January 7, 2010

Dear Friends,

Last year marked the sixth year of positive results in the seven years since inception of our composite[1] in 2002. As indicated below the common stocks in our composite returned +8.7% in the last quarter of 2009 and have appreciated +53.0% since 2002. Over the same seven years the S&P 500 has returned +26.7% in price terms and +45.7% including dividends. These results have been achieved with relatively low risk and minimal taxable gains, consistent with our long term focus and low portfolio turnover.

Figures in %	Composite (Gross of fees)	Composite (Net of fees)	Composite (Stocks only)	S&P 500 (Index)	S&P 500 (w/ Divs.)
2009 Q4	6.9	6.7	**8.7**	**5.5**	**6.0**
2009 Total	14.0	13.3	**16.5**	**23.4**	**26.4**
2003-09 Total	47.4	40.8	**53.0**	**26.7**	**45.7**
2003-09 Annualized	5.7	5.0	**6.3**	**3.4**	**5.5**

You may recall our resolve (some might say stubbornness) in the midst of the financial panic twelve months ago. In our January 2009 letter we wrote, *"[While our] view may be unpopular considering the dreary economic news sure to come, our optimism is grounded in factual observation of the market's valuation, its historical returns and the unprecedented wave of government support for a recovery…. Comparing the earnings yield on stocks to the meager 2.4% yield on 10-year Treasuries leads one to conclude that stocks are historically cheap, bonds are extremely overvalued or both."* We believed adding to our equity exposure as the recession deepened was the best way to preserve capital for our clients, and we acted accordingly.

A striking example was American Express, which rebounded strongly off its March low, as did Heineken, Microsoft, Nestle and Loews. Given the attractive valuations available in early 2009 we were more active than usual, adding eight new stocks, including Rayonier, Emerson Electric, Canadian National Railway, Deere & Co., Potash of Saskatchewan, Sysco Corp., Becton Dickinson and JM Smucker. All are up considerably from their purchase price and have favorable prospects in a world that is interdependent, hungry for resources and determined to live better lives. To make room for these companies we sold Wells Fargo, Ingersoll-Rand, UnitedHealth Group, FEMSA S.A. and Washington Post Co.

[1] As of January 1, 2009, the Douglass Winthrop Advisors 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 represents 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.

Our largest holding, Berkshire Hathaway, was flat for the year, closing at $99,200 per A share, or 1.2x estimated book value of $84,000. In part this reflects the market's rush to favor stocks that had declined most precipitously in 2008, especially lesser quality stocks whose very existence was in question owing to weak financial attributes or business models tied to housing and financial services. There was technical pressure on the stock too, as the Gates Foundation sold shares to fund philanthropic activities. We believe last year's placid action in Berkshire's stock price masks an impressive rise in the company's intrinsic value, driven by well-timed preferred stock investments in GE and Goldman Sachs, the acquisition of Burlington Northern (and the planned 50:1 split of B shares) and a recovery in Berkshire's publicly traded stocks. Importantly, Warren Buffett invited Steve Burke, the COO of Comcast, to join Berkshire's board. Buffett is a long time admirer of the Burke family and we see his addition to the board as potentially solving the simmering succession issue. We believe the company is among the fastest growing large companies, with unparalleled financial strength and a market capitalization that materially understates its intrinsic value. We expect to own Berkshire for years to come. Our approach to Berkshire mirrors the way we evaluate every investment: we seek understandable businesses with near permanent competitive advantages run by shareholder-oriented managements and available at a favorable price.

We aim for the highest *risk-adjusted, after tax* return for our clients, not just the highest pure return. By diligently applying this approach, we have constructed a portfolio of great companies that we believe will produce superior results over time. That said our portfolio may lag the market in periods of strong bullish sentiment. One can reasonably expect a portfolio invested in this manner to deliver modest returns in the months ahead.

After a decade of no return in the stock market, we believe preservation of capital is still the right strategy as storm clouds gather over financial markets in the United States and overseas. Our chief concern now is low interest rates in the United States (and other developed nations) driven by the 0% target for Fed Funds. While the Fed's monetary policy was critical to ending the recession and warding off deflation, it is distorting markets from Treasuries to commodities, and setting conditions for inflation. Yield-starved investors are being forced to "sell" cash and chase returns in higher-yielding assets, with scant regard to valuation. Sooner or later interest rates will head higher, driven by inflationary expectations or the deteriorating creditworthiness of sovereign debt issuers, notably the United States. The timing of a reversal in interest rates is uncertain but the fact of a reversal is not. Indeed, recent events in Greece and Dubai and rumbles of solvency crises in several European countries and Japan are evidence that global bond markets may become more discerning in financing government spending. Our fear is that rates may climb higher and faster than many believe, sparking a sustained sell-off in Treasury bonds and a potential fiscal crisis in the United States.

Our monetary and fiscal policies are troubling because they limit flexibility to deal with growing geopolitical risks facing investors. In contrast to our position twenty years ago, America today is beset by challenges to its status as a world power, its currency as the world's reserve and its leadership in technological innovation. What are today contained conflicts in the Middle East could spark into wars potentially engulfing allies or creating new adversaries. China and India, with a combined population nearly ten times that of the United States, seem committed to rapid industrialization at a time the United States faces a generational expansion of government in the economy. Our leaders seem to lack the political will to reexamine energy policy, preferring instead to sustain a system that pours billions of dollars into hostile oil exporting countries and passing on a chance to lead the world in developing clean energy technologies. For the first time in a century investors face the challenge of risking capital in a multi-polar world with competing centers of economic and political influence.

Given our expressed concerns, we advise clients to stay invested in the common stocks of companies that control their own economic destiny, return capital to shareholders through dividend and earnings growth, and are able to prevail in a changing global marketplace. With a mean market capitalization of $70 billion, substantial non-U.S. revenue and a higher return on equity than the S&P 500, our portfolio includes superior companies, many of which are available at valuations near their historic lows. We believe the outlook for our stocks is benign and vastly superior to that for bonds. In fact, we view the outlook for bonds today as comparable to that for stocks ten years ago: significantly overvalued with little prospect of a positive return.

In past letters we have included commentary on tax, trusts and estates matters. Much is happening on this front and we encourage our clients to let us know if we can provide advice on these all important planning questions. It is worth remembering that low fees, tax-efficiency and common sense trusts and estates advice are as important as investment acumen in preserving and building capital. Douglass Winthrop Advisors is uniquely positioned to deliver these services and we are grateful for your support of our firm. We wish you a happy, healthy and prosperous New Year.

Sincerely,

Jay Winthrop
Robert R. Douglass, Jr. Charles T. Howard
Lea P. Highet
Charles G. Crane