



PERSPECTIVE

4th Quarter 2011

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Perspective and Choices – What to do now



Robert K. Doyle
*President &
Chief Investment Officer*

To say that the third quarter, which just came to a close, was “interesting” is a dramatic understatement. “Tumultuous and chaotic” come to mind more so than “interesting.” The third quarter saw the S&P 500 shed 14% of its value. This is the worst quarterly drop since the fourth quarter of 2008. I have been in the

investment management business for many years, and I wish I could tell you

that living and working through market volatility like this gets easier over time, but it doesn’t. Those of you who have read my letters and commentary over the years will know: I encourage everyone to stay focused on the long-term; but, I assure you, I know how difficult it can be in unsettling times such as these.

However (and you knew this was coming), I know the most prudent behavior all investors should exhibit right now is to step back and put the current market activity into a broader perspective. Trust me, I know how hard this can be (our money is invested right next to our clients), but I also know it is vital to long-term success as an investor.

In a recent letter to many of our clients, I shared some news about two stocks: Phillip Morris and Microsoft. These two companies just announced a significant increase in their quarterly dividends. The companies are growing their earnings dramatically and are returning those earnings to shareholders. Furthermore, both companies are aggressively repurchasing their own shares on the open market, which make the remaining shares held by investors that much more valuable (see a related

column in this newsletter about share repurchases by Mike Murray, our Director of Research). These two companies are not isolated occurrences. Plenty of other blue-chip companies can be found that are growing their earnings, gaining market share, paying down debt, and returning profits to shareholders.

With the financial crisis of 2008 still fresh in many investors’ minds, it is not unusual for some to compare the current investing environment to 2008. Let me tell you this is not 2008 part II. The major U.S. banks are in much better shape financially than they were before the 2008 crisis. The economy is still growing, even though the growth is weak. Certainly, troubles overseas exist as well, particularly in Greece. I assure you, one way or another, and for good or for bad, the issue will be resolved. Depending on how the overseas issues are addressed, it may have a detrimental impact on our markets or it may not. The news may already be priced into the markets or it may not. There is no way of knowing for certain. However, I do know (for certain) another crisis du jour will arise once this has passed and that new crisis will be touted by the news media as the next end of the world as we know it.

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Opportunity knocking?

A multitude of companies similar to Phillip Morris and Microsoft are quietly growing their businesses in these tough economic times. During the recent quarter, Phillip Morris and Microsoft each saw meaningful declines in the value of their shares. However, the only news from the respective Companies was good news about growing earnings. This is a classic example of the temporary disconnect that can occur between a company’s intrinsic value and its current market value. Furthermore, I have read several articles recently about how tightly correlated the stock market is right now – meaning everything rises and falls together, regardless of

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the fundamentals. This is not exactly true, but to the extent this correlation theory is true, and the market is not pricing individual stocks appropriately – that, to me, sounds like an opportunity.

Our job as investors is to not get scared out of high-quality blue-chip stocks during periods of temporary disconnect such as this one. If there are opportunities to be had, seize them. Take advantage of market pricing inefficiencies and buy something on sale. By doing so, does that mean the price cannot fall further? Of course not, but opportunity is what we all long for as investors and when you are presented with one, take advantage of it. It has often been said that investors are the only group of people that don't like a bargain.

Recently I took a break from my daily routine in the office, and at 3:30 in the afternoon, I reviewed my 401k account. I took what little cash I had, and purchased shares of Phillip Morris at \$64.56 a share. I also have my account on reinvestment, so all dividends are purchasing additional shares. My shares are down 3.4% from the time of my recent purchase, and I couldn't care less. I purchased a stock that is down 11% from its 52-week high, locking in a cool dividend of nearly 5% in a company that is dominant and growing. Please understand, this is simply an illustration of my investment philosophy, and not a recommendation for anyone to purchase Phillip Morris.

Equity valuations were compelling even before the 4th Quarter downturn

In the table below, I have highlighted various metrics of the S&P 500 at a closing price of 1,320 over the past 12 years. The key take-away from this table is corporate fundamentals are strengthening, but such strength is not being reflected in the price.

