

## Thought for the Week: Monday, May 24<sup>th</sup>, 2010

### Neither a Borrower nor a Lender Be

In Hamlet, Shakespeare wrote:

*Neither a borrower nor a lender be,  
For loan oft loses both itself and friend*

...correct me if I'm wrong; but wasn't Old William a European? How prophetic is the second line: lending can lead to the loss of your money and friends! Did Hamlet get translated into Greek & Spanish?

**Recent events in Europe** remind us of the film classic 'Groundhog Day' where each day the principal character experiences the same events and tries to improve his situation with every iteration.

For example: Greece's troubles have been regurgitated in daily headlines for months now and Central Banks are regularly intervening in financial markets.

More importantly, **didn't the U.S. have similar, but more acute, issues** this last year or so?

Our feeling remains: **The recent sell-off and Doomsday predictions are over blown** – there's definite cause for concern on Debt and Financial system issues, but nothing that will derail the recent recovery.

As our May 10<sup>th</sup> Thought discussed "Does Debt Matter?" let's look at **why we maintain a positive outlook for specific sectors and companies**.

#### 1. Investor Sentiment

For months, investors kept popping their heads out of their burrows and predicting sunny skies ahead for stock markets and the indices kept going up. This happened in spite of various dark clouds overhead, including Greek debt issues, domestic unemployment, housing, etc.

Now that **Europe has committed to dealing with their problems** (no one is suggesting they have a long-term solution or they won't have to do more), the same investors have decided that they have a valid reason for pessimism. The dark cloud is no bigger but now it's covering the sun.

Strange thing is the last few weeks have seen a **constant supply of positive headlines**:

- **New Home Sales** rose ahead of expectations and previous estimates were raised (the April tax credit deadline probably caused this)
- The **Employment Trends Index** has risen for seven of eight months
- **Industrial Production** rose 5.2%, the fastest growth rate since June 2000
- **Retail Sales** have risen for seven straight months

## 2. Shakespeare had it Right!

The massive loans provided by the supposedly 'politically independent' European Central Bank (ECB) **will probably never be repaid** and/or will result in the severing of a number of close sovereign friendships.

**Credit is very tight in Europe, Banks need recapitalizing and the European Union is overextended.**

However, we haven't seen any Lehman or Bear collapses and they haven't yet flooded their capital markets with low interest rate money.

The **\$922 Billion should underpin the European financial system** for the next few years, although we still expect the market to periodically challenge European Countries, Currencies and Union.

## 3. Correction

Bull markets are often described as **"Climbing a Wall of Worry"** when they rise without clear positive news. This normally ends with Volatility (Inflection Point – see Feb 1<sup>st</sup> Thought) then a new clear direction.

FACT: **Bull Markets do not normally go 'straight up'** as they have recently done. They generally experience 'Corrections' prior to continuing onwards.

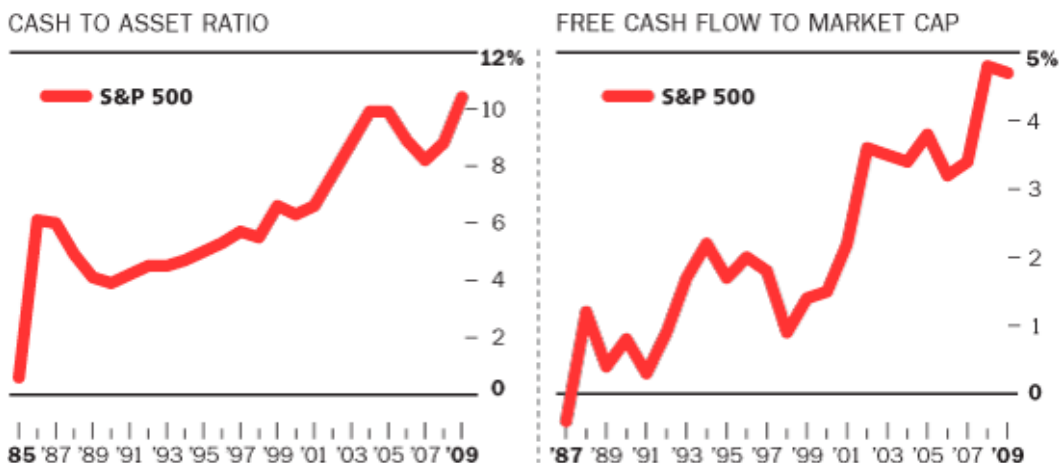
We believe the panic caused by the recent sharp correction has 'spooked' many investors. Our value-add as a manager is to understand these **emotionally 'oversold' situations and see them as a buying opportunity**. Our crystal ball doesn't predict market bottoms, but this looks like **a good time to enter the market**.

