



RESEARCH REPORT

September, 2011

Market Overview & Strategy Comments: *Back On Recession Watch.*

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<u>Key Statistics</u>	<u>Current</u>	<u>Change Since Previous Month</u>	<u>2011 Change</u>
Dow Jones Industrial Average *	11,613.53	-4.4%	+0.3%
S&P 500 Index *	1,218.89	-5.7%	-3.1%
S&P 500 Ave. P/E Ratio **	12.7x	-0.8x	-2.3x
NASDAQ *	2,579.46	-6.4%	-2.8%
1 Year Treasury Bill Yield	0.10%	-10 bps	-19 bps
10 Year Treasury Bond Yield	2.18%	-56 bps	-112 bps
30 Year Treasury Bond Yield	3.56%	-53 bps	-78 bps
Municipal Notes - 1 Year Yield	0.45%	+5 bps	-45 bps
Municipal Bonds - 10 Year Yield	2.75%	-45 bps	-120 bps
Reuters/Jefferies CRB Futures	\$342.57	+0.1%	+2.9%
Gasoline NY RBOB (\$ per gal.)	\$3.03	-2.6%	+26.8%
Natural Gas (\$ per MMBtu)	\$4.05	-2.2%	-8.0%
Gold (\$ per troy oz.)	\$1,828.50	+12.3%	+28.7%

* price only ** based on 2011 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”).

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.



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The anemic second quarter GDP figures recently released not only pointed to slow growth today – about 1% – but also upgraded the severity of the last recession and downgraded the strength of a subsequent recovery. Combining these weak figures with a protracted budget battle, sliding oil prices, sinking Treasury bond yields and continued Euro-zone financial worries, it's no surprise that investors are viewing the sharp correction in stocks during August as perhaps a sign that the recession is returning – a much discussed “double dip” recession.

Still, as we well know, the stock market tends to predict more recessions than actually occur. Even severe stock market corrections, such as the 40% drop in 1987, don't always lead to a recession. Furthermore, the volatility created by high frequency trading – which is at least partially responsible for the fact we are seeing huge daily swings on a regular basis – is making the action of the stock market even less trustworthy when it comes to predicting the economy.

Yet there is no question investors are worried as evidenced by the drop in Treasury bond yields and the decline in cyclical stocks relative to consumer staple stocks since this correction began. Moreover, leading forecasters such as the Federal Reserve, Goldman Sachs and Credit Suisse have all lowered their 2011 growth forecasts for our economy.

Still, despite growing concerns, the news is certainly far from all bad:

- Aside from oil, many other commodities are holding up, indicating solid underlying demand.
- Certain data is pointing to continued modest growth, such as employment claims, retail sales and durable goods orders. Fed surveys are mixed, with those in the East weaker while those in the Midwest aren't too bad.
- Household debt is now back down to 2005 levels, and thus can support some modest growth in spending despite the high unemployment rate.

Part of the difficulty with forecasting the strength of this recovery is the fact we have been experiencing an atypical expansion in the first place. Let's look at what's been going on:

- As a recent article from the *Wall Street Journal* outlined (based on data from the Commerce Department), this recovery is happening without any real help from the government. Yes, we had a stimulus package, but other than that government spending on all levels has subtracted from growth, and the budget deficit package could subtract as much as another 2% from growth in 2012.
- Until the budget battle distracted both consumers and businesses, consumer spending hasn't been too far off the mark for a typical expansion.
- Exports are contributing more to growth than the typical expansion, not a surprise given the faster growth rates of emerging economies and the weak dollar.
- Imports are running higher than normal, hurting growth in this recovery relative to the past.



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- State, local and federal spending is much more negative than normal, and more so at the state and local level. Historically this sector adds at least 0.5% to GDP growth, while during this recovery we've averaged between 0% and -1%, and this could get even worse.

One of the key factors to be gleaned from the above is that *weak government spending is at least in part masking decent results for businesses*, which are benefiting from solid albeit volatile demand for capital equipment, technology, consumer goods and exports. Therefore, we have reason to believe that the stock market could mend itself as investors see companies continue to do well despite the unsettling GDP figures.

Furthermore, with the trailing P/E multiple on the S&P 500 now just roughly 13x, it is below the average for the past ten recessions and the lowest overall since 1982. The earnings yield (the inverse of the P/E ratio) on stocks is now four times that of the 10-year Treasury bond, leaving stocks their cheapest relative to bonds in *decades*. These indicators tell us stocks may be discounting more bad news than is actually likely to occur.

Still, whether it's an actual recession, a "growth" recession or just a blip in the data, we think we are appropriately positioned:

- We are maintaining a significant weighting in consumer staples, which are recession resistant and have held up best in the correction. At the same time we are keeping minimal exposure to financials, which have been the worst sector this year, down about 20%. Current holdings in the consumer area include *Heinz, Coca Cola, Diageo, Kraft, Femsal* and *Colgate*. Health care is another one of the top performing sectors this year and we are holding about 10% there.
- A focus on higher yielding stocks provides a nice dividend stream while we wait out this uncertainty. Most of the consumer stocks mentioned above carry well above market yields as do *Johnson & Johnson* and *United Technologies*.
- We continue to have an above average weighting in multinational companies; they are still seeing growth overseas due to the continued strength in emerging economies. *3M, ABB, Google, IBM* and *Qualcomm* are all beneficiaries of emerging markets.
- We are using fears about the economy to take advantage of attractive spreads in the corporate bond sector and locking in some solid yields.

