

# BEACON STREET CAPITAL, LLC

INVESTMENT MANAGEMENT

## *Institutional-level Money Management for Individuals*

April 1, 2009

### Highlights

- The equity markets looked to growth stocks for excess returns in the first quarter as our strategies beat their benchmarks once again.
- Relative to our peer group, Beacon Street Capital was named **Top Gun Manager** in PSN's Large Cap Core Equity Universe for the 4th quarter, 1-year and 3-year periods ending December 31, 2008.
- Volatility for our portfolios remains significantly less than their benchmark indices. This dramatically improves the impact of compounding on long-term returns.

**Our Mission:** To provide a better way to invest in large-cap stocks.

**Our Objective:** To achieve significant alpha with low volatility over a 3-5 year horizon.

**Our Products:** Separately Managed Accounts of individually selected large-cap growth stocks.

### First Quarter 2009 Newsletter

The first quarter began where the fourth quarter ended, moving lower, but ended on a positive note as the rebound in commodities and emerging markets spread to US stocks that make up the materials, transportation and IT sectors. So, did equities put in a solid bottom in the first quarter or was the improvement due to sellers being exhausted? Only time will tell but for now, there is enough evidence to support both cases.

Nevertheless, our conservative approach to equity investing showed once again it's ability to outperform during declining markets. Our competitive edge is due to the growth potential we capture, the quality of stocks we own, and the amount of cash our strategy creates prior to a market decline. Consequently, our DowJones/*Select* composite beat the DJIA by 415 basis points for the quarter, while our S&P500/*Select* beat the S&P500 Index and the Russell 1000® Growth index by 777 and 88 basis points respectively. The strength of the Russell 1000® Growth index indicates to us that investors are moving away from value stocks because growth stocks are at historically low multiples relative to the growth prospects that the leading indicators are showing. Plus, in this type of environment under-valued stocks can remain under-valued for quite some time.

Heading into the second quarter, banks are expected to be profitable due to low interest rates and adjustments in mark-to-market rules. Mergers, acquisitions and even some IPO's are taking place in the housing and other sectors and this is positive as well. Any recovery, however, will be slow and if equity market declines do occur during the process they likely will be brief, but possibly sharp. In summary, massive fiscal support, low interest rates, increasingly attractive valuation levels and stronger bank capital structures should lay the foundation for an economic rebound and higher stock prices later this year or in 2010, but it will not be without bouts of fear and doubt.

Best Regards,

*BEACON STREET CAPITAL, LLC*

All results are unaudited and net of fees. Composite returns began January 2002 for the S&P500/*Select* and April 2002 for the DowJones/*Select*, are asset weighted and net of fees. Returns prior to November 2001 and March 2002 are total returns for model portfolios managed by Beacon Street Research, Inc., an affiliated company, on a real-time basis using the same methodology and manager, with stocks selected from those comprising the Standard & Poor's 500-Stock Index and Dow Jones Industrial Average. Past performance is no indication or guarantee of future performance.

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# First Quarter 2009 Newsletter

## Market Insights

The ongoing credit crisis and economic recession continued to provide a difficult backdrop for investors in the recently ended quarter and it seemed that for every step forward, investors also took two steps backward. However, as the Federal Reserve and Treasury, as well as governments around the world, stepped up efforts to support the economy and credit markets, fears of systemic collapse abated and investors began to show a new willingness to move back in and accept more risk in the markets. While January and February were dismal for equities, markets bounced back strongly after the first week of March following some positive news from the banking sector. Despite the 7.7% rise in March, the first quarter performance for the Dow Jones Industrial Average (DJIA) was the worst since 1939. The DJIA has now declined in each of the past six quarters, the first time there have been six consecutive quarterly declines since the period ending June 1970, almost 39 years ago.

Much of the news has been negative including limited credit availability and continued concern about the stability of major financial institutions; Gross Domestic Product (GDP) falling in the fourth quarter of 2008 by -6.3%, the worst decline since 1982; and the worst quarter on record (4Q 2008) for corporate profits, which also dragged down estimates for the first quarter of 2009. However there were also positive factors to grasp as well. While we are skeptical about the long-term effects of the actions being taken in the markets by the Government, providing liquidity at the current time is positive and will ease immediate gridlock. U.S. Stock valuations remain at levels not seen in several decades, inflation remains muted, oil and gas prices remain far below mid-2008 peak levels and geopolitical events continue to take a back seat to economic headlines.

