The Wall Street Wish List — Edition #10

By Brady Willett & Dr. Todd Alway
Wish List 2010, July 13, 2010

The 'Wish List' is not direct investment advice: we the producers are private investors, not professional investment advisors.
Please make your own final investment decisions.

1) Wish List Review and Outlook 2) New Research and Selections 3) Conclusion

Introduction

A Conflicted Currency Story

With an ETA of 3 billion years, not many people stay awake at night worrying about the day when the sun will cease to support life on earth. Not very long ago, people felt the same way about fiat currencies as they do about the sun (if they thought about fiat money at all). They knew - thanks to history and common sense - that the destruction of all fiat money was inevitable. However, this eventuality was so far off into the future that there was no need to worry. This isn't the case any longer.

From Medium of Exchange To Alchemy Overreach

Be it the Roman Denarius or Weimar Germany's Mark, history tells us that all fiat money eventually fails. On a basic level the reason for failure is that the temptation to print or debase a currency by those in power proves too great. In the case of Weimar Germany this 'temptation' bordered on the ridiculous in late 1923, when 1,783 printing presses, running around the clock, were required to print money and one U.S. dollar was worth $4 trillion German mark. The example of Zimbabwe, which also tried to out print the scourge of hyperinflation, serves as a more recent example of currency failure, although it is certain not to be the last.

The most ominous currency "failure" consideration today is the U.S. dollar, which is nearly 40-years into its grand experiment of being completely unshackled from the confines of gold. The largest debtor nation in history, the U.S. is also the world's largest economy and unofficial printer of the world's reserve currency. These factoids, not to mention the fact that all U.S. debt is denominated in USD, puts the U.S. in the seemingly unique position of being able to recklessly print its currency and tell the world to deal with it, at least for a period of time.

Whether or not the events thus far in 2010 foreshadow the destruction of the USD as we know it is unknown. However, at a minimum recent events have further pried open the possibility of the USD's demise. To be sure, just as Greece's debt quagmire sparked a Euro-wide panic in sovereign debt markets and serious concerns over the viability of the Euro itself, any number of financial panic possibilities could serve to further ignite anxieties over the viability of the U.S. dollar.*

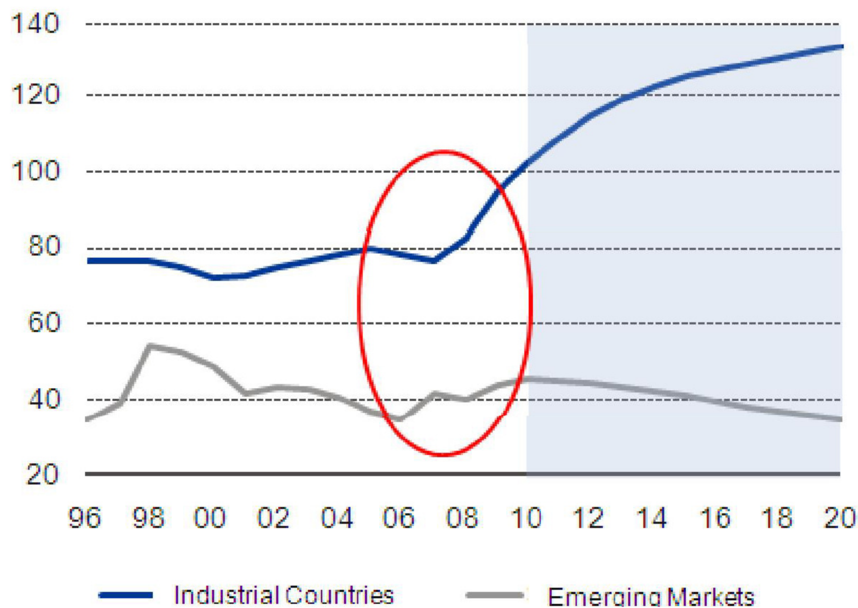
Will Anxieties Alone Foment A USD Catastrophe?

Some have contended that the debt related statistical similarities between the U.S. and Greece are meaningless and/or that for various reasons the U.S. will be permitted to borrow money much longer than most think possible (i.e. the sun will go supernova one day but not anytime soon). Somewhat surprisingly given our long-term warnings on the dollar, we completely concur! The paradox is as follows: widespread debt/austerity wrangling and the Euro's problems have definitely lent attention to the long-term viability of the dollar and fiat

money in general, but this has actually served to temporarily bolster the dollar's status as one of the ultimate safe haven currencies. One chart, contrasting U.S. interest rates and the price of gold (GLD) helps to highlight this trend.

