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# RESEARCH REPORT

*June, 2009*

**Market Overview & Strategy Comments**: *Housing and Trade Led Us Into the Recession – Can They Lead Us Out?*

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| Key Statistics | Current | Change Since Previous Month | 2009 Change |
|---|---|---|---|
| Dow Jones Industrial Average * | 8500.33 | +4.1% | -3.1% |
| S&P 500 Index * | 919.14 | +5.3% | +1.8% |
| S&P 500 Ave. P/E Ratio ** | 15.5x | +0.8x | +1.6x |
| NASDAQ * | 1774.33 | +3.3% | +12.5% |
| | | | |
| 1 Year Treasury Bill Yield | 0.47% | -2 bps | +10 bps |
| 10 Year Treasury Bond Yield | 3.47% | +31 bps | +122 bps |
| 30 Year Treasury Bond Yield | 4.34% | +29 bps | +165 bps |
| Municipal Notes - 1 Year Yield | 0.70% | -15 bps | -45 bps |
| Municipal Bonds - 10 Year Yield | 3.40% | +10 bps | -70 bps |
| | | | |
| Reuters/Jefferies CRB Futures | $253.05 | +13.8% | +10.2% |
| Gasoline NY RBOB ($ per gal.) | $1.93 | +31.0% | +91.5% |
| Natural Gas ($ per MMBtu) | $3.84 | +13.7% | -31.8% |
| Gold ($ per troy oz.) | $978.80 | +9.9% | +10.8% |

** price only  ** based on 2009 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").*
*For clients only. All factual materials are obtained from sources believed to be reliable but cannot be guaranteed. Securities are identified for illustrative purposes only. This should not be construed as a recommendation to purchase or sell any securities.*

**Market Overview & Strategy Comments**: *Housing and Trade Led Us Into the Recession – Can They Lead Us Out?*

The collapse in the housing market and the plunge in global trade triggered by the credit crisis sent our economy tumbling at a 6% rate both in the final quarter of 2008 and the first quarter of 2009. California and Michigan are two of the hardest hit states, facing soaring foreclosures and double digit unemployment. *Still, despite the gloomy GDP figures and regional economic issues, we see emerging signs of stabilization in the trade and housing sectors. For instance:*

- The housing supply/demand situation is finally showing signs of equilibrium, aided by lower market prices, the new home buyer tax credit and 5% mortgage rates. Sales of new homes and median prices rose in April and, with new home construction basically at a standstill, the excess supply of new homes on the market has fallen to just a few months of inventory.
- The dollar has recently dropped about 15% versus major currencies and also lost ground against many emerging currencies such as the real, peso and rand. A weaker dollar makes our goods more affordable on the international markets.
- Japan, one of the hardest hit of the world's economies due to its trade exposure, is seeing signs of improvement as exports and production bottom out.
- In 2008, developing country reserves totaled $4 trillion dollars, leaving them in much better shape to weather this economic downturn. For instance, India's economy, the third largest in Asia, grew faster than expected at almost 6%. China's prospects have also improved in part due to its $600 billion stimulus spending package, as manufacturing has grown three months in a row now, indicating 2009 GDP growth may hit 7.5%.
- While the news from Europe has not been great, U.K. housing prices unexpectedly rose in May leading to a rebound in consumer sentiment, and German retail sales climbed the most in four months.
- The record drawdown in inventories around the globe, combined with improved end-market demand, should create a rebound in industrial output. Last month U.S. industrial production contracted the least since October, and Japanese manufacturers are now boosting output (5% in April) as exports rebound. "We are seeing a good old-fashioned inventory rebuild associated with the fact that supply collapsed further than demand over the last 12 months," said Stephen King, Chief Economist at HSBC Bank.

*Is the end of the freefall in housing and percolating trade enough to get our economy going again?* It could be a short-term solution, but long-term, the jury is still out. Clearly, the stabilization of home prices would be great news for consumers and banks. And if output at our nation's factories stabilize, the huge job losses we've seen should also start to abate. Throw into the mix the big stimulus package and we could see a nice bounce in the economy.

*But then as we look further into the future, the picture gets a bit cloudier.* Consumer spending is likely to remain subdued – a victim of high unemployment, slow income growth, a lack of home equity that was used in the past to fuel consumer spending, and the need for consumers to catch up with their existing debts. Federal government spending should rise thanks to the stimulus package, but states are running a $100 billion deficit, cutting spending, and firing workers. Businesses, even if they see improved demand, have so much excess capacity – currently, utilization is running around 65% – 70% versus a traditional 80% level – that capital investment and hiring will be modest. Furthermore, the construction industry, long a key source of job and income growth in this country, may continue to struggle as commercial real estate is now under pressure and demand for new homes is likely to stay weak even if overall home sales firm up.