## 4. U.S. Company Strength

While Governments are jumping into massive financial holes and the U.S. consumer is digging themselves out of the financial hole they've been digging since Reagan, **many American companies are as financially strong as they've ever been.**

These companies will start returning cash to investors (which will raise share prices), increase corporate spending, maybe start hiring again (maybe) and use the cash to aggressively expand overseas.

Cash holdings by S&P 500 companies are at or near record levels, as is the ratio of free cash flow to stock-market capitalization—and that has some saying it's time for the companies "to cash out."



Source: Capital IQ

## What Might Go Wrong?

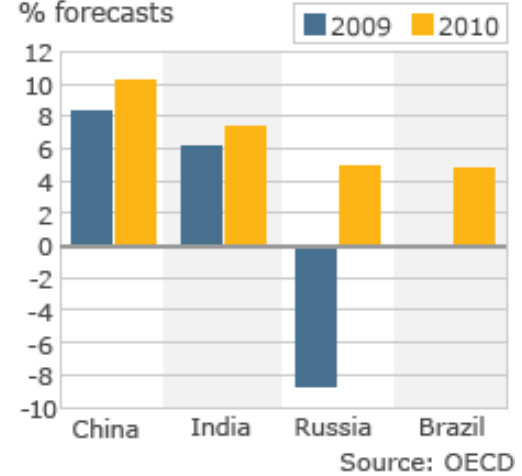
### 1. Emerging Markets' Soft Landing

The ballistic growth experienced in Emerging Markets, and enjoyed by many of our leading companies, has led their **governments to take action aimed at reducing growth to 'sustainable' levels – a Soft Landing**. This has resulted in many commentators worrying the net effect could stall Global growth.

However, **most forecasts still predict robust growth** in these regions. Even developed countries (OECD Members) have had their growth predictions revised upwards for 2010 and 2011.

Soft Landings are tricky though, just ask Capt. Sully Sullenberger. We **continue to monitor economic data for evidence of a hard landing** (a hard landing would destroy growth and demand).

**Non-OECD Members**  
% forecasts



### 2. Monetary Exit Strategy

Developed countries will soon need to perform a similar balancing act to a Soft Landing: How to **wean the financial system off its life support system**. This means exiting the “Monetary Easing” strategies currently in place – turning off the easy money spigot. Clearly, the banking system cannot stand on its own two feet yet, even if it’s off the critical list.

**When the easy money spigot is shut off, will credit come to a halt again?** Will current domestic growth be shown to be a result of Obama’s stimulus programs?

**We think global economic growth is sustainable at a healthy level** but we still see the continued potential for loss of confidence and aftershocks. This is not a market for short term investors who worry on a daily basis!

*“Only when the tide goes out do we get to see who’s swimming naked!”*

### 3. Cramer’s Casino – The Rise of the Machines

As investing has become more Globalized and more Computerized, so too have the risks and randomness of day-to-day price movements. There is no doubt that **machines and exotic trading strategies are dictating a great deal of price movement** (just look at the end of day volatility) and trading areas such as Dark Pools are unregulated. These, and other similar factors, are increasingly driving market prices and the effect is very difficult to predict in the short term.

**Ultimately, prices are driven by fundamentals and we believe fundamentals are still improving.**