While the slowdown in the U.S. recovery can partially explain the huge move into U.S. Treasuries (and subsequent decline in U.S. interest rates), the more important culprit behind this move appears to be major capital shifts in response to the burgeoning Euro debt crisis. In other words, with calls for the Euro's destruction on the rise, CDS swaps on many Euro-nations spiking to all-time highs, and everyone warning that the crisis could easily spread across the Atlantic, money *still* rushed in to the perceived safety of U.S. Treasuries. If U.S. interest rates had spiked higher during this panic we would have donned our apocalyptic gear and started accumulating ammo. This wasn't the case.

In short, the U.S. dollar may not go the way of Wiemar's mark (at least in the short term) because it is, as no currency has been before, infused into the financial gears of the entire global economy. Not only is it in no one's interests – except the speculators betting on it – that the dollar get dumped into the dustbin of history, but no important USD debt holder is in the position where the advantages of dumping the dollar outweigh the consequences of doing so. Thus, almost absurdly, USD is a crisis proof destination for capital, even as ominous U.S. borrowing trends foreshadow a long-term attrition of the dollar's fundamentals. A single chart, courtesy of DB Research, helps highlight this trend, as well as the broader debt trends between emerging and developed markets. Operating under the assumption that debt accumulation is becoming a negative – as the global embrace of austerity implies – it is clear that developed currencies like USD, the Euro, and Yen, will see many challenges in the coming decade.



As for the great gold bull, which is ongoing, there is no rule that says precious metals cannot continue to rise at the expense of *all* currencies. The appropriate analogy is that rising gold forecasts future tremors, not necessarily the next BIG one…

Does Bernanke Understand How Capital Moves?

For his part, Fed Chairman Ben Bernanke says that he is unaware exactly why paper currencies are losing appeal when compared to gold, registering what will undoubtedly be one of the quotes of the year: "I don't fully understand movements in the gold price." In any context this quote is ridiculous and more than a little disingenuous.

Rather than heap further scorn on Bernanke, a long quote from one of his 2004 speeches will suffice. Do the following comments on capital shifts in the early 1930s sound like they came from a man who is baffled by movements in the price of gold?

"….As with any system of fixed exchange rates, the gold standard was subject to speculative attack if investors doubted the ability of a country to maintain the value of its currency at the legally specified parity. ***In September 1931****, following a period of financial upheaval in Europe that created concerns about British investments on the Continent,* ***speculators attacked the British pound, presenting pounds to the Bank of England and demanding gold in return. Faced with the heavy demands of speculators for gold and a widespread loss of confidence in the pound****, the Bank of England quickly depleted its gold reserves. Unable to continue supporting the pound at its official value,* ***Great Britain was forced to leave the gold standard****, allowing the pound to float freely, its value determined by market forces.*

With the collapse of the pound, speculators turned their attention to the U.S. dollar, which (given the economic difficulties the United States was experiencing in the fall of 1931) looked to many to be the next currency in line for devaluation. Central banks as well as private investors converted a substantial quantity of dollar assets to gold in September and October of 1931, reducing the Federal Reserve's gold reserves. The

speculative attack on the dollar also helped to create a panic in the U.S. banking system. Fearing imminent devaluation of the dollar, many foreign and domestic depositors withdrew their funds from U.S. banks in order to convert them into gold or other assets. The worsening economic situation also made depositors increasingly distrustful of banks as a place to keep their savings…"

From this quote alone it is clear that Bernanke understands why gold rises during periods of currency uncertainty. And while the gold standard no longer remains in place, it seems obvious that when gold rises as other commodities sharply decline (as was the case during 2Q2010), this is largely because gold is functioning as a safe haven from fiat currencies.

Now, picture if you will Bernanke watching speculators attack the dollar in 1931 and then the Fed, guided by Bernanke's undying belief that the Fed can always print more money to avoid deflation, ratcheting up the printing presses to try and save the day. Something tells us the outcome would not be as rosy as Bernanke lets on.

The reality is that runs against currencies, like runs against banks, can only be backstopped if those doing the running are provided the correct incentive to stop running. Openly printing more money when investors are, quite literally, fleeing any and all forms fiat money for the safety of gold, is unlikely to provoke a desirable response.

As for the contention that at the height of the 2008 financial crisis printing/borrowing gobs of money did in fact work to stem the crisis, it is worth remembering that during the 2008-early 2009 crisis it was financial institutions and financial markets that were under attack, not sovereign debt markets and currencies. Should the world collectively seek to abandon fiat currencies, even Bernanke is well aware that further printing will only hasten the end.

So What Does All This Mean To The Investor?

