Suncoast Equity Management, Inc.

January 5, 2010

Dear Client:

During 2009 SEM investors achieved a 24.8% positive portfolio gain versus a 26.4% gain for the S&P500 index. During the two year period of 2008-2009, in which equity markets experienced the biggest short term decline since the crash of 1929, our clients meaningfully outperformed the benchmarks. We benefitted most by sticking to the **SEM – Disciplined Investment System** (SEM-DIS) which avoids risky companies. Over the years, the SEM-DIS produced solid relative results with less risk, as evidenced by a $1 million investment at our inception has grown to $2 million while this same $1 million would have only grown to $1.4 million if it was invested in the S&P 500 index. With the market up 60%+ from its March 9th 2009 low, you might feel as though the market has gained all it can. We believe that equities are still attractive and likely to achieve higher long term returns than bonds over the next decade.

Sticking to our discipline

Given all the market gyrations that have occurred in the past year and decade, having a sound investment discipline is critically important. We built our investment process to withstand financial crisis, inevitable shocks and other rough periods incurred throughout the business cycles. We understand that we will be investing in stocks during all types of future conditions including falling and rising interest rates, deflation and inflation, a weak and strong dollar. Our collective businesses are durable, weather-proof and can grow their intrinsic value over the long term.

The SEM-DIS foundation begins with the understanding that we are fractional owners of real businesses. This is unlike how most people think of stocks as pieces of paper or a digital quote whose price fluctuates wildly at times, up and down. Next, we incorporate various margins of safety, some quantitative, some qualitative including that we stay within our circle of knowledge. Finally, we understand the relationship between price and value; we take advantage of price when it is disconnected from value.

To be a successful investor it is not necessary to have an opinion of every company on the stock exchanges. We focus our efforts on companies with competitive advantages. Consequently, we are most knowledgeable about businesses that meet those general criteria. Our margin of safety emphasis is also a key contributor. The above market results we earned over time can be attributed as much to what we have avoided (low quality, high risk companies) as to what we selected.

Portfolio highlights

Looking forward, our businesses will continue to pursue long term growth. **Colgate** (CL), one of our key holdings for nearly seven years, has plenty of opportunity ahead as per capita toothpaste consumption in many emerging markets is still well below what would be implied by just once a day tooth brushing, let alone twice per day. CL's global distribution platform has a 44% share of the global toothpaste market, with a marketing-leading 36% share in the U.S. and 70%, 35%, 51% and 32% in rapidly growing markets of Brazil, Russia, India and China. Its core toothpaste category is less exposed to private-label threats as consumers tend to be highly brand loyal in oral care products.

SEM-DIS is drawn to growth businesses that earn above average returns on capital. Our technology holdings meet that criteria and cover a bit of the waterfront by serving different products, markets and experience different growth rates. Economic advantages can be similar in nature but at different development stages. Two of our holdings come to mind, **Microsoft** (MSFT) at a more mature stage and **Apple** (AAPL) at an earlier stage for their current number one product, the iPhone. We have owned MSFT for many years and we recently added a small position of AAPL to the portfolio. Both these companies share at least one, if not two, favorable components of economic moats that our friend at *Morningstar* research labels as (1) *network effect* (2) *switching costs*. *Network effect* occurs when the value of a product or service increases with the number of users. In terms of MSFT, it is its well-established and broad-reaching franchise of Windows, Office and Outlook, servicing corporate workers. MSFT's new Windows 7 operating system has achieved good reviews compared to its predecessor Vista, and is being warmly embraced as corporations look and need to upgrade. For AAPL its rapidly emerging iPhone serving mostly consumers is also benefitting from the *network effect*. Network based businesses can develop into natural monopolies or oligopolies.

Switching costs ask the question; do the costs – in time or money – of switching to a competing product/service outweigh the benefits? In the corporate world the costs and effort to adopt a new email server or move away from Microsoft Word, Excel and PowerPoint may not be worth potential savings, especially if everyone else uses those same products to communicate with. For AAPL the switching cost consideration has not occurred yet on any grand scale but could in the near future. When you need to replace or want to upgrade your phone it is highly likely you will stay with the iPhone because of all the applications you've downloaded. Your iPhone apps are not transferable to a Blackberry, Palm, Nokia, Samsung or Motorola phone. The entire "apps" phenomenon, started and led by AAPL, is creating significant switching cost barriers. Network effect and switching costs tend to strengthen and then weaken over time as competition tries to wedge-in for a share of those high returns. For MSFT and AAPL, future challenges to their existing economic moats can be addressed with the support of very strong cash rich balance sheets and sizable research and development staff. We eagerly await these developments to further play-out and look forward to the potential returns to us as shareholders.