One of the more important trends to watch going forward is the level and direction of the personal savings rate. Declining home prices and large stock market declines have combined to create the largest drop in household net worth since recording of these statistics began in 1952. In response households have begun to rebuild balance sheets by spending less, increasing savings and reducing debt. The personal savings rate increased to 4.2% in February after

### Exhibit 1:

#### DowJones/Select

##### Top Ten Holdings

McDonald's Corp	10.3%
IBM Corp.	8.3%
Coca-Cola Co.	7.8%
AT&T Inc.	7.1%
Johnson & Johnson	6.7%
Pfizer Inc.	6.5%
Procter & Gamble Co.	6.4%
Verizon Comm.	5.9%
Intel Corp.	5.5%
Microsoft Corp.	5.5%

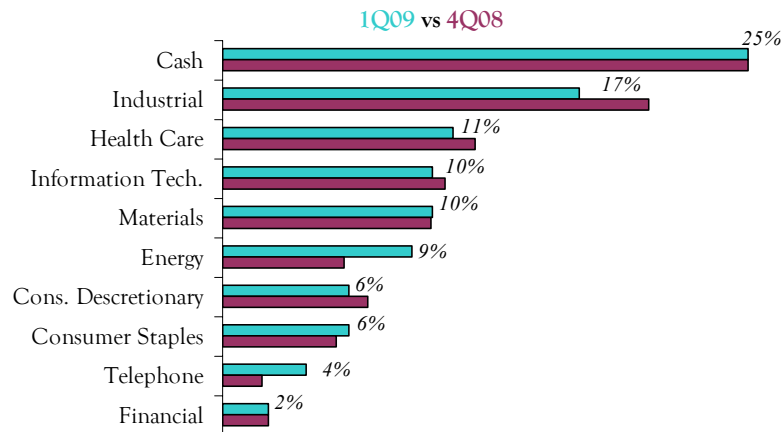
### Exhibit 2:

#### S&P500/Select

##### Top Ten Holdings

Freeport McMoRan	3.8%
Monsanto Co.	3.5%
Gilead Sciences Inc.	3.1%
McDonald's Corp.	3.0%
Apple Inc	2.6%
Mosaic Co.	2.6%
Altria Group Inc.	2.4%
Eli Lilly & Co.	2.4%
Norfolk Southern	2.4%
Baxter Int'l. Inc.	2.3%

### Exhibit 3: S&P500/Select Sector Weighting



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having been near zero over the previous two decades. Consumer spending has made up nearly 70% of economic output in the U.S. recently so any increase in saving and drop in spending is likely to put a strain on economic activity in the short term. Additionally, for the first time since 1952 U.S. consumer debt levels declined in the fourth quarter of 2008 in the first signs of de-leveraging, whether voluntary or otherwise. While a rise in personal savings and a decline in personal debt are positive long-term developments, they present challenges to consumer activity that filters through to being a short-term negative for economic growth. It is into this void that the federal government is attempting to assert itself with its stimulus spending to take up the slack in the economy. The major question is whether there will be success in this endeavor due to the size and nature of the stimulus and the amount of federal debt that will be required to fund the stimulus. Count us on the side of highly skeptical.

While there is currently talk of, and even fear of, deflation in some camps inflation expectations picked up some in the first quarter as the market appeared to price in reduced expectations for a prolonged deflationary spiral. Industrial, energy and agricultural commodity prices rose after significant declines in the second half of 2008. Additionally, the inflation rate implied by the yield on Treasury Inflation Protected Securities (TIPS) increased substantially in the first quarter. At the beginning of the quarter the 10-year TIPS breakeven rate was near zero, implying that market participants expected almost no price inflation over the next 10 years. By the end of the quarter the implied inflation rate had climbed to 1.3%, a substantial jump in just three months. And this implied inflation rate may actually be understated due to the near-term demand for Treasury securities in general as a safe haven in the current financial storm.

So where do we go from here? We will continue to be diligent in analyzing the companies in our universe and will continue to follow our discipline of buying those companies with positive growth potential and selling or avoiding those with negative potential. We expect to see some turnover in the portfolios and we also expect to continue to hold a significant amount of cash as more and more companies experience difficult sledding in this difficult environment, but over the long haul we expect to generate excess returns while limiting volatility for our clients.

*Herron P. Weems*  
*Managing Director*

## Performance Summary

**DowJones/Select:** We made one change to our DowJones/Select portfolios during the first quarter, buying Verizon Communications Inc (VZ), and this purchase took our cash position down to 18%. Verizon showed positive growth potential with its latest financial filings, plus it has a 6.1% dividend yield. As we mentioned last quarter, our theme at this phase of the market cycle is to find growth stocks with high dividends to cushion any market downturn and boost overall returns.