As much as we think we know about what the government of China will do to promote its interests, we have no way of knowing what millions of people will do with their fiat money should another financial crisis erupt (or the Euro-debt crisis spread). And with everyone, ourselves included, so focused on the macro conclusion that the dollar will remain a prominent reserve currency and a safe haven during times of crisis, it is easy to neglect those microscopic trends that could surprise. Quite frankly, people, in increasing quantities, are questioning the viability of fiat money. It is with this in mind that the shift into gold by many small and mid-sized investors is potentially very ominous.

On this front, we would implore everyone to read the Bernanke speech from March 2, 2004, entitled 'Money, Gold, and the Great Depression'. While the Bernanke quote above focused on the actions of the speculators and central banks around the world, Bernanke below highlights the knock-on effects of a currency/banking crisis. You cannot help but conjure up images of today when you read:

"Because bank deposits are a form of money, the closing of many banks greatly exacerbated the decline in the money supply. Moreover, afraid to leave their funds in banks, people hoarded cash, for example by burying their savings in coffee cans in the back yard. Hoarding effectively removed money from circulation, adding further to the deflationary pressures. Moreover, as I emphasized in early research of my own (Bernanke, 1983), the virtual shutting down of the U.S. banking system also deprived the economy of an important source of credit and other services normally provided by banks."

Is gold and its many investment derivatives the new 'coffee can' for a scared investing public today? Can any amount of monetary priming really counteract a full-fledged period of hoarding/deleveraging? And if Bernanke really believes in his anti-Great Depression playbook why is the threat of deflation on the rise today with the Fed sitting idly by?

"The Federal Reserve had the power at least to ameliorate the problems of the banks. For example, the Fed could have been more aggressive in lending cash to banks (taking their loans and other investments as collateral) [exactly what the Fed did in 2008], *or it could have simply put more cash in circulation. Either action would have made it easier for banks to obtain the cash necessary to pay off depositors, which might have stopped bank runs before they resulted in bank closings and failures."*

Remember that the above quote, in reference to 1931, is Bernanke's prescription to stop a run on the U.S. dollar and banks. With no gold standard in place today, currency apprehensions on the rise, austerity plans multiplying, and developed markets threatening to be overrun by debt, is a similar plan of attack really the best path for policy makers to take?

We would argue no.

Conclusions – Dollar Nears Supernova

At the end of the day, the Fed can buy MBS, Treasury Securities, equities, and literally any other asset you can think of. However, what they cannot buy via force de jour is long-term confidence in the paper they are printing. This leads to the ultimate paradox – one that we are quite certain we will be touching on in the coming years/decades:

* Bernanke is absolutely correct to suggest that printing more dollars can help solve a host of different problems. But only until the dollar itself becomes the problem.

During the quarter Friedrich von Hayek's 'Road to Serfdom' became a best seller on Amazon, more than 50-years after its original release. As Hayek gains notoriety, the limits of Keynesian thought are perhaps being reached…

Part I – Wish List Review & Outlook

Historical Wish List Performance		
Year	**Wish List**	**S&P 500**
2001	52.50%	-12.92%
2002	9.96%	-23.02%
2003	24.10%	26.05%
2004	25.27%	9.03%
2005	-3.01%	3.17%
2006	7.76%	13.59%
2007	-13.54%	3.66%
2008	-15.02%	-40.08%
2009	33.13%	32.01%*
Annualized Return	**18.50%**	**-1.27%**
Avg. Annual Return	13.46%	1.28%

** Using 4-quarter trailing dividend rate*

Since December 26, 2009 the nine Wish List companies selected – on an evenly weighted basis - have increased by 8.98% when including dividend payments and before taxes and commissions. During the same time (Dec 26, 2009 – June 30, 2010) the Dow Jones Industrial Average lost 7.09%, the S&P 500 lost 8.50%, and the Nasdaq lost 7.72% (to end only 58% *below* its all time high set in 2000). Using the first two quarters of 2010 as the reference, the Wish List outperformed the S&P 500 benchmark.

While we did not add/remove any companies during the quarter, we did get bombarded with some important new developments in three holdings (PMACA, CLRS (now BDE), and LAKE).

We continue to believe that *owning* gold is an excellent way to hedge against a weakening U.S. dollar. We have favored gold (not necessarily gold stocks) since the first Wish List in 2000. We will refrain from speculating on whether or not *purchasing* (more) gold is a safe idea right now with the metal trading near all-time highs. We will update our precious metals opinions online if they change. Our precious metals holdings are not included in Wish List performance.

Below is an alphabetical recap of the 9 companies that remain on the Wish List (loss/gains take into account historical dividend payments)

American Shared Hospital Services. - AMS

Bought – July 5, 06 - $6.12	2010 Gain: +9.66%
Hold – June 30, 10 - $2.95	Total Loss: -48.69%

A decent first quarter to begin 2010 has raised the prospect that AMS can generate attractive returns from existing and future Gamma Knife/Perfexion installations. Specifically, AMS was able to produce positive operational results for the three months ending March 31, 2010 while at the same time reiterating that future Perfexion installations are still on tap (5 additional Perfexion systems over the coming 2-years).

