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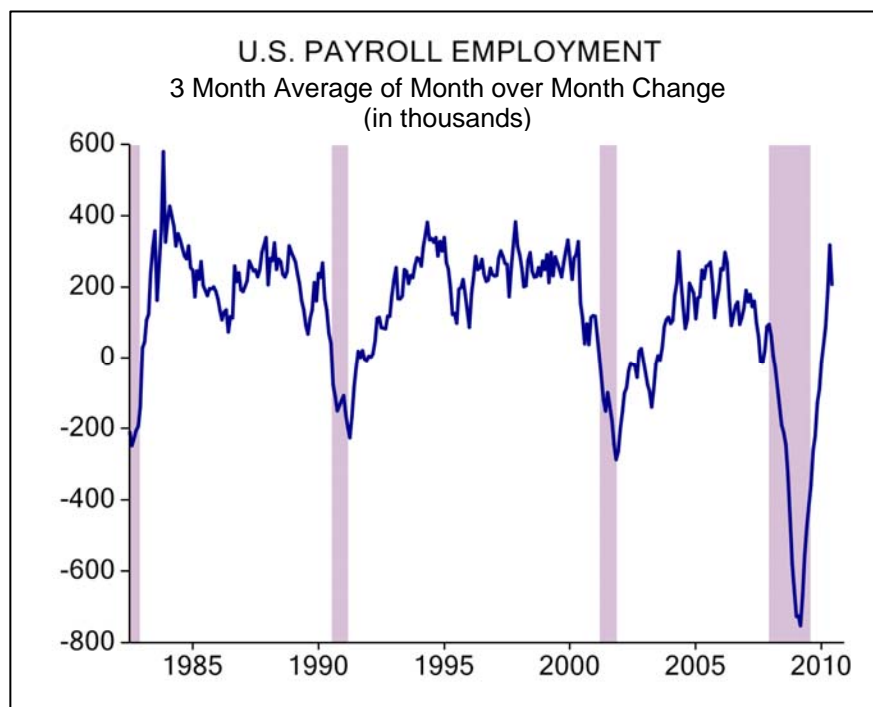
Dear Clients and Friends of Grisanti Brown & Partners,

As you know from our recent letters, and from our performance since early 2009, the value of our portfolio companies has benefited greatly from the beginning stages of an economic recovery. Over the last two months, however, they have suffered a setback as that recovery has been placed in doubt. There is clearly more “slow down” evidence than there was two months ago, and we are cognizant of the exceptional nature of world wide financial conditions, yet after weighing both sides of the argument -- a balancing that we discuss at length below -- we continue to regard an economic recovery as the most likely outcome. We believe that legitimate concerns have been magnified out of proportion by wounds barely healed from 2008, and that this has led equity investors to be overly pessimistic. What follows is our reasoning for this contrary position, a summary of the reasonable argument on the other side, and a review of your portfolio holdings.

For about 18 months we have believed that the accommodative position of the U.S. government (both our elected officials and the Federal Reserve) would create the conditions for economic recovery. We believed that the political willingness to capitalize all major U.S. banks with taxpayer money (Fall 2008), followed by a large stimulus program (Winter 2009) and accompanied (throughout) by incredibly low interest rates, would provide the foundation for an economic recovery. How we would eventually *pay* for that recovery when the bills came due was another very important question, but the immediate issue of preventing economic collapse, creating positive growth and increasing employment was addressed in an imperfect but effective manner. This solution, after all, has worked successfully to revive each recessionary economy since World War II. Some recoveries (like 1975 and 1982) have been robust, others (1991, 2002) have been anemic.¹

¹ The “double-dip” of 1981 can be explained by the anti-stimulative maintenance of very high interest rates needed at the time to combat inflation.

Similarly, in each recovery there has been ‘double dip’ fears of a second economic slowdown. Each economic statistic is scrutinized like tea leaves. Employment is perhaps the biggest statistical obsession in any recovery because of its economic and political significance. It is a lagging indicator, as it tends to improve only slowly and in fits and starts. During a ‘fit’ -- which could be a poor monthly jobs report -- fears of a double-dip recession rise, and equity markets tend to respond poorly. It is important, therefore, to smooth out the “noise” created by individual data points and take a longer view of employment, such as a 3-month average of each monthly job report. When looked at in this light, employment is clearly improving. Make no mistake -- it needs to grow further before the economy could be called healthy, and recent weakness *could be* a harbinger of a downturn. Still, we don’t believe there is enough evidence to distinguish the weakness we’ve observed over the last few weeks from the fits and starts of every post-war economic recovery.



There are many other statistics -- industrial production, consumer spending, unit labor costs and corporate profits, to name a few -- which show improvement of varying degrees from a year ago. Our position has been that U.S. taxpayers have paid a lot of money for this recovery, and we bought ourselves a decent one. The problem is, of course, that we bought this recovery on credit, and (as countries from Greece to Spain are learning) the bill will come due eventually. This is a serious problem, but it is a *different* issue than whether the recovery will take hold in the short term. This latter issue -- fear of a second economic slowdown -- is what is now spooking the U.S. equity market. Moreover, we believe this fear is magnified by painful memories of 2008 and the incredibly depressing news that comes day after day from the Gulf oil spill. (We would

observe that the market peaked on April 23rd, three days after the spill began and is down 15% since.)

