



RESEARCH REPORT

July, 2010

Market Overview & Strategy Comments: A Stock Market With Few Friends.

A recent cover article on leading bearish forecasters in *Bloomberg Businessweek* magazine was titled simply “GRRRRR!” It is a sentiment we can appreciate; there have only been a few periods in recent decades when the market has seemed so friendless. We discuss reasons for the pessimism and why we recommend patience.

<u>Key Statistics</u>	<u>Current</u>	<u>Change Since Previous Month</u>	<u>2010 Change</u>
Dow Jones Industrial Average *	9774.02	-3.6%	-6.3%
S&P 500 Index *	1030.71	-5.4%	-7.6%
S&P 500 Ave. P/E Ratio **	12.8x	-0.8x	-2.8x
NASDAQ *	2109.24	-6.5%	-7.0%
1 Year Treasury Bill Yield	0.32%	-2 bps	-15 bps
10 Year Treasury Bond Yield	2.97%	-34bps	-88 bps
30 Year Treasury Bond Yield	3.91%	-31 bps	-72 bps
Municipal Notes - 1 Year Yield	0.60%	-10 bps	+15 bps
Municipal Bonds - 10 Year Yield	3.55%	+5 bps	+5 bps
Reuters/Jefferies CRB Futures	\$258.52	+1.5%	-8.8%
Gasoline NY RBOB (\$ per gal.)	\$2.06	+2.0%	+0.4%
Natural Gas (\$ per MMBtu)	\$4.62	+6.3%	-17.2%
Gold (\$ per troy oz.)	\$1245.50	+2.7%	+13.7%

* 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: *A Stock Market With Few Friends.*

A recent cover article on leading bearish forecasters in *Bloomberg Businessweek* magazine was titled simply “GRRRRR!” It is a sentiment we can appreciate; there have only been a few periods in recent decades when the market has seemed so friendless. Some of the reasons for this negativity include:

- Volatility, as evidenced by May’s upsetting “Flash Crash.”
- Worries over the financial conditions in Greece, Spain and China – the downside of increased globalization.
- Unemployment. The average duration of unemployment is at a record 34.4 weeks, negatively impacting investor sentiment.
- A sense of despair created by the string of failures after the Gulf Coast oil spill.
- Disappointment that the economy is showing signs of a double dip instead of a dramatic “V” shaped recovery.
- Government tax and regulatory changes that are not market friendly, as they are likely to negatively impact capital gain and dividend taxes, the oil, health care and financial industries, and to date have not led to sustained job growth.

With all this, it comes as no surprise investors have been edging, then running, for the exits and as a result, despite impressive earnings growth, stocks have given up all their 2010 gains and then some. Meanwhile, mutual funds continue to see net outflows from equity funds and inflows into bond funds.

Yet there is good news out there – it just can’t seem to spark any momentum. Valuations are now around 12x earnings, well below historical averages; they are especially low when combined with rock bottom inflation and interest rates. Looking ahead, P/Es seem likely to go even lower as solid Q2 earnings reports are expected. Corporate America is doing what it’s supposed to do during recessions – cutting costs, making inroads abroad, increasing productivity – but investors just aren’t in the mood to pay attention. As pundit Jim Cramer says, the market is suffering from a certain amount of “malaise.”

So how are investors to react to this malaise? By remembering that disinterest is the friend of the long-term investor, creating historic investment opportunities. History has shown that the real profits are made when you buy stocks when no one wants them. Eventually, investors realize that the current negativity is overdone – just as enthusiasm is overdone during expansions – and they return to the market. In the meantime, investors should take a page or two from the playbooks being used in the World Cup. The winning teams all have the following:

- *A strong defense.* Besides asset allocation, investing in high quality companies with solid balance sheets and growing dividends allows an investor to wait out difficult periods.
- *An eye on the globe.* There are many great soccer players around the world – no one nation has a corner on them. The same holds for stocks; there are a number of exciting opportunities throughout the world, and we would be short-sighted to ignore them. While thus far in 2010 global investments have not offset U.S. losses, the past decade was highlighted by solid gains for investors participating in non-U.S. markets.



