CHASE INVESTMENT COUNSEL CORPORATION

300 Preston Avenue, Suite 500
Charlottesville, VA 22902-5096
Phone: 800-293-9104
Fax: 434-293-9002
www.chaseinv.com

Investment Professionals:

Peter W. Tuz, CFA
President & Director
Senior Security Analyst

Derwood S. Chase, Jr., CIC
Chairman & CEO, Founder

Edward S. Painvin, CFA, CMT
Chief Investment Officer

Brian J. Lazorishak, CFA
CIC, CIPM, CMT
Senior Quantitative Analyst
Portfolio Manager

Robert (Buck) C. Klintworth, CMT
Assistant Portfolio Manager
Quantitative Analyst

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September Is Coming

Earlier this year, HBO showed a mini-series called "Game of Thrones," based on books by author George Martin. A dire warning permeates the show: "Winter is coming." And with it a time of cold, darkness and starvation.

During the last week of August, the show came to mind because newspaper article after article carried the warning: "September is coming" as if we should quake in our boots and sell all we own. True: historically September has been the worst month of the year for stock market performance. According to the always-excellent Stock Market Almanac, over the past 60 years the S&P 500 has fallen 55% of the time in September (and obviously risen 45% of the time). But the average damage to the S&P 500 has been ½ of 1% during the month. Even in the worst September in the past 60 years, the S&P 500 fell about 12%. A similar move in 2012 would leave us about flat for the year.

People smarter than me have speculated on the causes of September's weakness. Reasons given include the upcoming end of fiscal years for most mutual funds; the end of summer and declining amounts of sunlight causing depression among investors; planetary alignment, and more clarity about whether company earnings this year are meeting expectations coupled with the initial outlook for next year. Some make more sense than others.

The main conclusion one can draw from all this is that there is not much more to worry about in September than in the year's other 11 months. At Chase Investment Counsel, we will ponder the market's outlook in September, but we will think much more about whether the companies we own in our portfolios are going to perform as we expect them to. Will they exhibit the characteristics we seek, consistent and strong growth, a good valuation relative to growth and an attractive technical outlook?

Two recent purchases come to mind: Watson Pharmaceuticals and Ascena Retail Group.

Watson Pharmaceuticals was bought in our large-cap accounts in late July, initially at $77.88 per share. Its weight in the portfolio was increased with more purchases throughout August. Watson's market capitalization is about $10.5 billion. It is one of the world's leading generic drug firms, and is at the forefront of global efforts to control rising health care costs. Its 160 generic products include versions of Lipitor, Concerta and other popular brand named drugs. Earnings in 2012 should rise 20% from last year's levels and again about 40% in 2013 due to new products and a timely acquisition. This year should mark the sixth consecutive year of earnings growth. Lastly at $82.50 (Sept. 4), the stock sells for about 14x this year's earnings – for a p/e to growth rate of .7x.

Ascena Retail Group is a recent mid-cap purchase. It has a market capitalization of about $3.2 billion. The firm sells women's apparel through about 2,500 stores operating under three names: Dress Barn, Maurice's and Justice, each aimed at a different segment of the market. It recently completed the acquisition of Charming Shoppes which will add about 1,200 additional stores many under the Lane Bryant name. Consumer spending among value priced retailers has been strong over the past year. Like Watson, Ascena has "Chase company" characteristics: earnings in 2012 should be up at least 15% and another 13% in 2013, they have risen in six of the past eight years and the stock sells for about 15x estimated earnings, or 1x its growth rate.

We expect both to do well over the next 12-18 months but if they don't live up to our expectations we will act accordingly. Whether the market does well or not in September we will know in 26 more days.

Regards,

Peter W. Tuz

Peter W. Tuz, CFA
President