But the most important reason we continue to believe in our portfolio investments in the face of the 15% decline is not found in improving economic statistics. Instead, business at our portfolio companies continues to range from decent to strong. This is the biggest difference from 2008, when conditions were terrible and getting worse. **JP Morgan** may be the best example of both the problem with your portfolio this quarter and the reason why we still have confidence going forward. It is one of our largest positions and it continues to see mortgage losses coming down, credit card delinquencies improving and its investment banking business coming back. It has one of the largest deposit bases in the United States and every day, whether the market is up or down, it is open for business. It has strong management and is now one of the best capitalized large banks in the world.² During the financial crisis it did not have a single unprofitable quarter. Perhaps the economy is somewhat weaker than it was two months ago, but that's still a far cry from 2008 and we still foresee JP Morgan earning about \$6.20 per share in 2012 (lowered by 13% due to new financial regulation). Like your portfolio as a whole, JP Morgan underperformed the market in the second quarter -- it is down 27% from its highs in April -- but at \$35 a share, it is still almost double what we originally paid for it in March 2009. More importantly, we believe it is still undervalued, and we think it ought to sell at 11 times 2012 earnings, or \$68 a share, for a potential return from its current price of about 90%.

Whether it's JP Morgan or **Dell Computer** or **Pfizer**, each of these portfolio companies fared poorly in the quarter, but continues to operate according to our investment thesis. Our earnings estimates remain intact, except for some modest reductions due to the declining euro. Rather than detailing the investment thesis for each portfolio company in the text of this letter, we have included our semi-annual Summary of Investments, which contains a description of each of your portfolio companies. The fundamental profit-making potential of these companies is the underpinning of your investment performance, and our confidence in that potential has not been shaken.

Although we believe the economy is getting better, we think it is important to appreciate the opposite side of this argument. Many will counter that the world has already accumulated enough debt that the inevitable austerity measures (think Greece) will force first Europe and then the world into recession. It is not inflationary growth they fear, but rather deflation and they regard stimulus initiatives as "pushing on a string." With consumers retrenching, governments overwhelmed with debt and even China slowing, where is the demand for goods and services going to come from? These are good questions, to which we have only hypothetical answers, but we do take comfort from the fact that these are the questions that are invariably asked in the throes of economic hard times. We submit the following quote from Time magazine:

² It is ironic that European banks are now going through fears of "toxic assets" and stress tests, at the same time that large U.S. banks can finally boast of healthy balance sheets. As we all recall, it was not painless getting to this preferable position.

The US economy remains almost comatose. The slump already ranks as the longest period of sustained weakness since the Depression. The economy is staggering under many “structural” burdens, as opposed to familiar “cyclical” problems. The structural faults represent once-in-a-lifetime dislocations that will take years to work out. Among them: the job drought, the debt hangover, the banking collapse, the real estate depression, the health-care cost explosion, and the runaway federal deficit.

That quote captures the current argument against our recovery thesis, except that it was written in September 1992, at the bottom of the recession that caused George Bush (the First) to lose to Bill Clinton. This quote shows that things can feel pretty bad, even as the economy begins to recover. In 1992 real GDP grew 3.4%, a decent showing after a recession, but clearly the Time quote reflects a much more subdued sentiment. Still, the S&P rose 8% in 1992 and 10% the next year. We believe today’s market, scarred by the events of 2008, finds itself in a similar gloomy place. But when we speak with our portfolio companies we get a different view of reality, one that might not be everything you could hope for, but is not nearly so dire as the current market would lead you to believe.

During the quarter we bought one new investment, **Air Products**, a stable, well-capitalized producer of industrial gases (like hydrogen, oxygen and nitrogen) for a variety of industries. Its detailed investment thesis can be found in the Summary of Investments. In addition, we sold a number of stocks in the second quarter. Microsoft and Cisco were sold because they had performed very well since the March 2009 market bottom (up 106% for Microsoft; 73% for Cisco) and further appreciation potential was estimated to be below our required portfolio return. We sold Wendy’s because the company had not been able to turn around its Arby’s restaurants, even though they had successfully transformed the Wendy’s division into a money maker. Finally, we sold Walgreen’s, which had been a good investment for us since purchase, but has lagged lately as its turn-around effort at stores seemed to be floundering. These sales have left us with a slight cash cushion, which we will shepherd until the current volatility either subsides or presents us with irresistible opportunities.

In closing, we are disappointed in the performance resulting from the current volatile market. Not only is this true in a business sense, but personally as well, since a great percentage of the partners’ assets are invested along side our clients in the same portfolio companies. Nevertheless, we are excited about the opportunities in the portfolio and we remain confident in the investments we have chosen. During these unsettling times, we would be pleased to answer any questions or respond to any concerns you may have. As always, we appreciate your trust and support.

GRISANTI BROWN & PARTNERS LLC