Colley Asset Management, Inc.

REGISTERED INVESTMENT ADVISOR

Hopefully, It's The Pause That Refreshes

Over the last five weeks or so, stock markets around the world have taken a pause. Hopefully, this pause will be short-term and we get back on the bull track after the pause. The correction was led by a pullback in industrials, commodities, oil, tech, and consumer sectors as conflicted data and news put the status of the global recovery in question. Here in the U.S.A., we just experienced a B+ Report Card from Corporate America as about 85% of the S&P 500 blue chip composite met or beat Wall Street estimates in the first quarter. Forward guidance (future projected estimates) is always a little cloudier, so when mixed statistics and depressing news create "downer" sentiment, the markets get anxious, act unsure, and look for clarity. When consensus and clarity aren't there, we get price retreats. Investors are looking for confirmation that the rally is still "on"and how it's being altered or changed.

Unfortunately, because it is very easy to get caught up in the daily deluge of headline news and day-trading mentality, recognizing that pauses and corrections are normal isn't easy to do. Pullbacks are actually normal behaviors that punctuate a recovering bull market and this "give and take" is really a "given".

These staircase type recoveries (that follow deep hitting recessions) are often irregular with little steps (up and down, but mostly up) being commonplace. **Simply put, mid-cycle pauses and corrections are normal conditions in a recovery**; not abnormal at all. Seizing these opportunities can be a part of investment strategy and some elect patience and ride it through, but confirm they are in the "right" sectors/selections. Sector reallocation and realignments can be part of a prudent strategy, too.

THE GRANITE PALACE, 358 BROADWAY, SUITE 304, SARATOGA SPRINGS, NY 12866
(518) 581 0500 • (800) 581 0501 • FAX (518) 581 0525

Of course, we all would prefer a straighter-line comeback, but the technical experts are astute and quick to point out that stocks are making new, higher "highs" after consolidating the pauses and corrections that reflect normal digestion. Unfortunately, some of the corrections are more than "gas" and hiccups, so being able to discern that the economic recovery is still intact is a very important assignment.

Some of the news is unpredictable and some of it is déjà vu (like the Middle East tensions and its effect on oil prices, peace, and terror alerts or the seeming repeat of the Eurozone's financials crisis, again, this Spring). An unpredictable event like Japan's earthquake and tsunami are very difficult and depressing situations to process and absorb; it's negative, but there is hope and optimism in their uphill battle.

The third time's a charm, as the saying goes, and 2011 offers a trio of financial market milestones. It's the crucial **third year of the so-called presidential cycle (up thirteen of the last fourteen elections**), the beginning of the **third year of the bull market that commenced in March 2009**...by the way, **all ten bull markets since 1949** have celebrated their third birthdays...in June, the start of the third year of slow but still positive U.S. economic growth. One further tidbit: the deeper the recession, the longer the recovery tends to last (4, 5, 6, even 7 years). So, be cautious, but don't despair.

Over years of conditioning, yours truly has learned to never expect "smooth sailing". Two wildcards right now deal with the challenges and variables surrounding economic and political courses being debated and set in Washington, D.C. and in Europe. What is ahead as we try to predict the rest of 2011? Let's take a closer look.

For starters, we are still in recovery mode, as it is just more modest and slower than many had hoped and expected. Some indicators are anchoring and dragging (i.e. debt challenges, unemployment, consumer spending, and real estate values). Some of these fundamentals are "on the mend" and healing will take more time and patience. Some of these concerns need more attention and focus and will remain "barbs" in the recovery fence.

The 2011 recovery path will probably mirror the 2010 curves...namely the first half of the year will be dull performance-wise and the end of 2011 will be stronger (as was the case in 2010 when the last quarter was the "star"). Confirmation that the recovery is still "on" will be challenged throughout the balance of the year, but gradual signs of improvement will continue to unfold. Expansions can contract before they grow, again, and history reminds us of that fact.

Advice to buy large-cap U.S. stocks with a global footprint paid off in 2010 and this theme will be an eventual winner, again, in 2011. The S&P 500's index, for example, shows that almost half of its component earnings and revenues come from abroad.

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Using "high-dividend" stocks as a bond substitute will continue to be a lucrative tactic. Steering away from long-term bonds will also remain on target because rate hikes will eventually increase. Owning stocks in cyclical areas (industrial and agriculture), energy, specialty consumer and healthcare, as well as cyclical technology and natural resources (metals, materials, commodities) will resume as the favorite. Favored reflects where the growth is and where the EPS momentum will continue to be. The economic recoveries in Brazil, India, China and other parts of the Pacific Rim (including emerging economies) are still a "green light, go" and even with some moderating, 6%-9% GDP growth which is still very robust. Furthermore, when QE2 (easing) winds down around 6/30 here in the U.S. and if China and Germany come to the rescue of the Euro (chasing yield advantages and backing up its exposure anyway), the U.S. dollar could weaken and commodities could pop some.

