Suncoast Equity Management, Inc.

January 6, 2009

Dear Client:

2008 has been a difficult year, to put it mildly. The year began with a business slowdown and then weakness intensified in the fourth quarter. We ended the year in the midst of the most severe economic downturn in a generation. SEM managed to outperform but not escape current conditions as the composite accounts declined 30% versus -37% for the S&P 500. The atmosphere is decidedly pessimistic (and perhaps too much so) going into 2009. Our position is to stay humble in face of a difficult period, but remain open to the possibility that recovery could happen sooner than most believe. Meanwhile, we see some of the best investment opportunities for patient, long-term investors that we have ever seen.

Recession to the Near "D" Word?

With unemployment rising and consumer demand falling precipitously, we take a quick look at Nobel-Prize winning economist Milton Friedman's thoughts. Freidman believed a recession erodes into a depression if the following develop:

1. Decline in the money supply
2. Higher trade tariffs
3. Raising taxes

In mid December, the Federal Reserve pledged to print dollars in unlimited volume and to trim its funds rate, if necessary, all the way to zero. So we have an increase in the money supply but it comes with short and mid to long term consequences we need to monitor and address. Near term, the increase in money supply depressed the value of the dollar against foreign currencies. We can't have foreign companies and governments scratching their heads asking why they are investing in the US$ if we continue to debase the value of it and as we must continue to welcome this inward investment. Down the road we will face the consequences of higher inflation. While the credit crisis needed a lending hand, we shouldn't run the printing press for much longer.

We can mitigate the negative consequences of bailouts and the flood of new money by driving beneficial actions with trade tariffs and taxes. We should hold firm on existing free trade agreements and strive to negotiate and enact new ones. We need to lower our corporate tax rate below the 35% level, which is the second highest in the developed world, as this action would free up cash flow for investment in research and product and service development. As President Barack Obama brings his new team into gear we hope they adopt these useful policies.

One indicator to watch closely is productivity, which is the value of output of goods and services a country produces per worker. Productivity is a key measure in realizing that the current generation is living better than the previous. Productivity growth slowed to 1.4% in 2007 from an average growth rate of 2.7% during 1995-2002. The interpretation; at 1.4% it takes nearly 52 years for the average U.S. living standards to double, versus 26 years at the 2.7% average. Productivity thrives within competitive and free markets. During the last twenty years, markets from commodities to semiconductors have gone from regional to global and any backward drift towards protectionism will hobble productivity and global growth. We see innovation ahead in areas such as cloud computing, nanotech engineering and saving energy.

Quick Rebound from Here?

The most remarkable difference between today and previous recessions is the connection among consumers throughout the world. Why is this? Everything runs at internet speed and everyone reacts at the same time. We have raised this idea in previous letters but more evidence exists. Following the collapse of Lehman in September there was an immediate decline of new auto purchases by consumers in China. Data shows car sales and a host of other discretionary spending declined year over year by 10% - 20% in October and November. This near instantaneous reaction of China consumers to the credit crisis in the U.S. is a new element of the global economy and our generation. Heightened information flows lead to both greater productivity (as we mentioned above with semiconductors) and greater volatility in the global markets.

The nearly universal sentiment going into 2009 following the dismal holiday shopping season is that this recession will get deeper and the spending declines experienced in the fourth quarter will continue for some time. But could we experience a quick rebound? If activity came to a halt more quickly than ever before, it could also restart more quickly. This is not a prediction but living in an Internet based world makes it a greater possibility.

Trust and Faith

As Warren Buffett once declared, “you only find out who is swimming naked when the tide goes out.” We have seen a number of collapses this year both from toxic assets (Lehman Brothers and others) and toxic individuals, with the most significant and sad being the astonishing twenty-year Ponzi scheme run by Bernard Madoff. Trust is broken because of events like this and the end result is a loss of faith across all kinds of investors. Mr. Madoff’s scam, which surfaced amidst the reality of a most difficult market, is worth a brief visit to guard against future dealings with unscrupulous characters. Madoff preyed on several shortcomings of human nature. The most prominent is the concept of social proof that people will follow and do what others do without a second thought. *The Wall Street Journal* columnist Jason Zweig huddled with noted psychologist Robert Cialdini, to summarize that Madoff created an aura of secrecy, mysterious allure, invitation only and exclusive club stature to fortify a “no questions asked” environment. The roughly 1% a month smooth returns reported to clients, on only Madoff letterhead (instead of an independent brokerage statement), for nearly two decades, in spite of the realities of the up and down markets were rarely questioned by existing investors. They should have been. Many other red flags were present including that Madoff’s books were audited by an accounting firm, Friehling & Horowitz LLC, which had no other like clients and no one had heard of except those associated with Madoff. Contrast that with the firm, ACA Beacon (www.beaconvs.com), which verifies **SEM**’s performance record, and the record of many other investment firms, which is among the top in our industry.

Relative Value – Time for Stocks

Significant amounts of capital have been pulled from the equity markets and invested in U.S. Treasuries. The Federal Reserve reports that the ratio of cash to market value of U.S. companies is at its highest since 1990. Allocation decisions are made on an individual planning basis (and we can help with this) yet this massive reallocation to cash, especially into Treasury securities, does not bode well for preservation of capital when inflation returns. Here is how it lays out:

	2008 Year End		2008 Year End
Treasury Yields		***Suncoast***	
2 year	0.8%	Price to Earnings Ratio	12.4
10 Year	2.2%	Earnings Yield	8.1%
AAA Corporate Bonds		***Standard & Poor's 500***	
2 year	3.3%	Price to Earnings Ratio	12.7
10 Year	4.4%	Earnings Yield	7.9%

If you invest $100 today in 10 year Treasuries you will receive a $2.20 yield. The same investment in AAA corporate bonds would return $4.40 and in the SEM portfolio would return $8.10. The earnings yield for the SEM stock portfolio is more than three and a half times Treasury yields and near twice the AAA Corporate Bond yield. This is a meaningful difference with the advantage clearly in equities corner.

