

4th Quarter 2011 International Growth Letter

At the start of a New Year, we all like to be optimistic, but the reality is that there is still so much uncertainty, and many of the issues that ignited the volatility and turmoil in the markets in 2011 remain unresolved. The European issues remain at the top of the list (European governments will all be issuing sizeable amounts of debt in January), followed by high unemployment and political uncertainty in France and the US, and whether Chinese growth is sustainable. That being said, our job is to be fully invested in large, liquid, international companies with growing businesses, strong earnings prospects and strong balance sheets. Many have solid dividends which are attractive in this low interest rate environment which the Fed has said will last for at least the next year and a half.

The JMH International portfolio significantly outperformed MSCI EAFE and EAFE growth (respectively) for the quarter (+6.0% versus +3.3% and +3.9%) and the year (-5.7% versus -12.1% and -12.1%) helped by the defensive nature of the portfolio and good stock selection. We were significantly overweight the healthcare sector (18% versus 10% for both EAFE and EAFEG), the best sector for the year. Consumer staples were the next strongest performer and we were overweight EAFE (22% versus 12%), matching EAFEG. At the other end of the spectrum, financials were the worst performer and we were significantly underweight (5% versus 21% and 9%). The stocks that we do hold in the financial sector outperformed, as did the stocks we hold in the next worst sector for the year, materials where we were also somewhat underweight (8% versus 10% and 14%). For the year, growth (-12.1%) and value (-12.1%) were equal with large caps (-11.8%) besting mid (-14.1%) and small (-15.9%) caps.

We started 2011 with an upswing as investors were optimistic that the global economy would continue to mend from the 2008 economic crisis. But that optimism was short-lived when the Libyan government (one of the world's major oil exporters) and other governments in the Middle East faced revolts in the streets toppling long-time dictators, and sending oil prices soaring, peaking for the year (+25%) in late April with US crude at \$113.93 and European Brent at \$126.65. Oil settled in at +8.2% for the year (+45% from the 2010 nadir) for US crude, and +13% for European Brent. In March, the unfortunate earthquake in Japan and the ensuing tsunami and nuclear disaster added to global woes.

After Greece and Ireland were bailed out in 2010, it was Portugal's turn in 2011. It received a 78B euro (\$101B) financing package in May from the EU (European Union) and the IMF International Monetary Fund). Greece could not meet its deficit-cutting targets, and the lenders demanded severe austerity measures. There was heightened speculation that Greece could default on its debt and leave the Euro. Late in July, Greece received a second bailout causing a contagion. In August, the ECB started buying the government bonds of Italy and Spain in an attempt to reduce borrowing costs. The leadership summits resulted in some positive steps, but failed to produce a plan to resolve the crisis.

The US economy softened on fears of a recession re-emerging. The US Congress' partisan politics brought the US dangerously close to default as well with disagreements over raising the debt ceiling. That was followed by Standard & Poor's downgrade of the US credit rating for the first time ever from AAA to AA+. China, the world's largest growth engine, caused anxiety as investors wondered if the country's Central Bank would be able to rein in inflation, especially property prices. China's biggest trading partner is the Euro zone. If Europe goes into a recession, it will slow China's growth considerably.

J.M. Hartwell LP

Investment Counsel since 1961

European banks have been asked by regulators to build capital buffers against their sovereign-debt exposure. Concurrently, many institutions have had difficulty getting cheap financing from the markets. This has prompted the ECB to step in and provide liquidity at low interest rates. These pressures have resulted in banks reducing lending to consumers and businesses, creating a credit crunch.

The amalgamation of the above factors led to double digit declines for the year in most European markets with the Stoxx Europe 600 index down (-11%). The markets of those countries on the periphery, not part of the common currency, fared better with the UK FTSE (-6%) and the Swiss market (-8%). (*All returns are local currency.*) Performance of the economies struggling the most was much worse with Greece (-52%), Portugal (-28%), Italy (-25%) and Spain (-13%). France (-17%) was pressured by worries about the exposure of French banks to troubled Euro zone countries and the ability of the government to retain its AAA credit rating. The German market fell (-15%). Even though Germany is in relatively healthy financial shape, there is concern about how much support it will have to give the weaker EU member states.

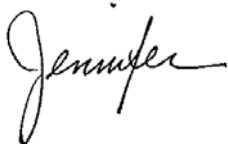
In recent years, high prices for Latin American mineral and agricultural exports have boosted foreign currency reserves. The high prices have also broadened the middle class which is eager to spend its new found wealth, boosting consumer spending. Conservative banking regulations have resulted in banks being well capitalized. This should give Latin America a cushion to withstand external shocks from around the globe, albeit a small cushion as these countries are heavily reliant on commodities and investment inflows from the struggling developed world. Another cushion at least for Brazil, the region's largest economy, is that interest rates are still double digit, leaving room for monetary stimulus. Brazil's BOVESPA was (-18%) for the year.

Even with the tsunami and nuclear disasters in Japan and its ongoing economic slump, the market was 'only' down 17% in 2011. Corporate balance sheets are in good shape with solid cash balances. Many stocks are trading at or near book values. But the continued strong yen is a headwind as exports are more expensive versus other Asian exporters with weaker currencies. Japanese government intervention to weaken the yen in August was a very short-lived respite. India was the worst performing major market in Asia last year (-24.6%). Investors have been disenchanted and perceive that India's economic boom is wavering. Inflation, increasing debt, infrastructure bottlenecks and political paralysis are the culprits.

We continue to be defensive, but our bottom-up stock selection process finds great companies in all sectors. Institutions and individuals around the globe still have a sizeable amount of money on the sidelines yet to be invested. While certainly sovereign debt issues persist, there are reasons to be optimistic in 2012. The US economic recovery is now self-sustaining, China has guided to 7.5% GDP growth, and the global interest rate easing cycle continues. Also, corporate balance sheets are strong with record cash on both an absolute basis and as a percentage of GDP. In this environment, we continue to believe that large cap, growth equities should outperform.

Thank you for your continuing support.

Sincerely,



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