In the quarter we owned four of the top five performing stocks in the Dow Jones Industrial Average and six of the top ten. Pfizer, Inc. (PFE) was a great disappointment this quarter with its surprise purchase offer for Wyeth valued at

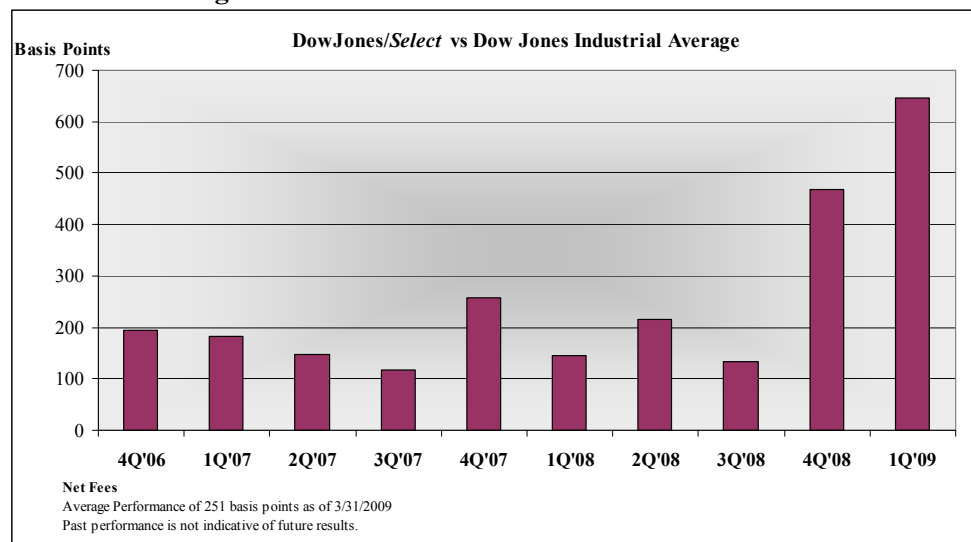
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approximately \$68 billion. This required PFE to halve their dividend which is partly why we purchased it. PFE had not cut its dividend in decades and due to their enormous cash flows we felt the dividend was rock solid. We were wrong. Should this stock return to our purchase price we will consider selling it pending the outcome of the merger process. Despite the high dividend yields and positive internal growth potential of stocks in this strategy, it still resulted in a loss for the quarter of -9.15%. However this compares favorably with a loss in the Dow Jones Industrial Average of -13.3% and a loss in the S&P500 Index of -11.01%.

Exhibits 4, 5 & 6 below show the performance of this Mega-cap core strategy. Since we view ourselves as long-term investors we felt it more constructive to look at the excess returns we have generated over a rolling 3-year basis (see Exhibit 5). This chart illustrates that while our concentrated portfolio performs well in a bull market, it provides a level of protection in a bear market relative to its benchmark.

<b>Exhibit 4: Net Returns vs Benchmarks</b>				
	<b>1Q09</b>	<b>1Year</b>	<b>3Yr. Avg</b>	<b>Inception</b>
<b>DowJones/Select</b>	-9.15%	-27.33%	-5.40%	-0.56%
<b>Dow Jones Ind. Avg.</b>	-13.30%	-37.95%	-11.85%	-4.37%
<b>S&amp;P500 Index</b>	-11.01%	-38.09%	-13.06%	-3.06%

### Exhibit 5: Rolling 3-Year Annualized Excess Returns



<b>Exhibit 6: 5 Year Statistics (April 2004 – March 2009)</b>				
<b>DowJones/Select vs S&amp;P500 Index</b>				
<b>Alpha</b>	<b>Standard Deviation</b>	<b>Tracking Error</b>	<b>Sharpe Ratio</b>	<b>Information Ratio</b>
2.81%	10.52 vs 14.69	6.53	-0.21	0.86

Source: *Informa Investment Solutions*

**S&P 500/Select:** During the first quarter we purchased seven new stocks and sold 10 for this strategy. We now own a total of 45 stocks in the composite portfolio. This gave us new positions in Energy (BP PLC and Diamond

