CAIRN INVESTMENT GROUP

Newsletter and Quarterly Update July 2009

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Important Reminders:

- Annual Privacy notices are Enclosed
- New Forms ADV II & Schedule F are available now online or by request

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Greetings from the Northwest!

Independence Day weekend and I am stealing a few hours away from the holiday to record some thoughts on the past quarter as well as the coming near and unknowable future. I paused to re-read the Declaration of Independence that was reprinted in the local paper. It is a remarkable document. So brave. Also remarkable is the quickly arriving second anniversary of Cairn Investment Group. July 27, 2009 marks two years as a new business during a period of anything but economic success for our communities, country and the world.

Since the first week of March, when valuations of equities seemed surprisingly low, we experienced a terrific market surge upward for about 10 weeks. Now it feels like the summer doldrums. Many have heard the old Wall Street adage of ñsell in May and go awayò. This may sound like a good tactic, and may even work from time to time, but I believe we have entered a period where the equity market will do another classic Wall Street act and ñclimb a wall of worryò. This is a remarkable time to be an investor. We are in the worst reces-

sion since 1932, interest rates are lower than low, and lending/borrowing activity is very sluggish. The biggest US Government stimulus program in decades is under way, with the first dollars just now hitting the intended projects. So what is this notion, ñclimbing a wall of worryò? As most market watchers have learned, the various markets like good news, donôt like bad news, and hate uncertainty. Uncertainty we have in abundance. Will the Administrationôs efforts and spending be successful? Will the extra spending add to national debt? How will this be paid for and by whom? Will the economy of the United States expand enough to soak

up the excess business capacity of the country? Will the world economy recover too fast and put upward pressure on commodity prices? Will the vast stimulus spending cause the dollar value to fall? Will investors flock to commodities as an inflation hedge? There are so many things for investors to worry about that you could conclude that the market could never rise. But it does, it climbs a wall, one worry at a time. Then typically, when investors look around and decide it must be safe to ñget back inò, itôs late in the business cycle.

The answers are going to be hard to see and hard to interpret when we do find them. Normally itôs not those things that we know to worry about that hurt us as investors, but those things we canôt know about that do. A case in point would be the current reorganization of General Motors (GM). Normally, the hierarchy of who gets what during a bankruptcy is fairly clear. Like a totem pole, with the common stock holders on the bottom and out of luck. Next on the totem, preferred stock holders, then several layers of junior and senior bond holders. As a part of this bankruptcy it appears that all preferred share holders and all bond holders are being blended together into a swirl with union pension obligations. The intent is to have every portion of the swirl give up its rights to what it thought it owned and instead receive some portion of 10% of the new GM. It seems as though the investorôs various status are being run over or ignored. Without being able to know what is in store for them and how they stack up on the totem pole of hierarchy, investors will not be very willing to commit their funds to an enterprise in the future.

Ellen Lara
Sean Tim Jim

Closer to home, our investment in Greenbrier (GBX) railcar and barge manufacturer is being challenged by the global slow down. This has caused their biggest customer, General Electric (GE), to want to modify an enormous manufacturing contract to build twelve thousand rail tank cars to a much smaller number. The stock price has been low enough to make you think that GBX will never build another railcar or barge again. I donôt believe that is the way it will turn out. Their next barge launching is Saturday July 11 at 9:00am. Iôll be there.

Our regional banks have also given us plenty of heartaches for the past two years. Most of the usual modeling, formulas and ratios that we use as guides for these small banks have not been useful. I do believe that in the leadership of small regional banks there is a passionate desire for success. In most situations these lenders are an important part of the small town community. The management and employees want their bank, their town and themselves to be successful. The strongest demonstration of their current condition is that the FDIC has not shut their doors. I read the FDIC closure list each Friday evening. What enlightening fun.

Low interest rates have caused us to look at some alternatives to corporate bonds in some accounts. We have embraced the higher dividend rates of some larger and hopefully fairly stable common stocks. For example Heinz (HNZ), which has recently been paying about 5% as an annual cash dividend. We have also embraced a couple of closed end bond funds (trades like a stock) and a few ETFs (exchange traded funds).

Unlike last year, when I felt the economy would begin recovering by now, I will make no near term predictions. All past recessions have ended in a recovery. That being the case I expect it to be slow and bumpy for a while. The tone of this letter may sound a bit gloomy, but please be confident that there are sunny days ahead.

Now a word from Sean Ogle, Portfolio Analyst and our all around technology wizard.*: "Many of you will remember that at the beginning of the quarter we asked you to complete an email survey regarding our quarterly reports. We had a fantastic response and really appreciated you taking the time to give us your thoughts. In the end we found some common themes, and slight changes have been made to this quarter's report. The majority of you agreed that the "household Summary" and "Portfolio Statement" reports were the most beneficial. Most people also agreed the "Portfolio Allocation pie chart" was slightly redundant and thus, the least beneficial. Therefore, in order to provide a more concise and useful report, we have removed it from this quarter's package.*

Thanks for the help and if you have any further comments please don't hesitate to email me at: sogle@cairninvestment.com".

This quarterôs group photo is from our buildings fourth floor terrace with the luxury residential ship ñThe Worldò moored along the Willamette River seawall. The office voted, and even though a ship board office suite was quite tempting, we decided to stay where we are. As always, donôt hesitate to call and come in to see us.

Warm Regards,

Jim Parr, Principal

P.S. The Oregon Sesquicentennial continues to be celebrated at the Oregon State Fair this Year August 28 to September 7.