



# RESEARCH REPORT

March, 2010

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**Market Overview & Strategy Comments:** *The Debt Wolf Knocks On “PIIGS” Door.*

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<u>Key Statistics</u>	<u>Current</u>	<u>Change Since Previous Month</u>	<u>2010 Change</u>
Dow Jones Industrial Average *	10325.26	+2.6%	-1.0%
S&P 500 Index *	1104.49	+2.9%	-1.0%
S&P 500 Ave. P/E Ratio **	14.5x	-0.3x	-1.1x
NASDAQ *	2238.26	+4.2%	-1.4%
1 Year Treasury Bill Yield	0.32%	+2 bps	-15 bps
10 Year Treasury Bond Yield	3.61%	-2 bps	-24 bps
30 Year Treasury Bond Yield	4.55%	+4 bps	-8 bps
Municipal Notes - 1 Year Yield	0.50%	-10 bps	+5 bps
Municipal Bonds - 10 Year Yield	3.45%	-15 bps	-5 bps
Reuters/Jefferies CRB Futures	\$274.77	+3.5%	-3.0%
Gasoline NY RBOB (\$ per gal.)	\$2.08	+9.2%	+1.3%
Natural Gas (\$ per MMBtu)	\$4.81	-6.2%	-13.6%
Gold (\$ per troy oz.)	\$1118.30	+3.3%	+2.1%

\* 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:** *The Debt Wolf Knocks On “PIIGS” Door.*

We have all become familiar with the term BRIC nations – Brazil, Russia, India and China – and the good economic news coming from these emerging economies. In many ways these countries have helped stabilize the world economy and get us back on the growth track. However, lately another group of countries has been in the news – the smaller European countries disparagingly called the PIIGS nations – Portugal, Italy, Ireland, Greece and Spain. These countries are in financial trouble as they struggle to refinance their heavy debt loads, threatening, at least to some degree the fragile recovery underway in many economies.

Most of PIIGS’ troubles began when the recession slashed tax revenues and sent unemployment and public support costs soaring, resulting in surging budget deficits. And now these debts, like the wolf in the fairy tale, are threatening at the door and investors are responding by being wary of lending further to these countries. While the actual likelihood of defaulting on their government debt is small, there are no clear mechanisms in place to deal with their national economic problems, and investors are concerned that the debt problems at these PIIGS nations could spark a credit crisis similar to the banking crisis of 2008. In response, stock markets around the globe are starting to correct, albeit to date fairly modestly, and the Euro has tumbled about 10% in value against the dollar over the past few months as investors worry about the potential costs of bailing out these troubled countries.

In many ways Europe’s problems resemble ours: stubbornly high unemployment, competitive issues relative to lower cost nations, high budget deficits (Greece is 13% to our 11%) and no easy solutions. We, however, benefit from a seemingly insatiable demand for our debt, making it easy for us to finance our deficits, while smaller countries such as Greece and Spain don’t have that luxury. And these countries will have no easier a time enacting spending cuts than we do; Spain, for example, is mired in 19% unemployment so big cuts to unemployment benefits are likely to meet fierce resistance.

Yet the PIIGS’ situation is not as dire as short-term investors and the media would lead us to believe. Due to their reliance on these countries for export demand, Germany (with a deficit of “only” 6% of GDP) and France have a vested interest in the fortunes of these nations. This increases the likelihood that more solid European countries will help keep the PIIGS’ houses from being toppled by the debt wolf lurking at the door. And while even the slight potential for national debt defaults is worrisome, investors need to keep things in perspective; these are all small countries with modest global economic footprints. Greece, for example, accounts for under 3% of the Euro zone GDP, so its actual impact on the regional economy and the Euro is likely to be minor.

But even if short-term fears are overdone, the longer-term structural problems in high-debt countries are likely to weigh on world GDP growth. Most economists estimate that the levels of debt now being carried by countries as large as the U.S. or as small as Greece cut GDP growth by roughly 1% per year or more. How we are going to tackle these debts is a political question, but clearly we are probably going to have to get used to mini-debt crises becoming the norm rather than the exception. As a result, choppy markets and economies are likely for the foreseeable future as these debt ridden countries balance the need for fiscal stimulus today to keep the recovery from faltering against future debt reduction to improve long-term prospects.



