



# RESEARCH REPORT

*April, 2010*

**Market Overview & Strategy Comments:** *Business Leads the Recovery, But Job Growth Lags as a Result.*

So far this year, consistent, broad-based good news has become the norm for the economy. Rising stock prices, low inflation, growth in capital spending, a stabilizing housing market and an end to job losses are all giving forecasters hope that the recovery from the worst recession since the 1930s is sustainable. So why are we experiencing an economic recovery without adding jobs? A look at some key differences in this recovery provides the answer.

<u>Key Statistics</u>	<u>Current</u>	<u>Change Since Previous Month</u>	<u>2010 Change</u>
Dow Jones Industrial Average *	10856.63	+5.1%	+4.1%
S&P 500 Index *	1169.43	+5.9%	+4.9%
S&P 500 Ave. P/E Ratio **	15.4x	+0.9x	-0.2x
NASDAQ *	2397.96	+7.1%	+5.7%
1 Year Treasury Bill Yield	0.41%	+9 bps	-6 bps
10 Year Treasury Bond Yield	3.84%	+23 bps	-1 bps
30 Year Treasury Bond Yield	4.72%	+17 bps	+9 bps
Municipal Notes - 1 Year Yield	0.60%	+10 bps	+15 bps
Municipal Bonds - 10 Year Yield	3.60%	+15 bps	+10 bps
Reuters/Jefferies CRB Futures	\$273.34	-0.5%	-3.5%
Gasoline NY RBOB (\$ per gal.)	\$2.31	+11.1%	+12.5%
Natural Gas (\$ per MMBtu)	\$3.87	-19.6%	-30.6%
Gold (\$ per troy oz.)	\$1113.30	-0.4%	+1.7%

\* price only \*\* based on 2010 earnings estimates.

The Reuters/Jefferies CRB Futures Price Index is an arithmetic average of commodity futures prices with monthly rebalancing.

Gasoline NY RBOB price excludes local, state and federal taxes (the "wholesale price").

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**Market Overview & Strategy Comments:** *Business Leads the Recovery, But Job Growth Lags as a Result.*

So far this year, consistent, broad-based good news has become the norm for the economy. Rising stock prices, low inflation, growth in capital spending, a stabilizing housing market and an end to job losses are all giving forecasters hope that the recovery from the worst recession since the 1930s is sustainable. Further, consumer spending rose for a fifth consecutive month in February and factory orders are up now ten of the past eleven months. Yet, despite all this, unemployment continues to struggle; Fed officials this month noted that while the economy has “continued to strengthen, employers remain reluctant to add to payrolls.”

It is going to take years to replace the nearly nine million jobs lost since 2008, so the sooner job growth returns the better. But why exactly are we experiencing an economic recovery without adding jobs? A look at some key differences in this recovery provides the answer.

First of all, of the past seven recoveries, exports are contributing *ten times* their usual amount to this recovery. And since manufacturers are under-utilized due to weak U.S. demand, this growth hasn't created many jobs; manufacturers have been able to get by with their current labor force. Consumer spending, due to wealth losses and weak jobs, has only contributed about 60% of its typical level to growth, and housing, a key job creator, only 1/3 as much as normal during a recovery. State and local governments, historically big job providers, have been cutting payrolls due to the \$200 billion state budget deficit.

The result is that we are experiencing a recovery where the prime benefits are going to businesses rather than consumers, causing slower job growth. Key consumer related sectors such as retail, housing, autos and financial services are all experiencing only modest levels of growth, and thus simply aren't creating many new jobs just yet.

*Is there any reason to think this could change for the better? Yes, though it will come slowly.*

- First of all, the budget bleeding at state and local governments has finally stopped. State governments on average may increase tax revenues by about 3.5% in the coming fiscal year, aided by higher sales tax and business tax revenues, the first time in two years the figure is expected to grow.
- As discussed last month, productivity growth is strong, allowing for higher profits despite the downturn. Higher profits and cash flows put businesses in a strong position to start hiring as soon as they adopt a less cautious stance.
- Exports are surging and now account for 26% of manufacturing shipments, up from less than 20% just five years ago. While so far exports have not led to big job gains, manufacturers are at least adding some jobs now. The manufacturing employment index is rising and indicating more employers are adding jobs than starting layoffs.
- The Conference Board Consumer Confidence Index rebounded in March, and the more consumers are willing to spend, the sooner job growth will return.



