



# EDMP, Inc.

## Quarterly Review 4th Quarter 2009

### Value over Volatility

Calendar year 2009 was a very profitable year for EDMP's valued clients. Even though the general stock market posted a strong recovery off of 2008's abysmal lows, our portfolios performed significantly better than the averages. Although the money was good, we believe the real value lies in the lessons to be learned.

It is our contention that 2009's outperformance was not an accident. Instead, it was a function of calculable mathematical principles of true and timeless sound investing practices. Even though stock price volatility can be extremely irrational in the short run, stocks do in truth have an intrinsic value. This True Worth™ is based on earnings and cash flows and therefore, can be rationally calculated. In the longer run, value is more important than volatility.

The recession of 2008 was a horrific and traumatic experience for investors, this cannot be denied. Based on price volatility, our portfolios followed the markets down in 2008. On the other hand, based on financial strength and earnings prowess, our companies performed much better than the average stock. To us, this is a testament to the long-term benefit of investing in the strongest companies. While the general stock market's price followed earnings down, our stock prices fell even though the earnings of our companies held up.

Consequently, based on earnings and financial strength, most of our portfolio companies became significantly undervalued. The stock market in general was priced as it deserved to be because of falling profits. In 2009, the profits of the S&P 500, a proxy for the general market, recovered and stock price rationally followed. The S&P 500's return for 2009 closely tracks and correlates to its 2009 earnings growth rate.

This is clearly depicted in Figure 1 below. Note that stock price for the S&P 500 ended above 2009 earnings at a closing PE ratio just above 19. This is slightly higher than the last 20-year average PE ratio of 17.5, and above the 80-year average S&P 500 PE ratio of 15. However, also note that current S&P 500 stock price is below earnings estimates for 2010. The bottom line is that we believe the general stock market today is fairly valued to slightly overvalued.

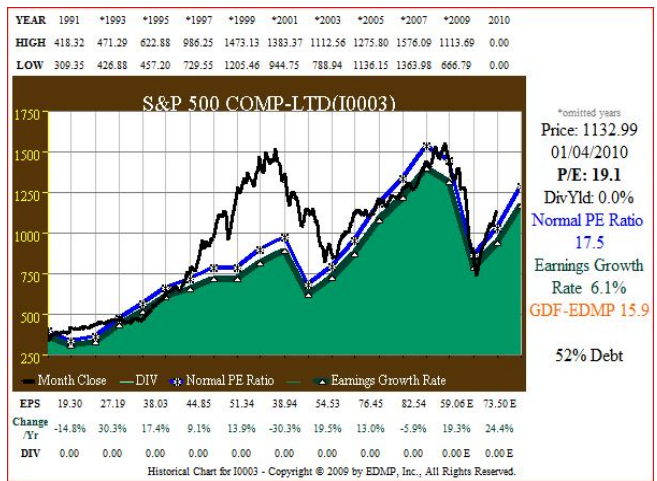


Figure 1 - S&P 500 20yr Earnings Correlated to Price

In contrast to the general stock market (S&P 500), we believe that our current portfolio in the aggregate remains fairly valued to undervalued based on current earnings and future earnings growth potential. There are a handful of portfolio companies that we feel are priced at the outer limits of our valuation model. Even though they are strong companies that we still like, based on valuation we are evaluating either a lightening up of the position or an outright sale. Fortunately, we are also evaluating several potential replacements that we feel offer compelling value.

Therefore, looking to the future, we still see a lot of potential opportunity in our current portfolio. On balance, our stronger-than-average companies are in our view poised for growth and fairly priced. In fact, many remain undervalued even considering their strong recovery in 2009. Others are fairly priced and expected to grow at above-average future rates.

There are important lessons here that we feel strongly need to be learned. The first is to make the distinction between the so-called stock market versus your specific portfolio. Your 2009 results were significantly better than the market's because your portfolio companies were stronger, faster growing businesses that were and are above average. Even though their earnings were solid, panic selling sunk all ships in 2008 and into the first quarter of 2009. However, as the year unfolded, the crème rose to the top. As previously noted, the drop in the market was justified, the drop in our portfolios, in our opinion, was not.

The next lesson is the importance of valuation. Like virtually all money managers, we had clients flee stocks and liquidate in 2008. Even though the intrinsic value of their portfolios were higher than the market was pricing them, the pressure was too great. It was difficult for us to watch clients sell perfectly good stocks for far less than they were worth.