Eventually, as capacity is used up or becomes obsolete, we should see capital investment and employment pick up the pace fueling a more sustainable expansion. But this could take several quarters or even a few years. Until then, things are likely to remain choppy. Sounds grim but there is a positive to this outlook – an uneven recovery and excess capacity should keep the lid on inflation and keep interest rates relatively low for the foreseeable future. Also in the positive column are the following:

- Corporate and tax-free municipal bonds are outperforming treasury bonds this year as investors return to more traditional risk profiles. Long-term treasury bonds have lost over 10% of their value this year while intermediate-term corporate bonds are up nicely. Bond portfolios have benefited as we trimmed treasuries in taxable accounts and have avoided long-term bonds.
- Cyclical stocks are doing better as the survivors take share from weaker competitors. This includes capital goods, retail and technology stocks, which have been the market leaders.

Going forward, we still are finding the best values in the investment grade sectors of the bond market relative to treasuries. Also, some of the less cyclical areas of the stock market may catch up to the cyclical market leaders as we expect the rebound in the economy to be somewhat subdued once the current inventory rebuild is over. These less cyclical stocks should include consistent yet modest growers in the health care and consumer areas.

In summary, while we are beginning to see real “green shoots,” we also believe it will take a while to untangle the myriad of problems created from the leverage and subsequent meltdown. Most recoveries do take a while to right themselves even if the stock market usually starts off with a bang. In the meantime, it is becoming increasingly clear that recent optimistic economic news in housing, inventories and corporate earnings revisions are something more than a fluke, and undoubtedly investors appreciate the good news they represent.