# RESEARCH REPORT

The good news is that the problems facing PIIGS are coming at a time when other economic news is showing improvement:

- *Inflation is still tame*, allowing interest rates to remain low. The President of the Federal Reserve Bank of NY said “there is just no inflation pressure in the U.S., so our focus has to be on growth and jobs.”
- *Emerging market consumers are now spending more than the U.S. in terms of global consumer demand*, helping keep economies afloat around the world. Global manufacturing is on the rebound with the U.S., China, India, Germany and even the UK reporting growth in manufacturing output led by a robust rebound in technology spending.
- *Corporate profits are showing healthy improvement* despite the choppy nature of the global economic rebound. Not surprisingly, many companies are seeing profit gains originate in the faster growing, financially strong emerging economies (which as a group carry much less debt – 40% of GDP versus 110% in developed nations). As the *Financial Times* stated “Corporate USA is on track to report one of the best quarterly earnings seasons on record” in terms of beating expectations.
- *Productivity growth is on the upswing*. When the recession hit, corporate America, along with many companies around the globe, cut costs dramatically. The downside was a jump in unemployment and lower capital spending, but the upside has been stronger profit margins, soaring cash flows and finally rising profits despite continued anemic domestic demand. These cost cutting efforts have resulted in productivity jumping at a roughly 8% annual rate during most of 2009, more than 3x the growth rate from 2000 to 2008. Soaring productivity also creates more profit per dollar of sales, and is putting companies in a strong position to increase investment as demand improves.

The bigger question, though, is the outlook for 2010. Clearly, there is new uncertainty due to the issue of the PIIGS and the resulting impact on the credit and currency markets, but companies holding down costs and with good exposure to emerging economies – such as *Google, Heinz, MasterCard, IBM*, and *ABB* – are reporting excellent profits and have good prospects for 2010 even if the U.S. and Europe report anemic growth rates.

In summary, the problems at some of the Euro zone countries are a reminder that the debt crisis which began in 2007 is not over even if conditions today are greatly improved relative to the dark days of 2008 and early 2009. While we have for the most part eliminated the crisis aspect of the debt bubbles, little has been done to solve the long-term structural aspects of it, and thus we are likely to continue to experience headaches from PIIGS and other struggling economies going forward. Still, due to the efforts of corporate executives to cut costs and move forward despite the lack of robust growth at home, profits are rising and in 2010 may be just 10% below peak levels reached a few years ago, which bodes well for the longer-term prospects of the equity markets.

*Securities identified are for illustrative purposes only. This should not be construed as a recommendation to purchase or sell any securities. The securities mentioned may or may not be held in all client portfolios. For a list of current recommendations, please see the back page of this report and/or contact your portfolio manager.*