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- Any improvement in the key housing sector could create some jobs. While new construction jobs may not appear for a few years, stability in prices and increased turnover could translate into an improvement in housing-related sectors such as mortgage lending, home improvement and home related retail spending.
- Freight, a key economic indicator, is showing improvement, up nicely from May 2009 lows. Movement of goods tells us a lot about trade flows and the health of the manufacturing sector. The more activity the better, as eventually it will lead to job gains.
- Household wealth, which fell by \$14 trillion during the recession, has since recouped over \$5 trillion as stock prices have rebounded and housing prices have stopped falling. This helps explain the rebound in consumer spending despite incomes being flat. In addition, Americans are cutting debt for the first time since 1945, putting themselves in a better position to finance future growth.
- Capital spending is bouncing back. New orders for non-defense cap goods excluding aircraft were up 9% from a year ago, though still down 20% from their pre-recession peak. While most of the cap-ex is being spent on technology, a willingness on the part of businesses to focus on growth, not just survival, bodes well for future job gains.

*In summary, the recovery is starting to broaden out beyond just the federal government's stimulus efforts, and now includes exports, a bit of consumer spending, and soon possibly even state governments. Even though this recovery has started as a jobless one, there is every reason to believe unemployment has seen its peak, which is critical for keeping growth on track.*

In the financial markets, improvement at state and local governments is good news for the municipal bond market, which is showing a positive return for the 1<sup>st</sup> quarter and a very solid return over the past twelve months. The same is true in the corporate bond market where the quest for higher yields and improving corporate balance sheets has led to excellent returns.

Stocks are also solidly in the black during the first quarter, though performance among sectors and regions has been inconsistent; foreign stocks are lagging due to the strong dollar, and smaller U.S. stocks are outperforming large-caps. In general, the more cyclical sectors such as financial, capital goods and retail stocks are doing well; they may not be leading the recovery or providing much in the way of job growth, but they are posting solid gains due to significantly lower costs and modest demand growth. Stocks are also benefiting from share buybacks which are back in vogue due to excess cash on balance sheets.

Overall, first quarter earnings should be strong, bringing cheer to investors. Also, it appears smaller investors are finally returning to stocks after a lengthy period of sitting on the sidelines - stock mutual funds in the first quarter saw new investments of about \$20 billion after a cumulative two year outflow of \$250 billion.

In conclusion, low inflation and modest growth are good news for the markets, and stocks and bonds both turned in a respectable quarter. We remain positive on the outlook for the balance of the year as investors turn away from 0% interest currently being earned on money funds and look for more profitable places to invest their cash. Our economy and the stock market seem to be taking slow job growth in stride as the recovery becomes more broad-based.

## CORE HOLDINGS LIST FOR 2010

Source: FactSet, First Call, Value Line, Bloomberg & CAM Estimates.

