Douglass Winthrop

New York Washington, D.C. West Palm Beach

January 9, 2012

Dear Friends,

We are pleased to present our December 31, 2011 investment commentary and, for our clients, your portfolio appraisal, performance history and realized gains and losses reports. As we do every year we enclose our privacy statement and our revised form ADV Parts 2A and 2B.

Period ending December 31, 2011	DWA Equities	S&P500 Total return	DWA Composite Gross of fees	DWA Composite Net of fees
Q4 2011	11.8	11.8	10.3	10.0
CY 2011	8.4	2.1	7.5	6.4
Since inception	93.6	71.2	82.1	70.6

All figures in %

In contrast to the gloomy reports from stock market commentators, most of our client portfolios experienced a positive result last year. As indicated in the table below, the stocks in our composite returned +8.4% in 2011 vs. +2.1% for the S&P500 including dividends and are ahead of this benchmark since inception on 12/31/02.[1]

While our short and long-term results are favorable, we expect to underperform our benchmark from time to time in the years ahead. As value investors we tend to lag the market when stocks rally sharply. Moreover, like all investors, we will make occasional mistakes in stock selection. Indeed, to consistently outperform over short periods would indicate that we weren't thinking critically enough or departing sufficiently from consensus. The key is to minimize the impact of our inevitable missteps and make the most of our insights. To this end, capital

[1] As of January 1, 2009, the Douglass Winthrop Advisors Composite (DWA Composite) includes all fee-paying accounts open for at least one quarter that provide data to Douglass Winthrop's Advent system. Prior to January 1, 2009 DWA Composite included all fee-paying, discretionary accounts that provided data to Douglass Winthrop's Advent system with an equity weighting of 65% or greater and a total value of $100,000 or greater on the last day of the prior quarter. Equity Composite and Fixed Income Composite represent the equity portion and fixed income portion, respectively, of all accounts in the DWA Composite. Results are calculated using a "Time Weighted Rate of Return" methodology, are gross of fees except where indicated, and include the reinvestment of dividends. Prior to January 1, 2009, DWA Composite excluded accounts that maintained legacy positions not initiated by Douglass Winthrop where these positions comprised more than 25% of account's value, and accounts open for less than one quarter. Past performance is no guarantee of future performance, and any investment could lose value. Results are unaudited.

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preservation is our guiding star, far more prominent in our night sky than short-term performance. In our view, many investors are led astray by chasing performance, owning stocks that are "working" while selling those out of favor. We aim to do the opposite, purchasing quality stocks when market prices understate our assessment of their intrinsic value. Our greatest advantage in this effort is our patient and supportive clients, who tolerate our long-term perspective and share our intellectual interest in investing.

The lackluster return for the S&P500, which was unchanged for the year excluding dividends, masked a year of upheaval in global affairs and financial markets. Kim Jong-Il, Muammar Qaddafi and Osama bin Laden departed the world stage as the Arab Spring unleashed furies in the Middle East, toppling regimes in Tunisia, Egypt and Libya. As the Iraq War ended and the war in Afghanistan grinded on, some questioned the strategic imperative for America's continued engagement in the region. Europe struggled to sustain monetary union while member countries pursue divergent fiscal policies. Here in the U.S. the airwaves buzzed with experts warning of a double-dip recession. Amid the turmoil investors flocked to Treasuries, which began the year overvalued in our view, suffered a ratings downgrade by S&P and yet ended the year even pricier, with 10-year yields falling below 2%. Stocks underperformed bonds despite a robust start to the year consistent with an historical pattern of strength in the third presidential year. In late summer, however, stocks fell abruptly as repeated efforts to achieve bipartisan deficit reduction failed. Of the big news stories of 2011, none loom as large and disquieting as the loss of political will in the U.S. and Europe to tackle the root causes of mounting sovereign debt and fiscal deficits. Every sensible plan combines increased revenue, tax code reform and entitlement restructuring, and yet politicians fail to act. Looking ahead to this year's presidential election, the polarization of our politics and the loss of political courage are themes that concern us most.

One of the fascinating aspects of the investment profession is the interplay between current events and financial markets. The outcome of the presidential election in the U.S., the likelihood (and timing) of a dissolution of the Euro, prospects for China's currency and economy, the implications of regime change in North Korea and the Middle East – all will affect the prices of securities we own or might seek to purchase. Yet, our ability to accurately and consistently forecast macroeconomic and geopolitical events, and then to express such forecasts profitably in a portfolio of financial securities, is dubious. Naturally, we are skeptical of claims by professional investors to have mastered this alchemy, as evidenced by the dreadful results of several prominent hedge fund managers last year. We feel it is more useful to concentrate our research on the investment attributes of individual securities.

Criticizing the ocean of ink spilled on macroeconomic forecasts does not mean investors should ignore the major external factors affecting the capital markets. To the contrary, we continually assess how a range of economic or political outcomes might permanently affect the intrinsic value of our portfolio companies. Gazing into our admittedly murky crystal ball, we expect a continued tough environment for investors in the months ahead even as many observers seem to be adopting rosier outlooks. Whether the deficit and debt crises are addressed by policymakers or by the financial markets themselves, it is hard to imagine interest rates remaining at their current low level. As rates rise, bonds will fall in price, whether in response to inflationary pressure, doubts over U.S. creditworthiness or because the economy at long last gains traction. Today's buyers of long term Treasuries are betting, foolishly in our view, that over the next ten years inflation will remain subdued, stock prices will drift lower and the strongest companies will fail to raise dividends as they have done steadily in recent years. Fear outweighs greed in the bond market currently, and we believe today's Treasury bond buyers will experience mediocre nominal returns and potentially negative real returns in the years ahead.

The outlook for stocks seems better but not great. As measured by price to earnings ratios, dividends and free cash flow yield, equities are fairly priced but not barn-burning cheap, and corporate profit margins are too high to support the start of a sustained rise in stock prices. Enduring bull markets begin when price to earnings ratios languish in single digits, corporate profit margins are compressed and investors have given up on stocks. We aren't there yet and, accordingly, expect average returns from stocks in the near term.

With stock markets fairly priced and good alternatives scarce, we believe our high quality portfolio represents the best line of defense against the economic and policy headwinds we envision. In general, our companies have fortress balance sheets, robust free cash flow and wide strategic moats that act as barriers to entry against potential competitors. Many, including

Berkshire Hathaway, Becton Dickinson, Nestle and MasterCard, have business models that produce recurring revenue and abundant reinvestment opportunities with minimal capital intensity. Nearly all are managed by owner-oriented leadership teams committed to returning capital to shareholders through growth in book value or dividends, or by repurchasing shares at sensible prices. By investing in these exceptional companies our clients have the potential to compound their capital tax efficiently in partnership with some of the most accomplished corporate leaders and asset allocators in the world.

In the months ahead we will endeavor to preserve and grow our clients' capital in challenging markets as we always have, by investing carefully in businesses that meet our standards for quality and valuation. Over time we expect this strategy to produce adequate risk adjusted returns. We are grateful to you, our clients, for the confidence you have shown in our firm and for letting us do work that we love and find meaningful. We wish our clients health and prosperity in 2012 and look forward to seeing you in person in our new offices this spring at 535 Fifth Avenue.

Sincerely,

Jay Winthrop Charles G. Crane
Robert R. Douglass, Jr. Lea P. Highet
Charles T. Howard Bryce O'Brien
Grant F. Winthrop