AMS also announced during the quarter that it has signed an agreement to bring a PBRT installation to the Kettering Medical Center in Orlando. The company is now eying 6 PBRT installations, contingent upon Still River and/or Varian receiving FDA approval for their machines.

While we remain positive, we will continue to reiterate previous sentiments as we believe they are important for any potential investor to understand.

"AMS is a speculative buy and represents a "long-term option to get in near the ground floor of proton radiation therapy." We cannot stress the word speculative enough, as AMS is a special situation company that does not fit into our more traditional investment approach."

Bowl America Inc. – BWL (A)

Bought – Dec 26, 2008 - $9.00	2010 Gain: +8.75%
Hold – June 30, 10 - $14.10	Total Gain: +65.27%

During the quarter ending March 28, 2010 Bowl America noted that two major snow storms negatively impacted financial results. These challenges are perhaps best summed up by the fact that the company was only able to produce gross margins of 14.6% during the quarter, versus 19.3% the previous year. Despite the poor quarter the company maintained the dividend rate and its balance sheet remained stable. As of March 28, 2010 Bowl America's working capital position was $8.9 million and the company had total outstanding debt of $7.3 million.

Since Bowl America has raised the dividend every year for nearly 4-decades, we do not envision that short-term setbacks will prompt a dividend cut. The business, despite some fluctuations, is durable and predictable. However, operational challenges have raised the prospect of no further dividend hikes any time soon. As of June 30, 2010 the dividend yield was an attractive 4.5%.

Chief Exec. Officer, Pres, Principal Operating Officer, Leslie Goldberg, signed a 1-year contract extension on June 22 which will see his annual salary drop to $52,000 from $76,000 (not including any bonuses). Mr. Goldberg is 80-years old. Chief Financial Officer and Controller, Cheryl A. Dragoo, also renewed her contract. Ms. Dragoo has been with the company since 1972.

Our best advice remains 'hold', consider trying to lock in *some* profits on a sharp rally, and keep some powder dry for the possibility of a share price slump.

It should be remembered that we own Bowl America for both short-term (dividend) and long-term (real estate divestitures) reasons. Regardless of whether or not prices rise or fall, our investment position may not materially change. If owning an illiquid stock is not your cup of tea, don't drink Bowl America (i.e. if you think you may quickly need capital stay away).

Clarus Corp. - BDE (new symbol)

Bought – Dec 26, 07 - $5.80	2010 Gain: +55.05%
Hold – June 30, 10 - $6.90	Total Gain: +18.96%

It took 8-years, but on May 10, 2010 Clarus finally pulled the trigger, with the deal being finalized on June 1, 2010:

"Clarus Corporation (OTC: CLRS.PK) (the "Company"), now a leading developer, manufacturer and distributor of outdoor equipment and lifestyle products, today announced that it successfully completed the acquisitions of both Black Diamond Equipment, Ltd. ("Black Diamond") and Gregory Mountain Products, Inc. ("Gregory")." 8-K

Following the deal Warren Kanders owned 6.6 million shares (including shares that only vest should the stock price rise significantly), and there were 21.5 million shares outstanding (June 24, 2010). Using the most recent share count and the quarter's closing share price, BDE was trading slightly below its shareholders' equity figure of $154 million. However, it is worth noting that almost **$100 million** of the balance sheet is in goodwill/intangibles, and the company has not released a wealth of historical financial data to help investor's model a returns profile.

We have stressed greatly about whether to continue to hold BDE now that the company has found its muse. Our conclusion is that we would not be against selling at slightly higher or even current prices, but would prefer to see how the company performs in the coming quarters. This outlook may change.

Incidentally, the danger is that if the company does not perform well over the very near-term you get stuck holding something that you probably would have never purchased with the current data available.

The two companies Clarus acquired both operate in markets which we know very little about, and their success/failure seems to have as much to do with marketing an image as constantly innovating. Competitors, of which there are too many to mention, are mostly small private companies, some of which have been around for more than a century. We do like that there is some visibility with Black Diamonds distributors, and that Gregory's revenues are 50% Asian.

Black Diamond created the 'Avalung' in the 1990s to help those caught in a avalanche survive (the device helps those buried in snow breathe). This seemingly inconsequential product does not generate a great deal of money, but does seem to be indicative of what the industry is about – unique/quality products that fit very specific needs for people that love rock climbing, hiking, skiing etc. Assuming Clarus can log some positive results, Kander's and company are sure to find plenty of acquisition options given both the specificity and small size of many competitors.

