

Outlook (continued from 2)

Our cautious stance toward the end of 2008 is driven by two main factors: First, we are concerned that politics will play an increased role in the world economy. In the U.S. indications are that there is growing support for protectionist economic policies. A move toward more controlled market policies can result in many

unwanted economic consequences and alarm us. Additionally, worldwide economic GDP growth increasingly comes from emerging economies. These countries will tend to be more independent and become more protectionist as they become more powerful. Second, we are not sure that the emerging market labor pools and

productivity gains will be able to offset the supply squeeze in developed country labor markets. If unions become stronger once again (as may happen in the U.S. and seems to be occurring in Europe) we may enter a period of higher wage inflation and the subsequent corporate margin compression. ■

Global Themes

One of the investment themes we have been following for some time is the trend toward healthy living, as embodied in the multi-billion-dollar "wellness industry". The industry has experienced explosive growth over the past ten years, and will likely continue as the confluence of the following macro trends will help drive demand for "healthy lifestyle" products and services for the foreseeable future:

Increased Health Care Costs. According to a recent report by the Centers for Medicare and Medicaid Services, the overall cost of health care¹ doubled from 1993 to 2004, and consumed nearly 16% of the nation's economic output in 2004. The 7.9% growth in health care related costs in 2004 (the most recent year with final numbers) was almost three times the domestic inflation rate of 2.7% and nearly \$140 billion higher than the comparable expenditures the year before (2003). Economists have long worried that health care costs will overwhelm the economy and many companies now complain that employee and retiree health costs are making them less competitive in a globalized economy. As a result, many companies are now focusing on prevention programs based on exercise/education, as well as higher health insurance deductibles as ways to try to contain rising health care costs.

Health Concerns Among Baby

Boomers. As part of the aging process, many Baby Boomers have discovered a

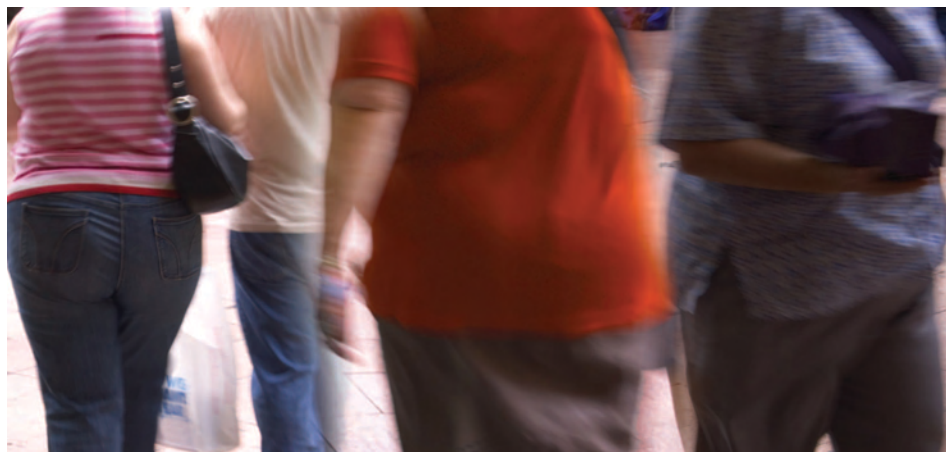
newfound appreciation for a healthier lifestyle. The generation that gave rise to fast food chains is now watching their diets, exercising more and beginning to look seriously at preventative and natural/alternative health care. Boomers want high quality, natural health care products that make them feel and look younger, strengthen their immune systems, enable them to control weight and give them increased energy. In short, they are looking for a higher quality of life and are more than willing to spend heavily on products and services they believe will help them slow the aging process. With high levels of discretionary income at their disposal, they have the economic leverage to significantly shift the demand curve these types of health-enhancing products.

Increased Obesity Rates. According to the Centers for Disease Control, over the past ten years, there has been a dramatic increase in obesity rates in the United

States. In 1995, obesity prevalence in each of the 50 states was less than 20%. By 2005, only four states had obesity prevalence rates less than 20%, while 17 states had prevalence rates equal to or greater than 25%, with three of those having prevalence rates equal to or greater than 30% (Louisiana, Mississippi and West Virginia).

Particularly concerning is the rapid increase in obesity rates among children. Over the past three decades, the childhood obesity rate has more than doubled for preschool children aged 2-5 years and adolescents aged 12-19 years, and more than tripled for children aged 6-11 years². These troubling trends have been largely attributed to the combination of sedentary lifestyles and increased consumption of high fat/high calorie foods. This trend is only likely to continue and, along with it, the potential market rewards for those

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¹Includes hospital and doctor bills, cost of pharmaceuticals, medical devices, insurance and home health care.

²Institute of Medicine of the National Academies study, September 2004; the term obese is used to refer to children between the ages of 2 and 18 years who have a body mass index (BMIs) equal to or greater than the 95th percentile of the age and gender specific BMI charts developed by the CDC.

Global Themes (continued from 3)

companies that can figure out ways to get children to exercise more and/or adopt a more balanced diet.

