

Alley Company Quarterly Letter The Arbiter of Value

October 17, 2011

In early August, stock prices around the world declined as correlations for risk assets shot higher and flight-to-safety Treasury bonds rallied. The third quarter started out with a political circus in the United States regarding the debt ceiling and finished with growing uncertainty over the Euro-zone's debt problems and the global implications.

Uncertainty begets volatility in the financial markets. The Dow Jones Industrial Average frequently swung by multiple percentage points in the quarter as investors grappled with macro headlines and the potential impact on the global economy and business momentum.

Uncertainty and volatility, however, have long played a role in financial markets and are an inherent part of investing. It is our job to sift through the volatility and stay focused on long-term fundamental value. In this regard, we continue to focus on investment opportunities in companies with quality fundamental track records, sustainable business prospects, and strong management teams. Fundamental reality will be the ultimate *arbiter of value* – i.e., money will always flow toward value over time.

Confidence in America has been shaken by factors that include the debt ceiling debate and lowering of our credit rating by Standard & Poor's. Despite our challenges, we look for the American system to continue being a haven for businesses to unleash their potential for innovation and productivity. Our view is supported by the American system's unmatched foundation:

- U.S. corporate and securities law is comprehensive and reliable
- the U.S. economy is large, developed, and diversified
- U.S. capital markets are deep and transparent
- the U.S. workforce is highly productive
- the U.S. university system is the best in the world
- the U.S. is the major military power in the world

Over the *near term*, value recognition in global financial markets will be heavily influenced by the Euro-zone's ability to stabilize its sovereign debt and banking system crises. And in the United States, eyes will be fixated on political developments surrounding debt/deficit plans and job creation initiatives. Sustainable increases in market confidence will be built on the adoption of bold and credible plans for successful long-term workout of these issues.

With bond prices rallying in the quarter, the yield on the 10-year Treasury bond moved below two percent. We continue to focus on bonds for their qualities in developing strategic asset allocation plans, but Treasuries at these levels are unattractive to us. Our preference in the bond market is for investment-grade corporates, high-yield corporates, and high-quality municipals.

With low current income from traditional sources in fixed income and a slow economic recovery outlook, we find high-quality companies with sound balance sheets, and in particular dividend-paying companies to be an attractive area of the financial markets. The following table highlights companies that are currently exhibiting rapid dividend growth and also have attractive current dividend yields.

<u>Company</u>	<u>Industry</u>	<u>Current Yield*</u>	<u>Dividend Growth*</u>
Philip Morris Int'l	Consumer Goods	4.9%	20.3%
McDonald's	Restaurants	3.2%	14.8%
Intel	Technology	3.9%	24.2%
BCE, Inc.	Telecom Services	5.5%	14.3%
Abbott Labs	Health Care	3.8%	9.1%
Conoco Phillips	Energy	4.2%	12.6%

*Current yield as of 9/30/11. Dividend growth represents the most recent annual rate of growth reported by the company.

Source: Alley Company, Thomson One Financial, Company reports

Many companies continue to execute very well in the current environment and third quarter 2011 financial results will give us another data point on the status of their business. Macro-economic factors aside, we are struck by the opportunity to invest in great companies at cheap valuations. Ultimately, the *arbiter of value* will be the performance of the companies themselves.

Alley Company is an investment advisor registered with the Securities and Exchange Commission (SEC). The Alley Company Quarterly discusses general developments, financial events in the news and investment principles. It is provided for information purposes only. It does not provide investment advice and is not an offer to sell a security or a solicitation of an offer, or a recommendation, to buy a security. The statements and opinions contained herein are solely those of Alley Company LLC. Certain information constitutes "forward-looking statements" and due to various risks and uncertainties, actual events or results may vary materially from those reflected or contemplated. Performance data shown represents past performance and is no guarantee of future results.