

July 28, 2011

For us quarter two 2011 has proven to be the “poster child” for an investment environment of frustration; conversely, volatility and negative market sentiment provided traders with ample opportunity to earn speculative gains. Rather than focusing on revenues, earnings and a company’s outlook, traders took short term positions based on news bites and thoughtless commentary, which in turn set off computerized algorithms and correlated trading randomly driving stock prices. In this environment, enterprise valuations and long term investing are lost in the moment. For patient long term investors we know sound fundamentals eventually will prevail.

The advent of financial media provides an expanded “soap box” for the political process, both domestic and global; politicians play on financial survival, a universal concern. With media pundits opting for the easiest path to “broadcasting” financial news we find their opinions circumspect, rather than doing the hard work of knowing the story and reporting edited facts, we’re delivered sensationalism. As an investment manager we must remain steadfast in our approach and not lose sight of the “forest for the trees”. The ongoing railing of the financial media continues to skew the news for the singular purpose of gaining attention to enhance viewership undermining investor confidence. Protecting and growing personal wealth is a long term proposal; current market mania is in direct opposition of this concept.

The theme of stable growth and solid corporate earnings continue. Annualized first quarter GDP was 1.9%. Of importance, personal consumption was positive while spending reductions in federal and state government and higher oil prices subtracted. Our GDP outlook for the balance of 2011 is 2.5% and 3% for 2012. Despite the devastation in Japan, weaker than expected activity in the US and shocks to oil prices, the IMF forecast for global growth for 2011 remains at 4.3%, growing to 4.5 % next year.

Throughout this cycle the negative prospects for job growth and a difficult real estate market continue to constrain economic expansion. Despite unemployment lingering around 9%, June retail sales posted an 8.1% increase in May and 7.5% year over year, suggesting that the 90% of employed were not discouraged from spending. Housing has also shown signs of bottoming; June starts were estimated to be 582 thousand annually, historically low levels compared to 2006 when new housing units peaked at 2.1 million.

Corporate earnings remain on track with a positive outlook for the balance of the year. According to analyst estimates S&P companies project net income growth of 19% for the year, including a 13% gain in the second quarter. Third quarter earnings per share growth is estimated to be 14.1% year over year. Good earnings and strong balance sheets continue to provide the foundation for additional growth.

The sovereign debt crisis remains an overriding concern. While market participants and observers view the problems of the US and Europe differently, we don’t. Most countries, states and municipal entities in mature economies have overspent and must now find ways to reduce debt while still providing means and services to their populous. The problems vary in size and nature, but in all instances encompass social, political and economic issues. Fiscal difficulties facing governments must be resolved by the will of the people which is very different than restructuring a corporate balance sheet. It is of global necessity that free market economies come together and find resolutions. Despite intrinsic obstacles, solutions can only be found with a global perspective. We take solace that these issues are being confronted and publicly discussed more widely than any other time in memory, and this in part reflects our constructive view for the equity markets.

We appreciate our clients trust and are currently accepting new clients.

McCullough & Associates