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- *Patience.* Soccer games are often won 1-0 after a long battle. Like soccer players, we have to be patient, maintain our composure and stay in the game so we are ready to capitalize on opportunities that can come up suddenly. As Warren Buffett once said, the stock market is efficient for transferring wealth from the active to the patient.

While stocks are as cheap as they have been in decades, what is currently lacking is a catalyst to ignite enthusiasm for them. There are many strengths out there, but investors are too busy focusing on what is going wrong to see there are a number of things on the right track, including:

- An increase in merger and acquisitions activity. With cash on corporate balance sheets at a record high 10% of assets, companies are starting to look for ways to put that money to work in a way to enhance growth prospects. Already we are seeing an increase in takeovers worldwide relative to last year.
- Continued strength in emerging economies. China, India, Brazil and many other emerging economies continue to grow solidly and are buying U.S. manufacturing goods.
- High levels of investor bearishness are usually a contrarian signal. As we saw in March 2009, when bearishness peaks and all bad news is discounted, it doesn't take much for stocks to turn around.
- Another stimulus package. With signs pointing to a slowdown here in the U.S., we may see a second round of tax incentives or stimulus initiatives announced that would reduce profit fears and help stocks.
- Higher savings rates, which are dampening spending now but will improve the long-term strength and stability of our economy.

Looking farther out, we see additional positives starting to develop. We see significant pent up demand for housing and mortgage rates are at all-time lows. In addition, overtime and the workweek are rising, pointing to improved hiring trends if the sense of uncertainty can be reduced.

For some perspective, the economy in 1982 faced a lot of the same challenges we face today – stocks were loathed but cheap, gold was ridiculously popular for hoarding, inflation was low, profits were rising, and – most importantly – “experts” were saying “buy and hold” strategies were dead! As it turned out, we were right on the cusp of bigger and better things -- *The computer and productivity revolutions took hold, we whipped inflation, and stocks returned 20% per year for almost 20 years!*

While there is no guarantee things are going to get better quickly, at this juncture we are now more likely to benefit from good news than suffer from more bad – the bad has already been discounted by the marketplace. We know as well as anyone that it's hard to be buyers and be patient with stocks when little progress is being made, but with history and valuations on our side, we think it will prove profitable to “friend” this friendless market.

