GLOBAL ALPHA

April 28, 2011

Dear clients and colleagues,

This week we want to talk about the dilemma facing investors. Is it better to Buy and Hold or should an investor take profits when the price of a stock price has increased significantly in value? As portfolio managers, we face an additional challenge, in that our clients expect us to beat an index.

Our answer to the question may disappoint you. We say: It ***depends***. But read on.

For companies with strong growth prospects, we believe Buy and Hold is the right strategy as long as the valuation is justifiable. What do we mean? As a rule of thumb, if a company has an enterprise value exceeding 12-15 times its earnings before interest, taxes and depreciation (Ebitda), two years forward, i.e. 2013, it is risky, unless the growth profile is very strong (20%+) and very predictable.

The danger with selling growth stocks just because they have done well in the short term is that they might continue to do well. Short-term trading affects human psychology. If we sell the shares of a company that we still like and whose stock price we think will be higher in 12 to 24 months, two things may happen. The stock goes up and we would be unlikely buyers. Or the stock declines, and then we are afraid that it may decline more or that something is wrong with the company we do not know and we do not buy.

Source Bloomberg

Let us illustrate. The graph above is of the stock price of Monro (MNRO US), a company in the portfolio and that we profiled in October of 2008 on our web site. Monro operates a chain of stores providing automotive undercar repair and maintenance (oil, brakes, exhaust, tires, etc.) in the Northeastern US. Monro currently has a market capitalization of $930 million. It is a company that we hope to keep in our portfolio until it reaches $5 Billion market cap, the threshold at which we have to sell to respect our small cap mandate. We are convinced that the company has the characteristics to grow to that valuation. A very large addressable market. A strong

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competitive position. A focused growth strategy. A disciplined use of capital. A stable, competent, motivated and incentivized management team.

An investment in the company on January 1, 2000 returned 1410%. Yes! 14 times the original investment. An annual rate of return of 27.1%. During the same period, the Russell 2000 returned 94.9% or 6.1% annually and the S&P 500 returned 11.8% or 1.0% annually.

We could have sold the stock and bought it back many times over that period. But it is very likely that we would not have achieved the same total return and we would have triggered taxable gains.

Monro has underperformed the market for periods of time, sometime fairly long. For example, during the period from July 05 to June 08, a period characterized by rising oil prices and strong new auto sales, Monro underperformed the Russell 2000 by 35%. But from then to the end of 2010, it outperformed by 231%.

In 2011, Monro is again underperforming the index; YTD it is underperforming by 21.7%. Again, a period of rising oil prices and stronger car sales.

We wish we could predict how Monro will do against the index in the next 12 to 24 months, but if we knew for sure, we would not be writing this commentary.

What we know is that the company will continue to grow. This year, it should grow earnings by 19% and next year by 23%. The company currently sells for 8.4x next year's ebitda. Not excessive given the strong growth and below what a LBO fund or a strategic investor would pay for the company.

Source Bloomberg

The graph above shows the enterprise value divided by the forward Ebitda. We see that the valuation is in line with historical averages, not indicating an excessive valuation.

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In conclusion, we believe that if a company is not overvalued or priced for perfection, Buy and Hold remains the best strategy for investors. We constantly update our valuation model based on discounted cash flow to determine if our companies are undervalued and we have a very well diversified portfolio, knowing that the market likes to rotate between sectors and industries.

Have a good week.

The Global Alpha team

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