The convergence of these trends continues to drive demand for providers/procurers of “healthy” products and services, ranging from exercise equipment and health clubs to organic foods/beverages (see inset this page) to dietary supplements. While health clubs were the first category of the “wellness industry” to experience a significant increase in demand, recent growth in the consumer packaged wellness category (see Exhibit 1) has meant that the trend towards healthier lifestyles is becoming more mainstream, further boosting demand for these products and services. ■

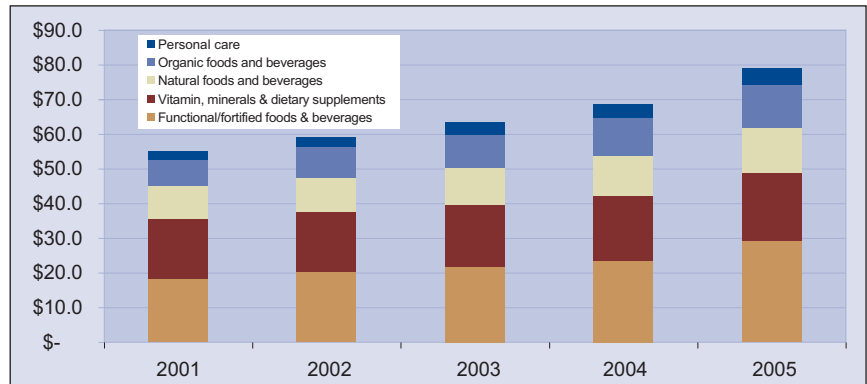


Exhibit 1. Fortified Foods Driving Growth in Consumer Packaged Wellness Industry.

Source: National Marketing Institute's Health and Wellness Trends Report, based on an annual research study of 2,000+ U.S. consumer households.

Organic Growth

One of the fastest growing sub-segments within the overall “wellness industry” is organic food (see exhibit 3). Over the past ten years, the organic food sales have grown at an 18.8% compound annual growth rate (CAGR), compared to a 2.8% for general food sales. As a result, organics have garnered a larger share of total food expenditures, rising from 0.8% of total food sales in 1997 to 3.0% in 2006. According to the *Nutrition Business Journal's* Annual Survey, organic food sales topped \$17 billion³ in 2006, which is quite impressive, considering that the same category registered sales of \$3.5 billion in 1997.

So what's behind the rapid growth? The general trend towards organic products is driven in large part by the same factors driving the overall wellness industry, as well as by concerns about food

safety. Outbreaks of mad-cow disease as well as e-coli contaminations in recent years have served to increase awareness among mainstream consumers about food safety and contaminants. Organic foods, which are produced according to certain production standards⁴, are commonly thought to have less of a risk of contamination. Moreover, recent bestsellers including “Fast Food Nation”, “Supersize Me”, and “The Omnivore's Dilemma” have also played a significant role in getting consumers to think about what they eat, and the effects these foods have on their health.

As a result, organic has become the new growth engine for food and beverage conglomerates⁵ as well as niche companies specializing in organic products, like portfolio holding Green Mountain Coffee Roasters (GMCR), maker of organic coffee. Organic products have also moved beyond specialty shops and are now widely available, as evidenced by the fact that roughly 46% of total organic food dollar volume was sold through the mass-market channel in 2006. Its growing mass market appeal, combined with its high growth/high margin profile as a product category means that demand (and supply) for organic products will continue unabated over the long term. We will continue to monitor this long-term trend for high quality companies that meet or exceed our stringent criteria as possible additions to our investment portfolios. ■

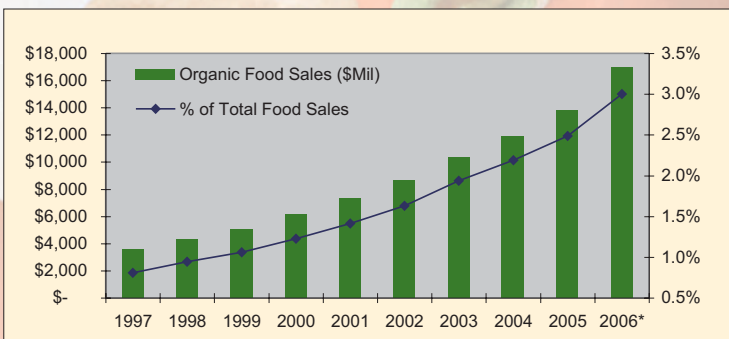


Exhibit 2. Organic's Growth. Source: Nutrition Business Journal estimates and annual survey of manufacturers, OTA's 2006 Manufacturer Survey.

³Source: Nutrition Business Journal estimates and annual survey of manufacturers, OTA's 2006 Manufacturer Survey.

⁴For crops, it means they were grown without the use of conventional pesticides, artificial fertilizers, human waste, or sewage sludge, and that they were processed without ionizing radiation or food additives. For animals, it means they were reared without the routine use of antibiotics and without the use of growth hormones. In most countries, organic produce must not be genetically modified. Source: Wikipedia.org

⁵Even portfolio holding PepsiCo (PEP), a company better known for its high sugar drinks and salty snacks, is expanding beyond its traditional product offerings and increasing its investments in its water, juice and healthy snacks divisions. Its Tropicana subsidiary recently came out with Tropicana Organic, the first organic beverage in the company's history.

⁶Includes supermarket/grocery chains, mass merchandisers and club stores. Source: National Marketing Institute 2006 “Health and Wellness Trends” Report