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
July 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>
	Standard & Poors 500	SPX	1,030.71	\$80.35	\$90.74	12.8x	11.4x	8%	1.4x	9,322,580	13%	2.2%
Financials:	Bank Of America	BAC	14.37	\$1.00	\$1.90	14.4x	7.6x	8%	0.9x	144,173	3%	0.3%
	Berkshire Hathaway Cl "B"	BRK/B	79.69	\$3.92	\$4.14	20.3x	19.2x	5%	3.8x	77,199	7%	0.0%
	MasterCard	MA	199.53	\$13.65	\$16.34	14.6x	12.2x	18%	0.7x	22,114	54%	0.3%
Consumer Staples:	Avon Products	AVP	26.50	\$1.98	\$2.29	13.4x	11.6x	9%	1.3x	11,353	64%	3.3%
	Coca Cola	KO	50.12	\$3.43	\$3.73	14.6x	13.4x	8%	1.7x	115,629	30%	3.5%
	Colgate Palmolive	CL	78.76	\$4.81	\$5.32	16.4x	14.8x	10%	1.5x	38,628	91%	2.7%
	Diageo Plc ADR	DEO	62.74	\$4.45	\$4.91	14.1x	12.8x	8%	1.6x	39,298	48%	3.7%
	Fomento Economico Mexico	FMX	43.15	\$2.90	\$3.67	14.9x	11.8x	19%	0.6x	9,325	11%	1.4%
	H.J. Heinz	HNZ	43.22	\$2.99	\$3.23	14.5x	13.4x	10%	1.4x	13,747	59%	4.2%
Health Care:	Becton Dickinson	BDX	67.62	\$5.19	\$5.66	13.0x	11.9x	11%	1.1x	15,778	24%	2.2%
	Johnson & Johnson	JNJ	59.06	\$4.81	\$5.23	12.3x	11.3x	7%	1.6x	162,892	26%	3.7%
	Novartis AG	NVS	48.32	\$4.94	\$5.20	9.8x	9.3x	4%	2.1x	127,450	16%	3.4%
Consumer Discretionary:	Johnson Controls, Inc.	JCI	26.87	\$2.08	\$2.51	12.9x	10.7x	14%	0.8x	18,076	NMF	1.9%
	Target Corp.	TGT	49.17	\$3.83	\$4.37	12.9x	11.2x	13%	0.9x	36,212	17%	2.0%
	Toyota Motor Co. ADR	TM	68.57	\$2.84	\$4.93	24.2x	13.9x	47%	0.3x	118,215	2%	1.4%
Technology:	Cisco Systems	CSCO	21.31	\$1.68	\$1.91	12.7x	11.2x	12%	0.9x	121,705	17%	0.0%
	EMC Corp.	EMC	18.30	\$1.20	\$1.37	15.3x	13.3x	15%	0.9x	37,618	8%	0.0%
	Google	GOOG	444.95	\$27.91	\$32.06	15.9x	13.9x	19%	0.7x	109,280	20%	0.0%
	International Business Machines	IBM	123.48	\$11.28	\$12.41	10.9x	9.9x	10%	1.0x	158,344	74%	2.1%
	Qualcomm	QCOM	32.84	\$2.36	\$2.57	13.9x	12.8x	17%	0.8x	53,870	8%	2.3%
Industrials:	3M Co.	MMM	78.99	\$5.56	\$6.18	14.2x	12.8x	11%	1.1x	56,325	28%	2.7%
	ABB Ltd. ADR	ABB	17.28	\$1.04	\$1.33	16.6x	13.0x	4%	3.2x	40,251	23%	0.0%
	Danaher Corp.	DHR	37.12	\$2.18	\$2.51	17.0x	14.8x	14%	1.1x	24,102	11%	0.2%
	United Technologies	UTX	64.91	\$4.65	\$5.35	14.0x	12.1x	12%	1.0x	60,566	21%	2.6%
Energy:	Apache Corp.	APA	84.19	\$9.96	\$12.61	8.5x	6.7x	9%	0.8x	28,395	NMF	0.7%
	Petroleo Brasileiro S.A. ADR	PBRA	29.80	\$3.86	\$4.30	7.7x	6.9x	6%	1.1x	55,141	20%	0.5%
	Sasol LTD ADR	SSL	35.27	\$3.80	\$5.05	9.3x	7.0x	5%	1.4x	22,544	17%	3.4%
	Schlumberger, Ltd.	SLB	55.34	\$2.84	\$3.82	19.5x	14.5x	15%	0.9x	66,010	18%	1.5%
Telecom Services:	America Movil ADR	AMX	47.50	\$3.76	\$4.38	12.6x	10.9x	13%	0.9x	67,521	46%	1.0%
	China Mobile Hong Kong	CHL	49.41	\$4.28	\$4.40	11.5x	11.2x	4%	2.5x	198,258	24%	3.3%
Transportation:	CSX Corp.	CSX	49.63	\$3.62	\$4.26	13.7x	11.6x	11%	1.1x	19,317	13%	1.9%
Exchange Traded Funds:	iShares MSCI EAFE Index	EFA	46.51	-	-	-	-	-	-	29,999	-	2.9%
	iShares MSCI Emerging Mkts	EEM	37.32	-	-	-	-	-	-	33,941	-	1.6%

0% weighting in utilities 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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