# CORE HOLDINGS LIST FOR 2009

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

| June 1, 2009 | Company Name | Ticker | Recent Close | 2009 EPS | 2010 EPS | 2009 P/E | 2010 P/E | Est EPS Growth | P/E to Growth | Market Cap($mm) | ROE | Div Yield |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Standard & Poors 500** | SPX | 919.14 | $59.30 | $71.25 | 15.5x | 12.9x | 8% | 1.6x | 8,035,004 | 14% | 2.3% |
| **Financials:** | Berkshire Hathaway Cl "B" | BRK/B | 2,972.00 | $181.33 | $219.00 | 16.4x | 13.6x | 10% | - | 44,072 | 4% | 0.0% |
| | MasterCard | MA | 176.33 | $10.46 | $12.41 | 16.9x | 14.2x | 18% | 0.8x | 17,371 | 11% | 0.3% |
| **Consumer Staples:** | Coca Cola | KO | 49.16 | $3.04 | $3.34 | 16.1x | 14.7x | 7% | 2.1x | 113,805 | 28% | 3.3% |
| | Colgate Palmolive | CL | 65.95 | $4.21 | $4.67 | 15.7x | 14.1x | 10% | 1.4x | 32,946 | 93% | 2.7% |
| | Diageo Plc ADR | DEO | 54.56 | $4.28 | $4.65 | 12.8x | 11.7x | 7% | 1.8x | 34,094 | 40% | 4.2% |
| | Fomento Economico Mexico | FMX | 32.69 | $1.85 | $2.26 | 17.7x | 14.4x | 23% | 0.6x | 7,065 | 9% | 0.6% |
| | H.J. Heinz | HNZ | 36.58 | $2.75 | $2.82 | 13.3x | 13.0x | 9% | 1.4x | 11,509 | 45% | 4.6% |
| | Walgreen Co. | WAG | 29.79 | $2.13 | $2.41 | 14.0x | 12.4x | 13% | 1.0x | 29,543 | 18% | 1.5% |
| **Health Care:** | Becton Dickinson | BDX | 67.68 | $5.05 | $5.59 | 13.4x | 12.1x | 12% | 1.0x | 16,212 | 24% | 2.0% |
| | Johnson & Johnson | JNJ | 55.16 | $4.52 | $4.89 | 12.2x | 11.3x | 6% | 1.8x | 151,997 | 30% | 3.6% |
| | Medtronic, Inc. | MDT | 34.35 | $3.07 | $3.35 | 11.2x | 10.3x | 11% | 1.0x | 38,447 | 19% | 2.2% |
| | Novartis AG | NVS | 40.02 | $3.87 | $4.28 | 10.3x | 9.4x | 7% | 1.3x | 105,798 | 16% | 3.6% |
| | Zimmer Holdings | ZMH | 44.55 | $3.88 | $4.29 | 11.5x | 10.4x | 10% | 1.1x | 9,583 | 15% | 0.0% |
| **Consumer Discretionary:** | Staples, Inc | SPLS | 20.45 | $1.15 | $1.35 | 17.7x | 15.1x | 15% | 1.0x | 14,636 | 14% | 1.6% |
| | Target Corp. | TGT | 39.30 | $2.83 | $3.08 | 13.9x | 12.7x | 14% | 0.9x | 29,554 | 15% | 1.6% |
| | Toyota Motor Co. ADR | TM | 80.15 | NMF | $1.96 | NMF | 40.9x | 3% | 13.6x | 138,178 | 15% | 2.4% |
| **Technology:** | Cisco Systems | CSCO | 18.50 | $1.11 | $1.20 | 16.7x | 15.5x | 13% | 1.2x | 106,706 | 24% | 0.0% |
| | EMC Corp. | EMC | 11.75 | $0.62 | $0.79 | 18.9x | 14.8x | 12% | 1.3x | 23,653 | 11% | 0.0% |
| | Fiserv, Inc. | FISV | 42.36 | $3.64 | $4.07 | 11.6x | 10.4x | 15% | 0.7x | 6,591 | 14% | 0.0% |
| | Google | GOOG | 417.23 | $18.53 | $21.98 | 22.5x | 19.0x | 20% | 1.0x | 100,589 | 17% | 0.0% |
| **Industrials:** | 3M Co. | MMM | 57.10 | $3.84 | $4.14 | 14.9x | 13.8x | 13% | 1.1x | 39,601 | 32% | 3.6% |
| | ABB Ltd. ADR | ABB | 16.46 | $1.09 | $0.96 | 15.1x | 17.2x | 10% | 1.7x | 38,233 | 28% | 0.0% |
| | Danaher Corp. | DHR | 60.35 | $3.43 | $3.65 | 17.6x | 16.5x | 11% | 1.5x | 19,234 | 14% | 0.2% |
| | General Electric | GE | 13.48 | $1.00 | $0.95 | 13.5x | 14.2x | 9% | 1.6x | 142,748 | 16% | 3.0% |
| | United Parcel Service | UPS | 51.14 | $2.32 | $2.84 | 22.1x | 18.0x | 12% | 1.5x | 35,760 | 32% | 3.5% |
| | United Technologies | UTX | 52.61 | $4.15 | $4.45 | 12.7x | 11.8x | 10% | 1.2x | 49,561 | 25% | 2.9% |
| **Energy:** | Apache Corp. | APA | 84.26 | $3.45 | $6.86 | 24.4x | 12.3x | 7% | 1.7x | 28,243 | 4% | 0.7% |
| | Petroleo Brasileiro S.A. ADR | PBRA | 34.97 | $2.54 | $3.05 | 13.7x | 11.5x | 8% | 1.5x | 64,707 | 30% | 0.8% |
| | Sasol LTD ADR | SSL | 37.79 | $3.64 | $3.93 | 10.4x | 9.6x | 15% | 0.6x | 24,081 | 32% | 3.4% |
| | Schlumberger, Ltd. | SLB | 57.23 | $2.55 | $2.51 | 22.4x | 22.8x | 5% | 4.6x | 68,470 | 34% | 1.5% |
| **Telecom Services:** | America Movil ADR | AMX | 38.33 | $2.98 | $3.46 | 12.8x | 11.1x | 13% | 0.9x | 39,628 | 43% | 1.4% |
| | China Mobile Hong Kong | CHL | 49.21 | $4.21 | $4.37 | 11.7x | 11.3x | 15% | 0.7x | 197,394 | 28% | 1.7% |
| **Transportation:** | Kansas City Southern | KSU | 16.49 | $0.74 | $1.25 | 22.2x | 13.2x | 20% | 0.7x | 1,510 | 10% | 0.0% |
| **Exchange Traded Funds:** | iShares MSCI EAFE Index | EFA | 47.45 | - | - | - | - | - | - | 30,377 | - | 2.3% |
| | iShares MSCI Emerging Mkts | EEM | 33.24 | - | - | - | - | - | - | 31,068 | - | 2.0% |

*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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