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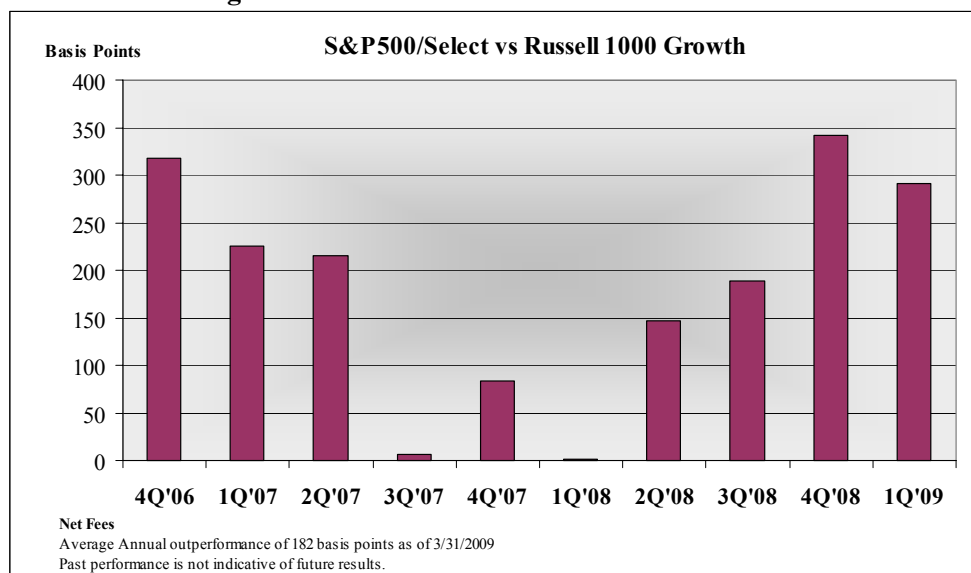
Offshore, after selling Valero), Transportation (Burlington Northern Santa Fe Corp and Norfolk Southern Corp, after selling CSX Corp), Health Care (Baxter International Inc, after selling Covance Inc) and Telecommunications (Verizon Communications). We also sold Corning Inc, Danaher Corp, Deere & Co, Google Inc, Parker-Hannifin Corp and Praxair Inc. UST was taken out due to a cash merger and the cash position in this strategy increased to 24.5% from 23% in the prior quarter.

The first quarter and longer-term composite performance for this Large Cap Growth product can be seen in Exhibits 7, 8 and 9. This strategy outperformed both its primary benchmark, the Russell 1000® Growth Index and the S&P500 Index by significant margins although all of the returns were negative. Exhibit 8 illustrates the excess returns generated from this strategy in both bull and bear markets.

### Exhibit 7: Net Returns vs Benchmark

	1Q09	1 Year	3Yr.Avg.	Inception
S&P500/Select	-3.24%	-28.28%	-8.37%	-0.27%
S&P 500 Index	-11.01%	-38.09%	-13.06%	-3.06%
Russell 1000® Growth Index	-4.12%	-34.28%	-11.28%	-3.60%

### Exhibit 8: Rolling 3-Year Annualized Excess Returns



### Exhibit 9: 5 Year Statistics (April 2004 – March 2009)

S&P500/Select vs Russell 1000® Growth				
Alpha	Standard Deviation	Tracking Error	Sharpe Ratio	Information Ratio
3.13%	12.66 vs 15.20	4.12	-0.23	1.08

Source: *Informa Investment Solutions*

### Institutional LCG:

Institutional investors seek to gain *alpha* with a high benchmark correlation. They require managers to be fully invested and the increased volatility will be offset by other investment products. Therefore we have created an institutional product, currently a model portfolio, using the actual composite trades and dividend income of the S&P500/*Select*. To stay fully invested we replaced the cash account with an Exchange Traded Fund (ETF). In this case we use the State Street Global Advisors SPDR S&P 500 (SPY).

As table 10 illustrates, excess return over the benchmark (alpha) is attained with a high correlation (RSQR) to the benchmark, but with a higher standard deviation (volatility) vs the benchmark. Furthermore, exhibit 11 shows the excess returns achieved against the Russell 1000® Growth benchmark on a rolling 5-year basis.

Exhibit 10: 5 Year Statistics (April 2004 – March 2009)					
Institutional LCG vs Russell® Growth					
Alpha	RSQR	Standard Deviation	Tracking Error	Sharpe Ratio	Information Ratio
2.69%	.94	14.78 vs 15.20	3.42	-0.31	0.81