In short, we are willing to stick around and continue to research what is an intriguing set of companies.

Great Plains Energy – GXP

Bought – Oct 6, 08 - $21.62	2010 Loss: -11.94%
Hold – June 30, 10 - $17.02	Total Loss: -13.59%

Great Plains' dividend yield is attractive (4.6%) and operations have been improving following a dismal 2008-2009. However, the company's balance sheet remains more levered than we would like, and this is clearly hurting the company's performance (i.e. interest expenses almost doubled from fiscal 2007 to 2009 to $180 million). Unless operations continue to improve the dividend could be cut again.

On June 4 Kansas City Power and Light, a subsidiary of Great Plains, filed a 14 percent rate increase request with the Missouri Public Service Commission. This rate increase is required to help fund the company's expansion plans.

To reiterate what we said last quarter: "the company may not re-acquire a sense of long-term balance sheet sustainability until fiscal 2011."

We consider GXP a quality hold, but perhaps not a screaming buy. We would not be against selling shares at slightly higher prices if we found a better use for the capital.

High Liner Foods – HLF (Toronto)

Bought – Dec 27, 04 - $9.65 2010 Gain: +29.25%
Hold – June 30, 10 - $11.15 Total Gain: +27.87%

Another quarter and another dividend hike. High Liner has increased its quarterly payout 5-times over the last 7-quarters!

We still see High Liner as a forever holding, but we will try to remain objective about High Liner's business. We are encouraged by the most recent financial results, the dividend increases, the stock price advance, and that the company's operations were not deeply impacted by the Great Recession.

This said, we do hope that the company can continue to firm up its balance sheet and that management does not rush into any further acquisition adventures.

Lakeland Industries – LAKE

Bought – Dec 29, 06 - $13.78 2010 Gain: +15.62%
Hold – June 30, 10 - $9.25 Total Loss: -32.87%

From an operational standpoint LAKE logged a steady quarter for the three months ending April 30, 2010. However, an unexpected $1.6 million charge for a VAT tax expense in Brazil negated what would have been a small bottom line profit. With a sluggish economic recovery in the U.S., the prospect of LAKE firing on all cylinders anytime soon remains remote - although there is one positive that continues to gush:

"Although we have increased production of these types of products at our facilities around the world to meet the substantial increase in demand for oil spill containment and remediation purposes, we are presently capacity constrained and the back orders are mounting." Lakeland President and Chief Executive Officer Christopher J. Ryan. June 14, 2010

LAKE received some attention as the oil spill story grew, but the stock has traded wildly on very little volume.

LAKE is also taking steps to get its inventory situation under control. Specifically, "Lakeland Industries was recently named one of what is expected to be a limited number of wholesale distributors for the sale of DuPont garments in the United States." This news means that the company will phase out production of Dupont-related garments and wind down related inventories. This could, in our opinion, have a negative impact on the company's margins as it plays middle man instead purchasing raw materials from Dupont and manufacturing/selling its own products. Lower margins or not, greater visibility on the inventories, and cost savings, could provide a higher degree of predictability for investors.

We continue to believe that Lakeland is well managed. In this space in previous years, we have categorized LAKE as a 'long-term holding'. We would add the word 'potential' to this statement as we continue to analyze the business and the best direction for capital deployment in the coming years.

Manitoba Telecom Services Inc – MTB (Toronto)

Bought – Dec 26, 09 - $33.79 2010 Loss: -16.51%
Hold – June 30, 10 - $26.91

A profitable quarter to begin the year was not enough to reverse MTB's negative working capital position. Not paying out $42 million in dividends would have.

It is difficult to know when, and if, MTB will cut its dividend, although it does appear likely that if operations

do not significantly improve in the coming quarters there will be a cut(s). The yield on the stock to end the quarter was 9.4%.

For the fourth times since 2001 the Canadian government is considering removing some foreign investment restrictions on Canadian telecom companies. Developments on this front could be worth monitoring.

PMA Capital Corp. – PMACA

Bought – Dec 26, 06 - $9.17	2010 Gain: +6.50%
Hold – June 30, 10 - $6.55	Total Loss: -28.57%

On June 10, 2010 PMACA announced that it would be acquired by Old Republic International Corp. (ORI). The all stock deal (ranging from 0.5 to 0.6 shares of ORI stock) immediately valued PMACA above $7/share, which was a 15% premium to PMACA's June 9 closing share price. This seemingly attractive acquisition price was actually lower than the price level PMACA was trading at 14-sessions prior.

