BRADYCO

Bradley F. Richardson April 13, 2007

The stock market began 2007 much like the first half of 2006, riding a rollercoaster. After starting off strong, equities had a sharp decline in mid-February before rebounding in March. The extremes of this volatility have not been seen in awhile. In fact, until the February sell-off, the S&P 500 had not declined by 2% or more in a single day in almost 4 years. (This contrasts with the past 75 years when such declines occurred an average of eight times per year!) Furthermore, the S&P index had been up for 8 straight months since the lows of July 2006. In short, the February decline was not unexpected and more such declines in the future would not be unusual.

Volatile or not, by the end of the quarter, the major market indices showed little change with the S&P 500 (including dividends) up 0.6% while the Dow Jones Industrial Average declined by 0.9%. Both results were in sharp contrast to the 6-7% gains of last quarter.

Looking to the future, the housing market continues to be weak while the rate of growth in corporate profits is expected to be the slowest in almost five years. While both trends could have some unpleasant short-term consequences, they are part of the normal economic cycle and thus, they should neither worry nor surprise those of us with long-term time horizons.

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This letter continues the segment discussing factors used to invest your money.

One of the questions I often hear is "what is the most important criterion you use to pick stocks?" While my analysis includes many factors, the most important is a concept that I learned from Warren Buffett: the degree of "predictability" in a company's future results.

During talks with groups of students, Mr. Buffett has discussed the idea of buying a stock assuming that you can't sell it for a minimum of 5 years. I have found this to be a useful exercise. Instead of just considering how well a company has been and is likely to do in the future, the 5 year rule makes you also focus on your degree of confidence in those forecasts. Since there are many good companies with predictable futures (examples include W. R. Wrigley and Coca Cola), it doesn't make sense to take chances on other strong companies (say Google or Apple) whose futures are too hard to predict accurately. (Unlike in Olympic diving, you don't get extra points for investment decisions with a high level of difficulty.). In short, when selecting stocks, my most important criterion is my comfort level with my ability to forecast a company's long-term results.

Thank you for your confidence.

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