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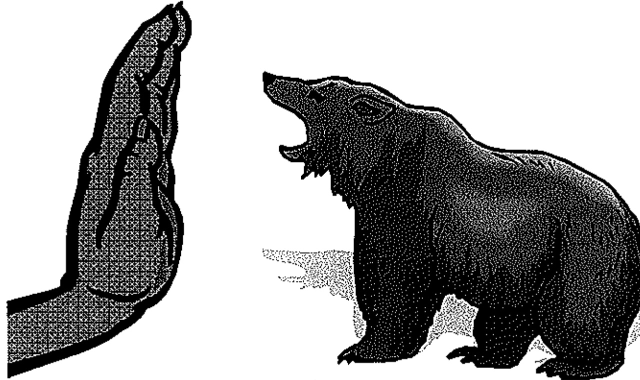
REGISTERED INVESTMENT ADVISOR



A CORRECTION, YES, BUT NOT A BEAR MARKET

Technically, all global equity markets experienced a sharp and emotional correction in May, retreating 14% (S&P 500) to 19% (NASDAQ) from the mid-April highs. The pullback in European stocks and bonds was even more pronounced. All told, the global equity markets fell about 16.5% from their April 15 peak, wiping out almost $7.5 trillion from world equity market capitalization. Ouch! For perspective's sake, May 2010 was the worst May performance in 50 years for both the DJIA and S&P 500. The BP/Gulf mess has added another component of market drag and negativity, and this has had a lingering effect.

What's next? Volatility has returned and forward forecasts have been modified. In my last Newsletter I made a logical case for a moderating recovery to continue to unfold, following some irregular fits and starts that coincided with a staircase type rebound (we rally, pause, retreat and re-rally, keeping an upward slope intact for most industry sectors while the life of the bull market both slows and lengthens after the correction).

Given the Euro-zone developments and their likely slowdown in GDP growth, the economists I revere have shaved 2010-11 growth estimates for the U.S. to 3.1% and 3.6%, respectively. The global growth story remains in mid-cycle growth moderation, **not a recession** and no double-dip. China, India and Brazil continue to be in a boom period.

Furthermore, bond experts pushed back the first significant Fed rate hike to first or second quarter 2011 and the first European Central Bank (ECB) hike to Feb/March 2011. **In other words, rates stay lower longer.** Raising rates too soon could cripple recovery efforts in the U.S. and Europe by making credit and borrowing costs too expensive and confining to growth. We also take a less "doom and gloom" view of the fallout from the European sovereign crisis, giving the double-dip scenario in the U.S. a very low

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probability (under 25%) rating. The "bear" and "short" players like to spook other investors into worrying about double-dipping rather than showing optimism. **Double-dips are extremely rare** and have occurred only twice since the 1929 crash. The first happened in the 1930's when capital liquidity was essentially non-existent (due to one out of every three banks closing and tight monetary controls by the government...i.e. no stimulus, no loan consumer help programs). The next double-dip (an early cycle reversal) hit us in 1981. This double-dip required a huge shock: then Fed chairman Volcker dramatically raised interest rates in an all-out assault on double-digit inflation. **Fast forward:** Bernanke has already said that he does not plan to follow that course of action. Secondly, the yield curve, a notably attractive indicator of economic rebound, remains steep while an inverted yield curve, as was the case in the 1980-82 time frame, would send a very different and alarming signal.

What just happened in May 2010 reflects an emotional meltdown because weak European data and bothersome U.S. unemployment numbers reinforced one another. Unemployment, I might add, continued to rise in the 1930's and into Reagan's first two years of his term, while we have at least seen some flattening out of the labor numbers and minor firming (which is a good precursor sign). However, the improvement on the job front will be slower than we all want.

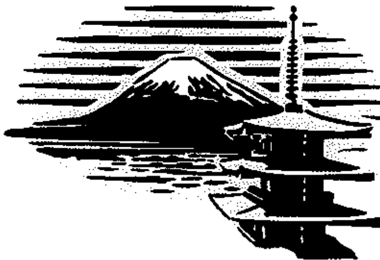
In terms of **valuation gauges**, the **P/E** and **PEG** measures are **both bullish** for most sectors. The only sector that may experience its own little double-dip is real estate/housing in **selected "hurt" areas of the country**. This is really too bad, but a reality, I'm afraid.

