energy weighting by twice trimming positions in Cimarex and Nabors Industries, once in April and again in May. Lastly, we sold our remaining position in Aflac due to concerns about their investment portfolio.

### **Conference Call**

**Our Second Quarter conference call will be posted on our website within 24 hours of the call. It may be accessed via the Presentations tab on our website at [www.eicatlanta.com/presentations](http://www.eicatlanta.com/presentations).**

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**Disclosures**

*Not approved for presentation to wrap program clients. Such presentations should reflect EIC's wrap composite information. EIC results are preliminary and are those of the All-Cap Value Composite, after commissions, before and after EIC management fees and are presented as supplemental information to a full GIPS® disclosure presentation. EIC returns after manager fees were 17.7% for Q2, 2009, 2.5% for 2009 YTD, and -17.9% for the trailing 12 months ending June 30, 2009. Growth of a dollar assumes a beginning dollar grows by reinvesting back into each strategy monthly. All returns include reinvestment of dividends and interest. Index returns exclude fees and commission costs. Results are historical and do not imply future rates of returns or volatility for EIC or the indices, which may be materially different from the past and from one another. Individual account results may differ from those of the composite.*

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