Assuming the deal closes as expected, it is safe to conclude that our investment in PMACA has been an utter failure. We didn't think, and the statistics never justified, that the company should trade at or above its book value. Nevertheless, we also didn't anticipate PMA would be acquired at a **45% discount** to book, especially when the company had been performing well over the last 5-quarters (run-off issues aside).

We are still considering becoming ORI shareholders (or doing nothing as the acquisition transpires) and we have also delved into the land of arbitrage speculation and derivatives considerations (ORI is optionable). However, at the end of the day we foresee an outright sale of our position as being most likely.

We have, from time to time, researched and considered Chubb (CB) as an investment option. We can only dream how much more relaxing and profitable it would have been to have selected this leader instead of the ongoing story that is PMACA…

Uranium Participation Corp. – U (T)

Bought – Dec 26, 09 - $6.69	2010 Loss: -15.54%
Hold – June 30, 10 - $5.65	

"We will gladly look like fools for 4-or more years, so long as our original thesis of a supply crunch (or investment rush into uranium) eventually transpires." WL 2010

During the quarter there was a lot of activity in the uranium sector, even though the price of uranium itself barely moved. Having slid to a low of $5.43/unit, it is safe to say that we were…ecstatic!

Some of the more interesting developments were as follows:

- Uranium One purchased a stake in Paladin Energy (April 30). Uranium One sold its stake in Paladin (June 8)

- Russia's ARMZ announced its intention to acquire control of Uranium One (June 8) and shares on UUU, at least initially, move higher. However, a day later shares plunge, the $1.06 dividend (to non-ARMZ holders) is thought by many not to be enough, and the deal is in doubt.

- Cameco increased its stake in UEX Corporation (UEX) to approximately 23.3% (June 20). However, UEX shares barely move on the news as Cameco "purchased additional shares in UEX to add a buffer to maintain its

rights under an agreement made in October between itself, UEX and Pioneer Metals Corp."

Suffice to say, in many cases all was not what it seemed in the uranium playground. We continue to be very interested and increasingly invested in the long-term uranium theme.

What stokes our excitement is that along with the 380 reactors currently being planned or proposed, 50 reactors are *currently* under construction (World Nuclear Association – February 2010. Other positives are the end of Russia's uranium agreement in 2013 (which brings both unknowns and the prospect of different supply constraints), and the current mining/price dynamics. On the latter consider the following: during 1Q-2010 Paladin Energy realized an average selling price of $50.49/lb and Uranium One averaged $46/lb, and yet both of these companies were unable to turn a profit. It is, in our opinion, highly unlikely that a $40/lb spot price is more representative of a ceiling than a floor….

Continue to color us bullish on uranium!

2010 Prospect List

2007	3.30%
2008	-49.36%
2009	59.43%

Prospects*	2Q-10
ALIF.OB	-9.28%
ICE.TO	6.06%
CDL-A.TO	3.55%
FEED	-35.32%
CPC	18.59%
MOCO	16.70%
BUI.TO	1.74%
FRU-UN.TO	4.90%
PM.V	-2.40%
PDN.TO	-16.27%
ABAT	-13.00%
SPCO.PK	16.23%
BCE.TO	9.44%
MPSP.OB	-17.81%
SLV	6.06%
GE	-6.61%
SWWC	73.51%
TIXC	-29.49%
S.TO	-12.67%
TSCM	22.03%
Average:	1.80%

The ongoing, and impressive, financial turnaround at **BCE** continues to rub salt in our MBT wounds. Our first foray into Canadian telecoms has, for lack of a better word, been a disaster.

Along with **Corby's**, one prospect we are paying the most attention to today is **FEED**. With its focus in the high growth country that is China, **AgFeed Industries, Inc.** could be a compelling long-term holding. However, rather than speculate on hog prices or a turnaround in Chinese stocks (platforms that may fall apart), we would only like to own **FEED** based upon the premise that 1) The 16-year old company can expand/sustain its market position and 2) Shares are attractively priced so as to negate what could be quarters/years with very little operational improvement. Although nearing, we do not think we are there yet…

Part II – New Research and Selections

Disclosure: We own shares in the 'Wish List' Companies covered above. We do not, nor does anyone associated with FallStreet.com, have any investment position in any of the other companies mentioned in this report. The 'Wish List' is not direct investment advice: we the producers are private investors, not professional investment advisors. Please make your own final investment decisions.

"…despite our openness to the recovery sticking around for awhile, we are raging equity bears. We believe that investors should be extremely selective when entering any stocks and particularly selective when acquiring greater exposure to the U.S. dollar. USD hegemony may not crack tomorrow or next year, but when it does come to pass it will be a game-changing investment event." WL-1Q2010

We try to refrain from allowing our macro speculations to influence our individual analysis of companies. Unfortunately – *or fortunately depending on how you look at it* – we are at the point when this is no longer possible; the point when we believe we have, baring an exceptional situation, enough equity exposure and when the equity markets in general could perform poorly over the long-term.