One of our regular questions come from investors who ask me to briefly explain "industrials" as a sector pick. Most people get the supply/demand dynamics relating to simple scarcity in the commodities, metals, fertilizers, and rare earth minerals, but let me elaborate a little on the "industrial" story. Basically, it's all about roads, bridges, water treatment plants, power grids, repairing communities after natural disasters (earthquakes, tornadoes, hurricanes, spills) and making products that relate to commerce, building factories and homes. It's also about transporting goods/commodities to where they need to go. This includes heavy equipment, cranes, shipping containers, refrigerated units, hardware, and railroad (and truck) products. Business, consumer, and infrastructure spending also include construction, engineering, electrical equipment, machinery, and freight movement and logistics. Whenever the recovery theme loses steam, these stocks will react and back off—but the overall trend is uphill and the field itself is very wide as the list below attests:

Company Name	Ticker	EPS
Manitowoc	MTW	40%-46%
Textron	TXT	25%-30%
General Electric	GE	18%-22%
Titan International	TWI	26%-28%
Timken	TKR	14%-17%
Snap On Tools	SNA	15%-18%
Fastenal	FAST	17%-20%
Caterpillar	CAT	26%-30%
Deere	DE	23%-28%
Shaw Industries	SHAW	20%+/-
Jacob Engineering	JEC	16%-18%
United Technologies	UTX	14%-16%
Clean Harbor	CLH	20%-23%
United Parcel Services	UPS	15%-18%

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If the recovery is still "on", you will definitely want to consider holding and owning some **Southern Copper** (SCCO), **Titanium Metals** (TIE), **Teck Resources** (TCK), **EEP** (7% yield), and **BPT** (8% yield) through this recovery.

Food and beverage is consumer positive and getting better and, also, this sector tends to have more resilient/defensive qualities in market drifts and selloffs:

Company Name	Ticker
Panera Bread	PNRA
Smuckers	SJM
Kraft	KFT
Hain Celestial	HAIN
HerbaLife	HLF
Coke or Pepsi	KO or PEP
Yum Brands	YUM

Avoid the risk-taking sectors that still dominate the financial/insurance and real estate markets unless you have special knowledge that gives you an advantage. At this stage of the recovery, these submarkets are ever so slowly getting better...some banks and lending institutions remain very leveraged and risk-laden. At some time in the future, REIT's will become wise picks, but don't be too "early to the party", as they say, because only a few have fiduciary soundness at this time.

Stay with the best of the best favorites in other sectors, including **Apple** (in technology), **Mosaic, Terra Nitrogen** and **Potash** (in agriculture/fertilizer/seed) and **Comcast** (in **specialty tech).**

Another broad brush indicator for our country's bull-bear pulse meter is GDP growth/shrinkage/steadiness. At the present time, consensus opinion for the GDP growth of the U.S. economy has been moderated as follows:

2011 1st Quarter	**Previous:**	**Revised:**
Actual:	✱ 2.9% was achieved	✱ had expected 3.1%
Was projected to be:	✱ 3.5%	✱ 3.0%
Was projected to be:	✱ 3.7%	✱ 3.5%
Was projected to be:	✱ 3.9%	✱ 3.7%

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The recovery is still in place and moving ahead at a tempered pace, averting talk of a double dip. However, the housing/real estate markets for certain geographic pockets of the U.S. are, unfortunately, experiencing some continued fade/dip (in both sales value and volume), creating a depressive overhang. If our U.S. economy is to experience a more robust (and more typical) GDP growth (on the order of 4%-5.5%), job creation and consumer news would need to be more positive. It is strongly contended that we are experiencing a normal mid-cycle pause with both bearish and bullish undertones. At present valuations, a case for a bull run could be made. Positive political news from Washington lawmakers would be another booster shot, but expect both parties to be on their best and, hopefully, smartest behavior in light of the upcoming Presidential Election in 2012. So far, we've been a little disappointed with some of the politics.

In closing, we can expect our financial markets to be extra sensitive to any news that portends a change in the growth gauges. Right now, as evidenced by the criss-cross of economic data, we will remain "paused" and probably stuck (short-term) in a DJIA range of 11,800 to 12,800. The recent deceleration period can be deceptive because six or seven weeks of conflicted data doesn't always define a trendline change, but the lack of positive thrust from new jobs is a definite anchor.

Gaining the historical perspective that "slow-mo" recoveries have "back and fill" pauses and usually endure much longer because they have tended to grind it out over four, five and six years (especially after the deepest recessions). This was true in the timeframes following the Desert Storm Recession of 1990-1992 (a recovery that lasted seven years) and after the tumultuous 1970's (when the "nifty fifty" blue chips "fell hard out of bed") but enjoyed several years of rebound. The classic case is the Great Depression which was followed by two different recoveries in the 1940's and again in the 1950's. Both were spiky, but of long duration.

As always, please don't hesitate to call me if you have any questions or concerns.

Wishing everyone an enjoyable start to the Summer.

With best regards,
JC - 6/1/11

P.S. *Personal View:* The political wrangling and fighting in Washington has reached an unhealthy pitch which seems unnecessarily adversarial and counterproductive. If the same energy that has been expended to point fingers and argue were refocused on negotiated efforts and solutions (i.e. debt, default, new jobs issues) we'd all be a lot better off...the markets and all of us would benefit from renewed efforts that were in the spirit of helping the country.

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