In summary, while the mixed news of late, combined with the market correction, puts us back on recession watch, we aren't yet convinced the economy is as weak as it is being portrayed. There's enough strength out there that we haven't given up hope. Still, we are maintaining a defensive posture overall given the likelihood of continued modest, rather than robust, global economic growth.

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CORE HOLDINGS LIST FOR 2011

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

			Recent	2011	2012	2011	2012	Est EPS	P/E to	Market		Div
September 1, 2011	<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	1,218.89	\$96.01	\$104.53	12.7x	11.7x	8.0%	1.5x	11,128,021	13%	2.0%
Financials:	Berkshire Hathaway Cl "B"	BRK/B	73.00	\$4.22	\$5.13	17.3x	14.2x	5.0%	2.8x	77,888	9%	0.0%
Consumer Staples:	Coca Cola	KO	70.45	\$3.88	\$4.29	18.2x	16.4x	8.0%	2.1x	161,760	42%	2.7%
	Colgate Palmolive	CL	89.97	\$5.07	\$5.57	17.7x	16.2x	9.2%	1.8x	43,770	76%	2.6%
	Diageo Plc ADR	DEO	80.26	\$5.45	\$5.98	14.7x	13.4x	3.9%	3.4x	50,243	46%	3.3%
	Fomento Economico Mexico	FMX	68.92	\$3.57	\$4.27	19.3x	16.2x	17.7%	0.9x	14,895	52%	1.7%
	H.J. Heinz	HNZ	52.64	\$3.24	\$3.56	16.2x	14.8x	8.0%	1.8x	16,900	40%	3.6%
	Kraft Foods	KFT	35.02	\$2.28	\$2.54	15.4x	13.8x	8.0%	1.7x	61,849	8%	3.3%
Health Care:	Becton Dickinson	BDX	81.38	\$5.81	\$6.39	14.0x	12.7x	10.0%	1.3x	17,696	24%	2.0%
	Johnson & Johnson	JNJ	65.80	\$4.97	\$5.30	13.2x	12.4x	5.8%	2.1x	180,315	25%	3.5%
	Novartis AG	NVS	58.46	\$5.47	\$5.67	10.7x	10.3x	5.5%	1.9x	160,509	16%	3.4%
Consumer Discretionary:	Johnson Controls, Inc.	JCI	31.88	\$2.64	\$3.41	12.1x	9.3x	15.7%	0.6x	21,670	16%	2.0%
	Target Corp.	TGT	51.67	\$4.19	\$4.34	12.3x	11.9x	12.6%	0.9x	34,889	19%	2.3%
	Yum! Brands Inc.	YUM	54.37	\$2.85	\$3.21	19.0x	16.9x	12.1%	1.4x	25,250	89%	1.8%
Technology:	Apple Computers	AAPL	384.83	\$28.85	\$33.93	13.3x	11.3x	18.2%	0.6x	356,772	35%	0.0%
	EMC Corp.	EMC	22.59	\$1.49	\$1.73	15.1x	13.0x	15.0%	0.9x	46,647	12%	0.0%
	Google	GOOG	540.96	\$35.51	\$42.02	15.2x	12.9x	19.2%	0.7x	137,523	21%	0.0%
	International Business Machines	IBM	171.91	\$13.29	\$14.75	12.9x	11.7x	9.0%	1.3x	205,308	65%	1.7%
	Oracle Corp	ORCL	28.07	\$2.32	\$2.54	12.1x	11.0x	13.7%	0.8x	141,998	24%	0.9%
	Qualcomm	QCOM	51.46	\$3.26	\$3.58	15.8x	14.4x	15.8%	0.9x	86,298	8%	1.7%
Industrials:	3M Co.	MMM	82.98	\$6.20	\$6.90	13.4x	12.0x	13.5%	0.9x	58,877	29%	2.7%
	ABB Ltd. ADR	ABB	21.27	\$1.55	\$1.81	13.7x	11.8x	4.8%	2.5x	49,080	18%	3.2%
	Caterpillar	CAT	91.00	\$6.97	\$9.28	13.0x	9.8x	10.3%	0.9x	58,792	28%	2.0%
	Danaher Corp.	DHR	45.81	\$2.82	\$3.32	16.3x	13.8x	15.3%	0.9x	31,405	14%	0.2%
	United Technologies	UTX	74.25	\$5.45	\$6.19	13.6x	12.0x	9.8%	1.2x	67,472	21%	2.6%
Energy:	Apache Corp.	APA	103.07	\$11.94	\$12.52	8.6x	8.2x	10.6%	0.8x	39,571	NMF	0.6%
	Exxon Mobil	XOM	74.02	\$8.60	\$8.82	8.6x	8.4x	2.1%	4.0x	359,894	24%	2.5%
	Sasol LTD ADR	SSL	48.12	\$5.55	\$6.50	8.7x	7.4x	1.9%	3.9x	30,939	18%	3.2%
	Schlumberger, Ltd.	SLB	78.12	\$3.82	\$5.47	20.4x	14.3x	14.0%	1.0x	105,413	17%	1.3%
Basic Materials:	BHP Billiton PLC	BBL	68.12	\$8.67	\$9.16	7.9x	7.4x	23.0%	0.3x	71,937	29%	3.0%
Telecom Services:	America Movil ADR	AMX	25.56	\$2.12	\$2.32	12.1x	11.0x	6.5%	1.7x	68,434	33%	1.1%
Transportation:	CSX Corp.	CSX	21.94	\$1.74	\$2.02	12.6x	10.8x	11.3%	1.0x	24,030	18%	2.2%
Exchange Traded Funds:	iShares MSCI Emerging Mkts	EEM	42.75	-	-	-	-	-	-	33,531	NMF	1.9%

0% weighting in utilities.

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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