Akin to the 2002-2007 market recovery being built on the faulty premise of a sustainable economic advance (i.e. all the U.S. jobs created during this period are gone), the current recovery is based upon the belief that a self-fulfilling recovery will transpire once enough monetary and fiscal stimulus has been fed into the system. What needs to be remembered is that this 'system', particularly in the U.S., has been surviving off of unsustainable debt and asset price trends for more than 2-decades.

Following a horrible jobs report, President Obama proclaimed proudly that nearly 600,000 jobs had been created this year. What he didn't mention was that 652,000 people became discouraged and stopped looking for work in June alone. Until, and if, the U.S. jobs markets materially improves no recovery in either the economy or stock market appears safe.

In sum, we are market bears in search of isolated opportunities – a difficult proposition given how poorly all stocks could perform unless economic recovery continues.

American Dairy Inc. (ADY)

High growth company in a highly fragmented industry.

American Dairy deals in dairy products in the People's Republic of China. The company has been around since 1985, but only began to take its current form with its 2003 acquisition of American Flying Crane Corporation. ADY has an aggregate milk powder production capacity of approximately 1,234 tons per day. It is attractive because of its high growth outlook and respectable valuations (PEG ratio below 0.5), and also because shares have been battered during the recent sell off in Chinese stocks. Finally, in our opinion, ADY is a possible acquisition target for a larger competitor.

Product Sales ($'000)	2009	2008	2007	2006	2005	2004
Milk powder	216,230	121,255	120,418	101,502	99,486	49,065
Raw milk powder	34,328	60,753	35,566	5,187	na	na
Soybean powder	7,319	4,400	3,253	3,529	3,604	3,065
Rice cereal	6,730	4,631	5,332	3,159	3,898	7,319
Walnut products	3,070	1,663	1,212	1,509	na	na
Other	3,401	490	187	196	na	na
Total Revenues	271,078	193,192	165,968	115,082	122,799	68,023
Outstanding	19,004,337	16,993,390	16,327,616	14,745,930	13,836,573	12,077,085
Diluted	20,180,598	17,636,862	17,696,997	17,651,712	15,664,772	13,455,700
Revenues per d-share	10.71	6.88	6.80	5.75	6.35	3.65
Average stock price	24.22	10.86	19.36	13.85	6.32	3.94
Price/Sales	2.26	1.58	2.85	2.41	1.00	1.08
Current P/S ($15/share)	1.26			*Some statistics revised and/or unadited*		

What gives us pause is how poorly the company can perform quarter-to-quarter, and the fact that future operational returns are geared towards the success of the company in pushing 'higher margin' products. Whenever we run across a company that is intent on focusing on higher margin products while reducing exposure to lower margin products, we immediately become skeptical (it is like a company saying they were run by malcontents yesterday but *really* want to make more money tomorrow). The new, higher margin product offering from ADY (released in May) is AstroBaby! – a high-end series of infant formula products. How this product is accepted may ultimately determine how ADY's stock price does over the near term.

Another issue at play is a recent investment from Sequoia Capital China Growth Fund I, L.P.
In August 2009 Sequoia invested $63 million in ADY (2.1 million shares at $30/share) with the provisos that ADY cannot issue more stock unless certain performance targets are met (and/or unless Sequoia approves), that ADY must issue more shares to Sequoia if certain targets are not met, and, finally:

"…if the average closing prices of our common stock for the fifteen trading days commencing on the third anniversary of the closing date is less than $39.00 per share, the purchasers will have the right to cause us to repurchase all of the securities acquired in connection with the agreement, which could significantly impact our liquidity and capital resources." ADY, 10K.

Suffice to say, Sequoia is heavily invested in ADY, guiding the direction of the company, and diluting shareholders at the same time. This somewhat convoluted story is a major consideration, and at the end of day a potential positive for the simple reason that ADY has an unavoidable incentive to produce results quickly. That ADY has a strong insider base also highlights the incentive for results, with CEO You-Bin Leng recently purchasing nearly $1 million at $20.79/share (Mr. Leng owns almost 9 million shares.)