			Recent	2010	2011	2010	2011	Est EPS	P/E to	Market		Div
April 1, 2010	<u>Company Name</u>	<u>Ticker</u>	<u>Close</u>	<u>EPS</u>	<u>EPS</u>	<u>P/E</u>	<u>P/E</u>	<u>Growth</u>	<u>Growth</u>	<u>Cap(\$mm)</u>	<u>ROE</u>	<u>Yield</u>
	<b>Standard &amp; Poors 500</b>	SPX	1,169.43	\$76.06	\$94.83	15.4x	12.3x	8%	1.5x	10,559,993	13%	1.9%
<b>Financials:</b>	Berkshire Hathaway Cl "B"	BRK/B	81.27	\$3.64	\$3.86	22.4x	21.1x	5%	4.2x	75,257	7%	0.0%
	MasterCard	MA	254.00	\$13.53	\$16.18	18.8x	15.7x	18%	0.9x	28,052	54%	0.2%
<b>Consumer Staples:</b>	Avon Products	AVP	33.87	\$2.03	\$2.38	16.7x	14.3x	9%	1.6x	14,714	64%	2.6%
	Coca Cola	KO	55.00	\$3.41	\$3.74	16.1x	14.7x	8%	1.9x	126,782	30%	3.2%
	Colgate Palmolive	CL	85.26	\$4.86	\$5.37	17.6x	15.9x	10%	1.6x	41,966	91%	2.5%
	Diageo Plc ADR	DEO	67.45	\$4.57	\$4.98	14.8x	13.6x	8%	1.7x	42,238	48%	3.5%
	Fomento Economico Mexico	FMX	47.53	\$2.79	\$3.51	17.0x	13.6x	20%	0.7x	10,272	13%	0.8%
	H.J. Heinz	HNZ	45.61	\$3.04	\$3.30	15.0x	13.8x	10%	1.5x	14,424	59%	3.7%
	Walgreen Co.	WAG	37.09	\$2.40	\$2.80	15.5x	13.2x	14%	1.0x	36,290	15%	1.5%
<b>Health Care:</b>	Becton Dickinson	BDX	78.73	\$5.26	\$5.76	15.0x	13.7x	11%	1.2x	18,557	24%	1.9%
	Johnson & Johnson	JNJ	65.20	\$4.91	\$5.36	13.3x	12.2x	7%	1.8x	179,708	26%	3.0%
	Novartis AG	NVS	54.10	\$4.70	\$5.07	11.5x	10.7x	4%	2.4x	142,695	16%	3.1%
<b>Consumer Discretionary:</b>	Staples, Inc	SPLS	23.39	\$1.31	\$1.59	17.8x	14.7x	15%	1.0x	17,064	12%	1.5%
	Target Corp.	TGT	52.60	\$3.62	\$4.21	14.5x	12.5x	14%	0.9x	38,888	17%	1.3%
	Toyota Motor Co. ADR	TM	80.42	\$2.66	\$4.93	30.3x	16.3x	33%	0.5x	138,644	NMF	1.4%
<b>Technology:</b>	Cisco Systems	CSCO	26.03	\$1.62	\$1.83	16.1x	14.2x	12%	1.2x	149,038	17%	0.0%
	EMC Corp.	EMC	18.04	\$1.14	\$1.31	15.8x	13.8x	14%	1.0x	36,974	8%	0.0%
	Google	GOOG	567.01	\$27.45	\$31.51	20.7x	18.0x	22%	0.8x	138,934	20%	0.0%
	International Business Machines	IBM	128.25	\$11.09	\$12.12	11.6x	10.6x	10%	1.1x	166,597	74%	1.7%
	Qualcomm	QCOM	41.99	\$2.36	\$2.60	17.8x	16.1x	18%	0.9x	70,518	8%	1.6%
<b>Industrials:</b>	3M Co.	MMM	83.57	\$5.11	\$5.72	16.4x	14.6x	11%	1.4x	59,495	28%	2.5%
	ABB Ltd. ADR	ABB	21.84	\$1.12	\$1.33	19.4x	16.4x	4%	4.0x	50,740	23%	0.0%
	Danaher Corp.	DHR	79.91	\$4.10	\$4.65	19.5x	17.2x	13%	1.4x	25,849	11%	0.2%
	United Technologies	UTX	73.61	\$4.63	\$5.31	15.9x	13.9x	11%	1.2x	68,929	21%	2.3%
<b>Energy:</b>	Apache Corp.	APA	101.50	\$9.83	\$12.76	10.3x	8.0x	11%	0.7x	34,160	NMF	0.6%
	Petroleo Brasileiro S.A. ADR	PBRA	39.59	\$3.70	\$4.09	10.7x	9.7x	7%	1.5x	73,256	26%	0.4%
	Sasol LTD ADR	SSL	41.27	\$3.91	\$5.10	10.6x	8.1x	5%	1.6x	26,357	17%	2.9%
	Schlumberger, Ltd.	SLB	63.46	\$2.88	\$3.84	22.0x	16.5x	15%	1.1x	75,875	18%	1.3%
<b>Telecom Services:</b>	America Movil ADR	AMX	50.34	\$3.80	\$4.27	13.2x	11.8x	13%	0.9x	50,208	44%	0.9%
	China Mobile Hong Kong	CHL	48.12	\$4.24	\$4.34	11.4x	11.1x	3%	3.6x	193,070	24%	3.4%
<b>Exchange Traded Funds:</b>	iShares MSCI EAFE Index	EFA	55.98	-	-	-	-	-	-	35,805	-	2.6%
	iShares MSCI Emerging Mkts	EEM	42.12	-	-	-	-	-	-	35,143	-	1.4%

0% weighting in utilities, transportation and materials.

The above is a list of common stocks currently held in clients' portfolios. Not all stocks are held in all portfolios for various reasons. Upon request we will furnish a list of all equity recommendations made within the past twelve months. This list includes the name of the security, date and nature of the recommendation, price at which the recommendation was acted upon, and the current market price of the security. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list.

Please contact Mickey Herst for a copy of the list.

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