



# Johnston Asset Management

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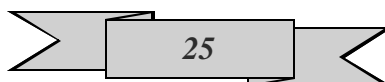
Richard Johnston  
President

Happy New Year! We are gratified that after a very difficult 2008 and a harrowing first quarter of 2009, market and portfolio returns rebounded strongly. Our three investment mainstays of quality, growth and attractive valuation combined to produce strong returns for the year and helped to repair much of the

damage done by the bear market. As a reference, since December 2007 our portfolios are down less than 4%, compared to a loss of 20% for the S&P 500. We have a little way to go to get us back to even, but we are close. Market surges like last year's are fairly typical coming out of a recession, but we enter the new year cautiously. We are cautious because the market is discounting earnings growth of over 20% in most of the major indices for 2010. On the one hand, that sounds like a lot of growth, but on the other hand it is compared to a depressed 2009. Nonetheless, global economies have to negotiate a minefield of issues for that forecast to prove accurate. Consumers in the US are still paying down the debt they accumulated during the residential real estate bubble, curtailing their spending power. After a near death experience, banks are still risk averse and have limited their lending. We are under a new regime of regulation and public

spending, and expect to see increased compliance costs and higher tax rates around the world, particularly as we continue to support a multi-front war on terrorism. Emerging from the crisis, we face another set of risks that depend on the skill of policy makers around the world as they seek to unwind their stimulative policies before they become inflationary or de-stabilizing in other ways. Central bankers and politicians do not have to be perfect, but it is easy to envision a couple of critical mistakes in timing causing a swoon in the recovery or a surge in inflation. While global equity markets are still well off their highs, they are not particularly cheap relative to their prospective earning power, and therefore remain especially vulnerable to serious policy mistakes.

This probably paints a bleaker picture than how we really feel. We expect consumers, businesses, and global economies to eventually emerge healthier from this painful process. The companies in the portfolio generally performed well through the last two years. Very few of our holdings reported losses, and most of the management teams exhibited great skill in appropriately reducing costs while sheltering their competitive advantages. As such, they are poised to re-emerge strongly, and in most cases revenue and earnings growth has resumed. By and large the portfolio's valuation remains attractive; the companies are financially sound and poised for a bright future.



Johnston Asset Management celebrates its 25th anniversary this month, a milestone we would not have achieved without the support of our clients. We are especially grateful for your continued support through the most turbulent market in the firm's history. We manage our business as we manage your portfolios: conservatively, but always looking to improve and grow. As such, we remain on a solid footing and look forward to serving you for the next 25 years and beyond.