In Figure 2 we look at Aflac, a financial that maintained strong earnings, yet was pummeled by the market nevertheless. We believe that even after such a strong recovery, Figure 2 illustrates that Aflac remains undervalued today. Whether overvalued or undervalued considerable research over many years has convinced us that price will inevitably move to True Wroth™ value.

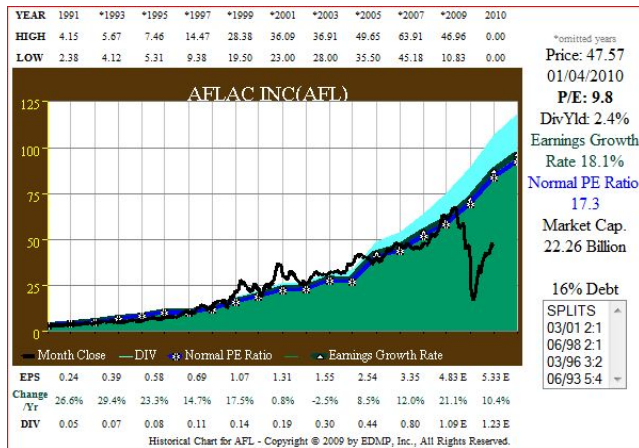


Figure 2 - Aflac 20yr Earnings Correlated to Price

In Figure 3 we look at Nike, an example of a company that had only a modest drop in earnings but a large drop in price. As you can see, the stock price quickly recovered. We believe that Nike is fairly priced today, but not undervalued.

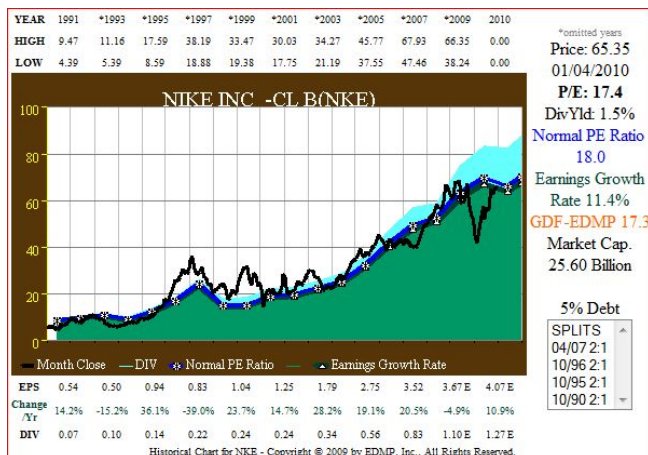


Figure 3 - Nike 20yr Earnings Correlated to Price

Our final example is Danaher which experienced a drop in earnings, but hardly a collapse. In truth, 2009 was a very profitable year, though lower than 2008. The recovery in price has led to what we feel is a modest overvaluation currently. Therefore, we are searching for a more attractively valued replacement. Note that we still like Danaher and its prospects for growth, only the valuation bothers us.

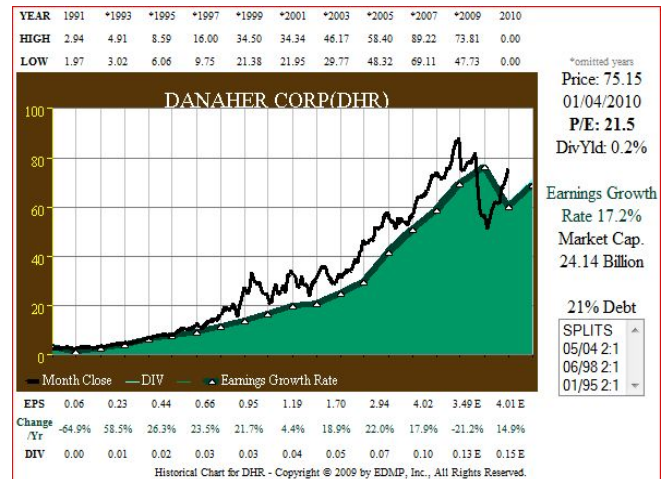


Figure 4 - Danaher 20yr Earnings Correlated to Price

The final lesson is one that we have preached about incessantly: Earnings Determine Market Price, always have, always will.

Sincerely,

Charles C. Carnevale  
Chief Investment Officer

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