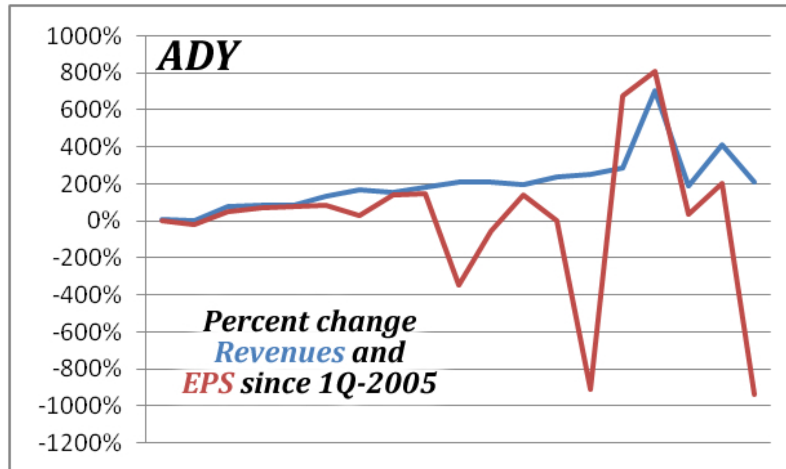
Financially Speaking

From a financial perspective ADY is attractive because it has grown rapidly and still has room to grow as the Chinese economy expands and the consumption of its products increases. However, this growth has arrived in fits and starts, and when you consider dilution the company's balance sheet has shown no improvement over the last two quarters. Question is, why?

($'000)	31-Mar-10	31-Dec-09	Sept 30-09	30-Jun-09	31-Mar-09	31-Dec-08
Cash	55,855,753	48,949,524	43,491,803	42,191,219	54,112,534	11,785,408
Current Assets	175,526,087	177,585,871	181,702,608	159,596,761	184,277,520	151,946,546
Total Assets	448,098,235	440,257,737	421,020,241	360,919,749	403,106,631	358,546,802
Intangibles	726,053	821,331	0	0	0	0
Goodwill	1,784,796	1,784,331	2,288,380	2,285,973	2,285,706	2,282,838
Current Debt	166,738,090	164,711,037	139,812,632	175,286,476	225,961,128	221,413,867
Total Debt	278,690,652	277,450,756	236,808,505	207,119,841	258,485,014	242,122,456
Shareholders' Equity	169,407,583	162,806,981	184,211,736	153,799,908	144,621,617	116,424,346
Working Capital	6,118,504	14,778,890	-2,509,128	5,796,853	39,655,903	35,522,200
Equity Per Diluted Share	7.63	8.07	8.53	7.63	8.07	6.86

The first explanation for the company's unimpressive balance sheet and volatile financial results is pricing (i.e. commodity prices/competitive forces n any category can quickly change), while another is unexpected events beyond the companies control (i.e. the melamine crisis' or new product launches from competitors). Needless to say, growth and earnings have not been pulled higher in a predictable manner, and with the company's push into higher margin areas this suggests that this trend is unlikely to change. The term 'feast or famine' is applicable.

Av. Sales Price Per Kilogram	2009	2008	2007	2006
Milk powder	$7.51	7.43	6.92	4.59
Raw milk powder	2.95	3.67	2.76	2.27
Soybean powder	2.19	2.04	1.82	1.68
Rice cereal	6.1	5.68	4.13	3.46
Walnut products	5.11	5.09	5.03	4.84
Other	6.27	0.67	1.93	0.87



Investment Opinion

American Dairy is an attractive growth story that operates in one of the world's fastest growing economies. There are major incentives in place for the company to produce immediate results, and near-term consequences if such results are not achieved. In short, ADY is a high risk/reward candidate that we would consider selecting as a speculative buy on further share price weakness. With the company being optionable, hedging strategies are also worth considering.

Some other companies we looked at during the quarter were **Baxter International Inc. (BAX)**, **Diamond Offshore Drilling (DO),** and **Oceaneering International (OII).** The latter companies have been negatively impacted by the BP Oil spill and could stage a sharp recovery in stock price, while **BAX** is a beaten down company with strong cash-flows.

Part III - Conclusions

There sometimes arrives a point in a monopoly game when your opponent has so much real estate and/or your cash reserves are so low, that you don't even risk another roll around the board. With regards to currency failures, a similar a point arrives when the prospect and pains associated with trying to pay back debt become unthinkable, untenable, and unacceptable.

Let us hope that the U.S. sees and responds appropriately when this point arrives for USD. Let us also hope that U. S. debt holders, almost certain to feel double-crossed by U.S. dalliances with some form of debt repudiation, will acquiesce peacefully. After all, everyone has to be at the table if the game is to start over again….

Sincerely,

Brady Willett
Todd Alway

Copyright. © 2010 FallStreet.com. All Rights Reserved. Tel: (506) 386-5555

The 'Wish List' is not direct investment advice: we the producers are private investors, not professional investment advisors. Please make your own final investment decisions. Shares in selected Wish List companies are purchased *after* reports are published.