## 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
March 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	1,104.49	\$75.91	\$89.03	14.5x	12.4x	8%	1.6x	9,951,037	13%	2.0%
<b>Financials:</b>	Berkshire Hathaway Cl "B"	BRK/B	80.13	\$3.64	\$3.86	22.0x	20.8x	5%	4.2x	61,251	7%	0.0%
	MasterCard	MA	224.37	\$13.47	\$16.09	16.7x	13.9x	18%	0.8x	24,780	54%	0.3%
<b>Consumer Staples:</b>	Avon Products	AVP	30.44	\$2.04	\$2.36	14.9x	12.9x	9%	1.5x	13,013	64%	2.9%
	Coca Cola	KO	52.72	\$3.41	\$3.74	15.5x	14.1x	8%	1.8x	122,162	30%	3.3%
	Colgate Palmolive	CL	82.94	\$4.86	\$5.37	17.1x	15.5x	10%	1.5x	40,951	91%	2.6%
	Diageo Plc ADR	DEO	65.28	\$4.64	\$5.06	14.1x	12.9x	8%	1.6x	40,872	48%	3.6%
	Fomento Economico Mexico	FMX	42.80	\$2.60	\$3.27	16.4x	13.1x	20%	0.7x	9,250	13%	0.9%
	H.J. Heinz	HNZ	45.90	\$3.02	\$3.29	15.2x	13.9x	10%	1.5x	14,515	59%	3.7%
	Walgreen Co.	WAG	35.24	\$2.43	\$2.83	14.5x	12.4x	14%	0.9x	34,718	15%	1.6%
<b>Health Care:</b>	Becton Dickinson	BDX	77.87	\$5.26	\$5.75	14.8x	13.5x	12%	1.2x	18,354	24%	1.9%
	Johnson & Johnson	JNJ	63.00	\$4.92	\$5.37	12.8x	11.7x	7%	1.7x	173,823	30%	3.1%
	Novartis AG	NVS	55.32	\$4.71	\$5.10	11.7x	10.8x	4%	2.5x	145,913	16%	3.0%
<b>Consumer Discretionary:</b>	Staples, Inc	SPLS	25.76	\$1.37	\$1.63	18.8x	15.8x	15%	1.1x	18,648	14%	1.3%
	Target Corp.	TGT	51.52	\$3.58	\$4.11	14.4x	12.5x	13%	1.0x	38,362	17%	1.3%
	Toyota Motor Co. ADR	TM	74.83	\$2.63	\$5.08	28.4x	14.7x	33%	0.4x	129,007	NMF	1.5%
<b>Technology:</b>	Cisco Systems	CSCO	24.33	\$1.61	\$1.83	15.1x	13.3x	12%	1.1x	139,305	17%	0.0%
	EMC Corp.	EMC	17.49	\$1.14	\$1.31	15.3x	13.4x	14%	1.0x	35,676	8%	0.0%
	Google	GOOG	526.80	\$27.29	\$31.54	19.3x	16.7x	22%	0.8x	128,472	20%	0.0%
	International Business Machines	IBM	127.16	\$11.09	\$12.10	11.5x	10.5x	10%	1.1x	165,181	74%	1.7%
	Qualcomm	QCOM	36.68	\$2.29	\$2.57	16.0x	14.3x	18%	0.8x	61,649	8%	1.9%
<b>Industrials:</b>	3M Co.	MMM	80.15	\$5.08	\$5.69	15.8x	14.1x	11%	1.3x	57,045	28%	2.6%
	ABB Ltd. ADR	ABB	20.26	\$1.12	\$1.32	18.1x	15.3x	5%	3.3x	47,069	23%	0.0%
	Danaher Corp.	DHR	73.97	\$4.09	\$4.62	18.1x	16.0x	13%	1.3x	23,928	11%	0.2%
	United Technologies	UTX	68.65	\$4.64	\$5.31	14.8x	12.9x	11%	1.2x	64,353	21%	2.5%
<b>Energy:</b>	Apache Corp.	APA	103.64	\$10.09	\$12.76	10.3x	8.1x	11%	0.8x	34,868	NMF	0.6%
	Petroleo Brasileiro S.A. ADR	PBRA	38.40	\$3.67	\$4.00	10.5x	9.6x	12%	0.8x	71,054	26%	0.9%
	Sasol LTD ADR	SSL	36.63	\$3.62	\$4.65	10.1x	7.9x	5%	1.6x	23,388	17%	3.0%
	Schlumberger, Ltd.	SLB	61.10	\$2.91	\$3.86	21.0x	15.8x	12%	1.3x	73,053	18%	1.4%
<b>Telecom Services:</b>	America Movil ADR	AMX	44.57	\$3.79	\$4.27	11.8x	10.4x	13%	0.8x	44,821	44%	1.0%
	China Mobile Hong Kong	CHL	49.43	\$4.23	\$4.36	11.7x	11.3x	13%	0.9x	198,324	28%	3.2%
<b>Exchange Traded Funds:</b>	iShares MSCI EAFE Index	EFA	52.62	-	-	-	-	-	-	33,403	-	2.7%
	iShares MSCI Emerging Mkts	EEM	38.96	-	-	-	-	-	-	33,591	-	1.5%

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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