“In the short-term, virtually no risk exists for cash, but with only modest inflation, like we are currently experiencing, the loss of purchasing power will steadily decline the value of the investment.”

The lure of the sidelines

The sirens song of “go to cash until all settles down” must be very alluring right now. How tempting it must be to simply go to cash and buy back in when there is certainty and clarity. Of course, you already know in your heart that when certainty and clarity return to the markets again, the S&P 500 will already be 20% higher than it is today.

At the end of the quarter, a 10-year U.S. Treasury was yielding 1.92%, cash yields were basically at 0%, and the dividend yield of the S&P 500 was 2.35%. If my only choices as a long-term investor were cash, U.S. Treasuries and the S&P 500, I would choose the S&P. In the short-term, virtually no risk exists for cash, but with only modest inflation, like we are currently experiencing, the loss of purchasing power will steadily decline the value of the investment. As for U.S. Treasuries, I am only too happy to pass up an investment that is experiencing a yield so low and a price so high that they were last seen during the Eisenhower Administration...

As I noted at the beginning of my comments about putting the current market activity into a broader perspective, I believe the most important perspective is time. In my many years as an investment manager, I have seen bull markets and bear markets, huge single day gains and big one-day drops. The question for us at Doyle Wealth Management is not whether or not we own stocks during such uncertainty and volatility, but rather which stocks do we own and why. We buy stocks only with a long time frame in mind, based on the ability of the specific company to provide us with reliable growth at a consistent pace and a return to shareholders. We do not dart in and out of the market based on the ebb-and-flow of the nightly news. Rather, we screen balance sheets, look for competitive positions and remain true to our core beliefs. If this means buying a stock on sale from a panicked seller, we are more than glad to oblige.

*By Robert K. Doyle, CPA, PFS
President & Chief Investment Officer*

Return to Shareholders



Michael W. Murray, CFA
Director of Research

The goal of our investment research is to find companies that we believe are undervalued. In order to be successful, we must look objectively at each opportunity that presents itself. To ensure consistency, we evaluate each company using the same criteria.

“ Depending on which study you look at, anywhere between 40% and 90% of the total return from stocks have come from dividend yields and real dividend growth.”

We examine:

- Market Position
- Pricing Power
- Sources of Growth
- Gross and Operating Margins
- Free Cash Flow
- Balance Sheet
- Dividends and Share Repurchases

Dividends and share repurchases are particularly important to us because when used appropriately, they can significantly add to the total returns of long-term shareholders.

Dividends are the portion of corporate profits paid out to shareholders in the form of cash. These cash payments are typically made quarterly. When evaluating a dividend, we not only look at payment history and current yield, but we spend most of our time focusing on sustainability; and, most importantly, the company’s ability to raise future payments. Dividends have contributed a large portion of total return to shareholders. Depending on which study you look at, anywhere between 40% and 90% of the total return from stocks have come from dividend yields and real dividend growth.

Whereas dividends involve actual cash payments to shareholders, share buybacks represent cash distributed to existing shareholders in exchange for a fraction of the company’s outstanding equity. Share repurchases have gained popularity among companies because of their flexibility and tax efficiency. Dividends are subject to double taxation. Corporations pay taxes on earnings, and then individuals pay taxes on their dividend income. According to the Federal Reserve, on an annualized basis, during the second quarter of 2011, U.S. corporations overall bought back \$475.2 billion more of their own shares than they issued. Share repurchases are an effective

way for companies to return excess cash to shareholders, especially when their stock is trading at a discount to intrinsic value. Berkshire Hathaway Inc., the holding company run by Warren Buffett, recently announced a share buyback. In its announcement, Berkshire stated that its businesses “are worth considerably more” than the company’s share price.

A share repurchase, or stock buyback, is when a company buys back shares of its stock from the marketplace. The repurchased shares are absorbed by the company, and the number of shares outstanding decreases. When this occurs, the relative ownership of each share increases because there are fewer shares, or claims, on the earnings available to shareholders. A couple of things happen, but first and foremost, earnings per share immediately increase. Ultimately, earnings drive stock prices. Some financial ratios also improve but it is the increase in earnings per share that is most important to us. When evaluating a buyback, it is important to track the reduction in shares outstanding.