Source: Informa Investment Solutions

### Exhibit 11: Rolling 5-Year Annualized Excess Returns

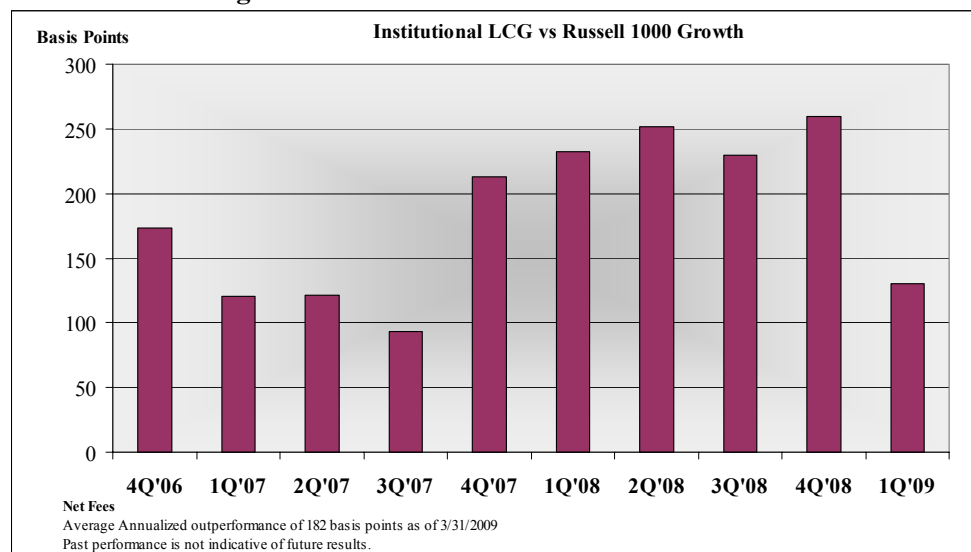


Exhibit 12: Net Returns vs Benchmarks				
	1Q09	1Year	5Yr. Avg.	Inception
<b>Institutional LCG</b>	-5.97%	-34.17%	-3.08%	-2.52%
<b>Russell 1000® Growth Index</b>	-11.01%	-38.09%	-4.77%	-3.06%
<b>S&amp;P 500 Index</b>	-4.12%	-34.28%	-4.38%	-3.82%

## About the Firm

Beacon Street Capital, LLC, provides affluent individuals and business professionals in the Southeast with a conservative, consistent, long-term approach to managing money that has generated excess returns with reduced volatility. Our strategy reflects sound investing principles, delivered with a sophisticated level of financial services. We believe our clients deserve nothing less.

We select for our client's individual equity securities that show positive internal growth potential and financial strength. These securities are held and actively monitored in a separately managed account held by an independent custodian, and we provide detailed quarterly updates.

Whether growing assets for retirement or building a family estate, we believe that wealth properly managed is wealth with a future. Please contact us to explore how we can help you with this process.

### Definitions:

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<sup>1</sup> *Standard Deviation*: A measure of volatility, or the range of a portfolio's performance. The more an investment's return varies from its average, the higher the standard deviation. Unlike *beta*, which measures volatility relative to the market, standard deviation is a measure of total risk, or the total variation of the return. The lower the standard deviation the lower the risk, or volatility of the portfolio.

<sup>2</sup> *Sharpe Ratio*: A measure of risk-adjusted return. The Sharpe Ratio incorporates the standard deviation and the excess returns over 90-day Treasury bills to measure the reward per unit of risk. The higher the ratio over 0.0 the better the investment's historical risk-adjusted performance.

<sup>3</sup> *Information Ratio*: One of the most important tools for measuring the performance of an active manager against an appropriate benchmark. It is the ratio of excess returns to standard deviation of excess returns of the portfolio, and is used to estimate the return added by the manager for each 1% of risk added by the manager. A 5-year average *Information Ratio* over 0.50 is considered "good", over 0.75 "very good", and over 1.00 "exceptional".

<sup>4</sup> *Beta*: Measures volatility in relation to the benchmark (or market). A portfolio with a *beta* of 1.5 means that the portfolio return is expected to move 1.5 times the benchmark return. If the benchmark return is 10%, the portfolio return is expected to be 15%. If the benchmark return is -10%, the portfolio return is expected to be -15%. A low *beta* represents lower volatility, which is often associated with low returns; a high *beta* represents higher volatility, which is often associated with high returns. It is unusual to have a combination of high returns and low volatility. However, a good manager picking outstanding stocks can provide excess returns without adding excess risk. This is call "adding *alpha*".

<sup>5</sup> *Alpha*: Measures the return added by the manager. It is the excess return over the benchmark return, adjusted for volatility.

<sup>6</sup> *R-Square*: Measures the correlation between the portfolio return and the benchmark return, or how well they fit from a statistical standpoint. A correlation of a 1.00 means a perfect fit and any number over .70 means the *Alpha* and *Beta* measurements are meaningful.

<sup>7</sup> *Tracking Error*: The standard deviation of the excess returns. The lower the tracking error the lower the risk.

<sup>8</sup> *Russell-1000® Growth Index*: This Index is more representative of the overall large capitalization market and thus more representative of our investment style. It is also widely used by institutional consultants, such as *Informa Investment Solutions Inc.*, which tracks and reports our performance through its *PNS Manager Database*, when seeking investment managers for their clients.