CAM contends that **2010 will be a year of constructive change and transition for the markets**. In essence, we must **modify** the "raging" bull (with a few exceptions) to a "sitting" bull that's getting ready to break out and charge. Most low quality and small cap companies are more expensive than **high quality companies on book value** (where large caps trade at a discount and offer more global revenue momentum). CAM is **pro large cap because it simply makes the most sense** to stay with a "lean and mean" large cap growth engine (**fewer surprises, less risk, more resiliency**). History has taught us many lessons and today's fundamentals indicate a smart approach: **buy scarce assets** that emphasize **yield, growth and quality**. The theme of scarcity is important to understand.

Business and consumer spending, especially in tight times, will be governed by need. There is a need for income; hence good income yield is both scarce and important. With 5-year US Treasuries yielding only 2.25% (10-yr is a mere 3.17%) and CD's and money market returns dismally low, dividend yield and high grade bond funds are in high demand. This trend will continue well into 2011. Ask me about our high yield stock list

(including royalty trusts and LLP's) as well as the bond funds (JHI, MRF, ACG, BSP, CSP) that have monthly payout features and a smart "sweet spot" yield curve structure.

Another **two areas of opportunity** lie with global commodities and consumer staples; the need for both is high, so in this case, demand requires supply. CAM is bullish on steel, copper, platinum, alternative energy and oil clean-up technologies. Risks are oil above $100/barrel by this winter, gold heading to $1500/oz. with a move in silver to follow, and natural gas remaining bearish. In terms of consumer staples and basics, we all know the list and we get to add "best of breed" choices (i.e. **Apple**), mega-cap multinationals (like **Procter and Gamble, GE, Johnson & Johnson, Caterpillar, Deere, Colgate Palmolive**), and structured themes (special niche situations like **FRO, SFL, FAST, MTW, SHAW** and emerging market winners) as well as certain ETF's **(XLF, XHB, GLD)** which offer prudent diversification and sector specificity. **The last (but not least) common denominator for all clients must be quality (and hence safety).** We can't sacrifice on quality and that's why I am currently "ice cold" on most NY Muni. bonds.



In Focus – and Reflection:

Much has been said about Japan's zero growth decade of the 1990's and a few points are worth highlighting. Although the present and future wisdom is very key in determining strategy and performance, a look back at history can be very telling.

As low growth, near-zero interest rates and high government debt spark fears of deflation and higher taxes here in the U.S., investors are certainly anxious and they want to know about the storied lessons learned from Japan over the past two decades. The **"protectionist"** economic behavior of Japan was **reclusive, smothering and detrimental**. The rapid run-up in property values which doubled due to high inflation and then halved as slow-growth took over and squeezed out the excesses was very scary, and banks in Japan reacted slowly. Interestingly, it took U.S. policy makers only 19 months to lower interest rates and create liquidity and borrowing power while Japanese

policy makers took 9 years to establish a better money supply. Real estate values (up 120%) and high inflation (19% 3-yr. average at the onset) **did do Japan in** (as many contend they prolonged their own recession)...Japanese investors also chose to invest outside the country to get their growth and their yields. The U.S. is not a protectionist country and has an import/export imbalance to prove it. My short synopsis (which I can elaborate on for further discussion) concludes that the **U.S. recovery is alive and improving – not yet well**, but the healing will be a little slower than originally hoped. However, we will definitely not experience a decade of no growth, no-yield, as the early signs are already pointing to a recovery...with an extra reward for **a little more patience** (sometimes the bull takes a bit of time to warm up).

We are coming upon earnings season and investors are still looking for insights into the pace of recovery. The doldrums may get some much-needed clarity when second-quarter earnings for corporate America come out later in July.

I'll sign off for now and ask you to feel free to touch base with me at any time. Happy 4th of July; here's wishing everyone a safe, fun and patriotic-filled holiday.

JC
6/25/10

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