Many times companies announce large buybacks but fail to reduce share count due to the issuance of stock to redeem employee stock options. These types of buybacks typically benefit management more than current shareholders.

Here is a hypothetical example of how a meaningful share buyback increases earnings per share and return on assets. Suppose a company repurchases two million shares at \$10 per share for a total buyback of \$20 million.

	Before Buyback	After Buyback
Cash	\$30,000,000	\$10,000,000
Assets	\$100,000,000	\$80,000,000
Earnings	\$10,000,000	\$10,000,000
Shares Outstanding	10,000,000	8,000,000
Return on Assets	10%	13%
Earnings Per Share	\$1.00	\$1.25

Return to shareholders through dividends and meaningful buybacks is an important part of the equation when we are evaluating stocks.

*By Michael W. Murray, CFA
Director of Research*

DWM News



Anne Drake McMullen
*Vice President of
Business Development*

In an effort to strengthen the local and regional economy, Doyle Wealth Management played a supportive role in securing a visit by Florida's Chief Financial Officer, Jeff Atwater, to St. Petersburg in mid-August. During the visit, Chief Atwater met with members of the Chamber of Commerce to discuss economic issues; attended a healthcare symposium at All Children's Hospital (where Jillian Doyle serves on the Board) to discuss growth in the research/ healthcare

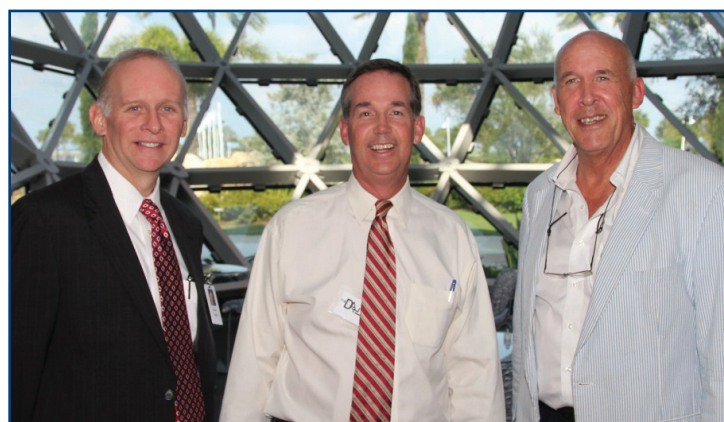
sector; and took a tour of cultural arts centers critical to Florida's tourism industry, including the Dalí Museum (where Bob Doyle serves as a Trustee).

The CFO also visited a non-profit, Louise Graham Regeneration Center, who employs adults with disabilities in a shredding business to focus on economic alternatives for our disabled population. The visit culminated with a private reception which was hosted at our office with local business leaders and elected officials.

Happy Thanksgiving!



Bob Doyle, Jillian Doyle and CFO Jeff Atwater during the reception at DWM office



Bob Doyle, CFO Jeff Atwater and Hank Hine, Museum Director, touring the new Dali Museum

photos by Mike Dupre

*By Anne Drake McMullen
Vice President of Business Development*



DOYLE WEALTH MANAGEMENT INC.

REGISTERED INVESTMENT ADVISOR

Robert K. Doyle, CPA, PFS
President & Chief Investment Officer
bdoyle@doylewealth.com

Michael Murray, CFA
Director of Research
mmurray@doylewealth.com

Brenda Dill
Operations Manager
bdill@doylewealth.com

Jillian D. Doyle, CPA
Principal & Chief Financial Officer
jdoyle@doylewealth.com

Rich Heiman
Director of Investment Services
rheiman@doylewealth.com

Patricia Chandlee
Operations Manager
pchandlee@doylewealth.com

Anne Drake McMullen
Vice President of Business Development
adrake@doylewealth.com

Stacey Ellis
Director of Client Services
sellis@doylewealth.com

Robyn Bowman
Operations Manager
rbowman@doylewealth.com

333 3rd Avenue North, Suite 300 • St. Petersburg, FL 33701

727.898.3063 • Toll Free: 800.932.8505 • Fax: 727.898.3073

If you would like to be included on our email list, please call or email Brenda Dill at bdill@doylewealth.com