January 6, 2011

Dear Clients and Friends,

The stock market made an impressive run last year, weathering a massive oil spill in the Gulf, a Greek debt crisis, military strikes on the Korean peninsula, surges in commodity prices and a tumultuous Congressional election with implications for taxable investors. We have included an update on taxes written by our partner, Lea Highet. For our clients, we are pleased to enclose your 2010 portfolio appraisal, performance history and realized gains reports.

Period ending December 31, 2010	DWA Equities	DWA Composite (gross of fees)	DWA Composite (net of fees)	S&P500 w/ Dividends	S&P500 Price only
1 Year	16.8%	14.5%	13.8%	15.1%	12.9%
3 Years (a)	-1.2%	-0.3%	-1.1%	-2.9%	-5.0%
5 Years (a)	4.1%	4.2%	3.6%	2.3%	0.2%
Since inception (a)	7.5%	6.8%	6.1%	6.7%	4.6%

(a) Annualized

As indicated in the table below the common stocks in our composite[1] returned 16.8% last year vs. 15.1% for the S&P 500 with dividends. Our long term results are also ahead of this benchmark and have been achieved with low turnover, no leverage or short selling and a bias toward high quality companies. In fact, our composite has produced positive results in seven of the eight years since it was established, representing an annualized return of 7.5% for our common stocks vs. 6.7% for the S&P 500 including dividends.

A brief historical perspective provides context for these figures. Our firm was founded as the Internet bubble crested and burst, discrediting a generation of talking heads prophesying no end to the ascent of technology stocks. Real estate rose from the NASDAQ ashes, propelled by institutional and then retail investors lulled by the old saw that real

[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.

estate seldom goes down, and certainly never everywhere at once. “Uncorrelated assets” were the next thing: long/short hedge funds, global macro funds, absolute return funds, funds of funds. Several endowments are recovering from that strategy, relearning the importance of liquidity, knowing what you own and the discipline of value investing. We don’t dwell on how investors fared with each investment model. Given sufficient time much conventional wisdom proves flawed. To us the really interesting questions are: where is the mispriced asset now? How might the world unfold in ways quite different from the consensus view? This exercise is harder than the retelling of history but it has the potential for profit and the integrity of pursuing truth, not fashion.

Our clients’ portfolios are managed with these principles in mind. Not diversification for its own sake, not short term trading advantages or fealty to whichever investment theory grips the popular imagination. We seek exceptional businesses run by owner managers available at prices below our estimate of intrinsic value. Adhering to this model of value investing, our clients have accumulated positions at favorable prices in companies including Nestle, Emerson Electric, Berkshire Hathaway, Brown-Forman and Becton Dickinson. We are rigorous researchers and pay careful attention to financial measures such as free cash flow, balance sheet flexibility, tangible net worth, accounting policies and returns on capital.
Equally important, our long term perspective enables us to act with conviction when market participants with shorter time horizons are buffeted by temporary events, such as monthly employment data, quarterly earnings guidance or comments by public officials. While quality stocks are not as cheap as they were one and two years ago, and bonds are teetering under the twin burdens of rising rates and dodgy credits, the highest quality stocks remain fairly priced and we are buying them.

As 2010 drew to a close the markets were abuzz with nascent social networking companies, rare earth miners, commodities of all type and bonds. Commodities in particular continue their steep ascent and it is worth pausing to reflect on their investment prospects. Today’s financial buyers of commodities are betting against paper currencies, for continued strong growth in China and the developing world, on the likelihood of higher inflation and in the hope that future buyers will pay even higher prices. Certain of these arguments make sense to us and we have participated in commodities indirectly by owning Potash, Deere, Rayonier, Canadian National Railway and the oil majors. However, a measure of skepticism is in order. Unlike companies, which if well managed are able to create jobs, products or services and pay stockholder dividends, commodities have no intrinsic value. They don’t produce income or create jobs by themselves. Looking at gold as Warren Buffett might, at current prices 100% of the world’s gold reserves are equal in value to all the farmland in the United States, the gross national products of Canada and Brazil and ten Coca Cola companies, combined. Exchanging gold on these terms is a trade we’d love to make.

A number of portfolio companies announced or completed capital transactions last year. Berkshire Hathaway closed its acquisition of Burlington Northern Santa Fe, signifying an important transition for Berkshire from a company dominated by minority investments in publicly traded companies to an operating business levered to global economic growth. Nestle completed the sale of its Alcon eye care business to Novartis, receiving over $30 billion in cash for a business acquired for less than $250 million in the 1970s. ExxonMobil completed its purchase of XTO, adding significant domestic natural gas reserves. Comcast is on the verge of completing its merger with NBCU, which should reduce the risks of owning a distribution network in a rapidly changing media landscape. Finally, Wal-Mart, Heineken and Diageo plc expanded their operations in emerging markets through acquisitions in Mexico and Africa. Each of these transactions was highly strategic in nature and was accomplished on terms favorable to shareholders.

Looking ahead we note that 2011 is the third year of the Presidency, typically a strong year for stocks. Equity valuations are reasonable relative to (rosy) earnings estimates, interest rates are low and the U.S. economy is lumbering out of recession. Taking a longer view, however, we see gathering clouds. As markets have recovered sharply from their March 2009 lows, a swelling optimism has taken hold, potentially distracting investors from risks. Despite pockets of value among the high quality stocks we've discussed, stocks in aggregate are not cheap. The market capitalization of all U.S. stocks is slightly greater than GDP, p/e multiples are above average when measured against ten-year earnings and dividend yields are low by historic standards. Government policy seems ill equipped to address the fiscal challenges that surely lie ahead. While the Bush era tax cuts were preserved, the extensions are temporary and therefore muted in their impact on corporate investment decisions. Similarly, the failure of the Simpson Bowles Commission to muster approval of its deficit reduction plan suggests a lack of political will to tackle entitlement and tax policy reform. Finally, monetary policy is too accommodating for our taste and runs the risk of reflating asset bubbles, whether in commodities, stocks or bonds. At some point bond investors will require higher yields, especially on sovereign debt, potentially stalling the economic recovery now underway. In the challenging world we envision, we believe our strategy of owning the highest quality equities in companies best positioned to prevail in economic headwinds stands the best chance of preserving and growing our clients' capital.

As we embark on 2011 we are grateful for your support and privileged to be entrusted with the management of our clients' assets, which now exceed $600 million in aggregate. We commit to doing our best every day to earn the confidence you have placed in our firm. A New Year is a time to reflect on our many blessings and to hope that the challenges besetting our country and the world will be eased in the months ahead. We wish you a happy and prosperous year and hope to see you soon.

Sincerely,

Jay Winthrop
Lea Paine Highet
Robert R. Douglass, Jr.
Charles T. Howard
Charles G. Crane
D. Bryce O'Brien