You buy bonds to get yield and stocks to get the earnings; though, you’ll need earnings to fight inflation, as fixed rates of return at these low levels won’t be much help. The earnings for stocks are obviously down (and could fall further in 2009) but when the economy comes back, they will grow compared to returns on bonds which are fixed and low. In past recessions such as 1990-1991 and 1974-1975, AAA corporate bond rates were more competitive at the 9% level and stocks moved to lower valuations as a result. AAA credit ratings are held by companies such as ADP and Microsoft. Investors can seek higher corporate 10-year yields, but in most cases must incur greater risk.

Businesses pay dividends out of earnings. Although this is not a primary factor in our selection process, it is of interest to note that our portfolio yield of 1.9% is only slightly below that of a 10 year U.S. Treasury yield. The dividend yield for the S&P 500 index is higher at 3.0% and exceeds the current 2.2% yield on 10-year Treasuries, which hasn’t happened since 1957. The S&P 500’s dividend yield is also nearly twice what it was at the end of 2007 and the highest since 1990.

Earnings growth is a more important component for the SEM stock portfolio. We anticipate earnings growth for our portfolio of approximately 6%-8% in 2009, in spite of a few companies that will likely experience an earnings decline. This growth rate is well ahead of the slight decline in earnings expected for the S&P 500 companies in the aggregate.

Portfolio Commentary

We continue to apply our time-tested and proven **Disciplined Investment Process** (**SEM-DIS**). Our approach is to own high quality businesses with great financial strength that do well in all circumstances. The companies we own rarely hit the ball out of the park but rather achieve long term gains that accomplish our goal of preserving and growing capital.

Several of our companies will experience a contraction in earnings in the coming quarters but they are not in a permanent decline. The intrinsic value of a stock is the discounted free cash flows the underlying business will generate in the coming years, *not just the current year.* Several companies are recession-resistant, few are recession proof.

Our companies have cash either on their balance sheet or can borrow because of high credit ratings. These companies clearly have the opportunity to support growth by buying complementary or competitive businesses at discounted prices. Recent examples in our portfolio include **General Dynamics (GD)** strategic purchase of Jet Aviation for $2.25 billion which expands its ability to service Gulfstream and the business jet market well beyond North America. The purchase price GD will pay is equal to about one year of the company's operating free cash flow. Another recent example includes **St. Jude Medical's (STJ)** purchase of Radi Medical and MediGuide for a combined $550 million. MediGuide's medical navigation technology has meaningful potential for multiple applications while Radi Medical provides technology for physiological assessment of coronary lesions and separately a device for vascular closure, among other products.

Berkshire Hathaway (BRK) continues to take advantage of this opportune investment environment. Though Buffett could not close on its September bid for Constellation Energy (as that company accepted a competing bid from Electricite de France), he still doubled his (our) investment. For the original $1 billion investment, BRK's subsidiary MidAmerican will realize in value over $2.1 billion by receiving (1) $600 million in cash, (2) 9.9% ownership in Constellation recently valued at $530 million and (3) a one year $1 billion note earning 14%. In a separate announcement just before year-end, the state of Florida paid BRK $224 million for a 2008 agreement. That agreement would have called on BRK to buy $4 billion of 30-year Florida bonds (which BRK would have earned 6.5% annually) if the state fund incurred $25 billion of hurricane losses this past year. The state of Florida felt it was worth paying BRK this money because of the uncertainty of its ability to issue bonds in that environment had it occurred. It goes without saying that we are delighted to be part owners of this enterprise and hope the investment opportunities keep rolling in.

We have made some changes in our portfolio with an emphasis on relative value and companies that can grow their earnings even during difficult times. We accept earnings weakness during a general economic downturn but will disengage from owning those businesses which have unexpectedly lost share or other business advantages. An example this past quarter was our sale of **Nokia (NOK).** NOK is still the global market share leader in mobile phones at 38%; however, in the smartphone segment its market share dropped to 38.9% from 51.4%. Although NOK still believes it can pick up share, likely from struggling manufacturers such as Palm and Motorola, the steep loss of share in this profitable segment globally to Apple's iPhone and Research-In-Motion's Blackberry is concerning and not likely recoverable.

The worst mindset is that it is all gloom and doom. Although the markets will remain volatile, and the remaining bad loans will likely get reconciled to asset values, the U.S. and the global economy are remarkably resilient. Trying to guess the bottom is futile. The high quality companies we own are selling at discounts not seen in years. The flight from equities creates some of the best opportunities for patient, long-term investors. Thanks for your continued confidence. Please call anytime.

Sincerely,

Donald R. Jowdy
President

Suncoast Equity Management, Inc.

Performance results versus the Standard & Poor's 500 Index

Time Period (Ended 12/31/08)	SEM % Return*	S&P 500 % Return	SEM - Value of $1,000,000	S&P 500 - Value of $1,000,000
One- Year (2008)	-30.10%	-37.03%	$ 699,000	$ 629,700
Three-Year	-5.92%	-8.40%	$ 832,900	$ 769,000
Five-Years	-1.39%	-2.20%	$ 932,400	$ 894,700
Seven- Years	-0.04%	-1.56%	$ 996,900	$ 895,900
Ten- Years	+2.64%	-1.41%	$ 1,297,400	$ 867,700

* 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%
Since Inception (Overall Gain)	63.74%	11.56%	52.18%
Average Annual Gain	4.59%	1.00%	3.59%

Suncoast Equity Management's (SEM) performance is Net of All Fees.

Highlight denotes years of meaningful underperformance.