Despite our expectations for lower defense spending we still believe **General Dynamics** (GD) has an opportunity to grow. Acquisitions are an important growth component and opportunities are more plentiful in an economic downturn. Meanwhile, GD's defense programs on balance have a fairly positive outlook, including cyber security and Ohio-class submarines. The Gulfstream business is being supported by the Jet Aviation service business bought in 2008. A company in our portfolio whose intrinsic value has risen but whose stock price barely budged in 2009 is **Berkshire Hathaway** (BRKB). We believe that Buffett took advantage of the financial crisis and made a number of very good investments this past year, culminating with the largest, Burlington Northern Santa Fe Railroad (BNI), in November. As a result, our Class B Share holdings will get split by 50 to 1 in the first quarter to accommodate stock being issued to BNI shareholders wishing to become shareholders of BRKB. If the economy heads toward a steady growth path, Buffett's many existing and new businesses have strong potential, meanwhile its rock solid balance sheet remains at the foundation.

Quick look back and forward

A look back over the last decade reveals it has been tough on several fronts and not just for business and equity investors. In spite of the difficulties, some positive global issues offer a peek into the potential for the next decade as it relates to investment prospects. Foremost, even though the U.S. engaged itself in two seemingly endless and intractable wars, across the globe economic and political liberalization propelled hundreds of millions of people up the income curve. As recently reported by the *Wall Street Journal*, the number of households with annual disposable incomes of more than $10,000 rocketed in countries as diverse as Algeria, Brazil, Kazakhstan and Poland. China zoomed past Japan and the U.S. to become the largest market for auto sales. And mobile phone subscriptions in India as well as other nations rose 240-fold over the last decade. In the U.S. the percentage of households utilizing broadband grew from below 20% to above 80%.

Although the exact progress the world makes is unpredictable, equity markets will benefit. We will have challenges and hurdles to overcome, especially a U.S. administration that is becoming increasingly involved in business affairs and in need of a stronger financial position. Businesses have a global opportunity to grow during the next decade and the outlook for our portfolio is positive long-term given the solid business prospects for our companies and the relative value of our stocks versus fixed income investments. Watching a little college football this weekend I was somewhat amused and taken aback that Citibank would waste its ad dollars on a national TV commercial offering a 2.5% CD rate for five years. At SEM we will hold true to our purpose and mission, preserving and growing your wealth while taking less risk. We recognize that it is our personal responsibility to execute this mission and to make the greatest effort to continue to learn and work to improve it. Thanks for your support and Happy New Year!

Sincerely,

Donald R. Jowdy
President

P.S. – We have embraced social networking with the purpose of keeping those interested more informed of our current thinking. So please join us on **Facebook** and become a fan as we share with you our thoughts, articles of interest and book recommendations from time to time. If you are not familiar with Facebook but have an interest in receiving the messages we post, give us a call or send us an email at info@SuncoastEquity.com.

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Performance results versus the Standard & Poor's 500 Index

Time Period	**SEM % Return***	**S&P 500 % Return**	**SEM - Value of $1,000,000**	**S&P 500 - Value of $1,000,000**
One- Year	+24.75%	+26.41%	$ 1,247,500	$ 1,264,100
Three-Year	-1.34%	-5.63%	$ 960,300	$ 840,200
Five-Years	+0.67%	+0.40%	$ 1,033,700	$ 1,020,000
Ten- Years	+2.69%	-0.97%	$ 1,304,300	$ 906,900
Inception (12 Years)	+6.13%	+2.91%	$ 2,042,600	$ 1,411,300

* Composite results of all SEM managed accounts, net of all fees.
Note: Performance results for the three, five, seven and ten year periods represent the annual average rates of return.

SEM Composite Account
vs. the Standard & Poor's 500

Year	**SEM***	**S&P 500**	**Relative Results**
1998	26.19%	28.57%	-2.38%
1999	24.10%	21.03%	3.07%
2000	4.50%	-9.15%	13.65%
2001	0.35%	-11.91%	12.26%
2002	-10.98%	-22.15%	11.17%
2003	20.12%	28.62%	-8.50%
2004	12.52%	10.96%	1.56%
2005	-0.51%	4.86%	-5.37%
2006	8.20%	15.77%	-7.62%
2007	10.13%	5.48%	4.65%
2008	-30.10%	-37.03%	6.93%
2009	24.75%	26.41%	-1.66 %
Since Inception (Overall Gain)	104.26%	41.13%	63.13%
Average Annual Gain	6.13%	2.91%	3.22%

Suncoast Equity Management's (SEM) performance is Net of All Fees.
Highlight denotes years of meaningful underperformance.