



North American Management

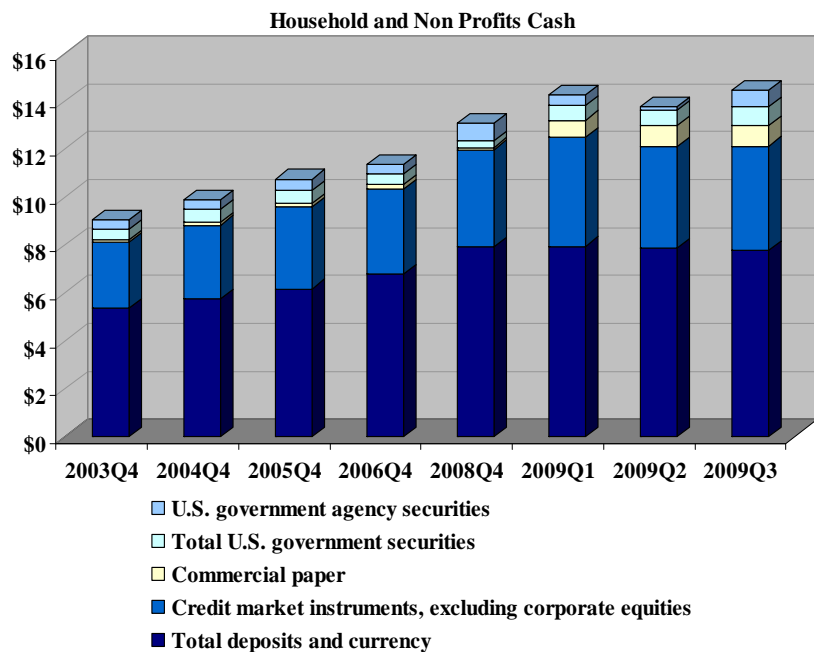
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US households reacted swiftly to the crash in equity prices in 2008 by boosting savings and dramatically cutting spending. Though many markets have rallied more than 70% off their lows, there has not been a concurrent rise in equity investment, as retail investors have been reluctant to embrace risk. The magnitude of this retrenchment is reflected in the level of household cash balances, now approaching \$13 trillion,* far exceeding the total capitalization of the US equity market¹. It is important to remember that investors have endured two corrections of more than 50% in their portfolios in the last decade, and many may have decided they simply cannot risk further loss as retirement approaches. The outflows from equity mutual funds throughout 2009 and early in 2010 ended up in cash and bond mutual funds, depressing investment grade yields to pre-crisis levels. Unfortunately, high yields from low risk investments are an anomaly, and do not persist for long. Recent comments from the Federal Reserve advocating low interest rates increase the likelihood that bond investors will be gradually starved for yield, and may have to raise their risk tolerances.

We believe that cash holdings and bond fund inflows should start to dissipate as investors decide that equities prove to be a better choice. Nervous investors may focus first on lower volatility blue chip stocks with stable dividends and business models. Interestingly, we have found a number of these companies trading at a discount to their historic multiples, in many cases below the S&P 500 earnings multiple. A stronger migration to equities should materialize when we see more evidence of economic stabilization, even at diminished growth rates.



The corporate sector weathered the downturn significantly better than many households and this resulted in improved free cash flow generation. We expect that in a slower growth environment more corporations will pursue strategic acquisitions, more aggressive research and development programs, and return capital to shareholders. Recently, Wal-Mart raised its dividend payout by 11%, and merger and acquisition activity has reached its highest level in several years, with three deals announced in the past month. As these trends continue, we expect a gradual return to more aggressive consumer behavior in the US.

¹ Historically, cash has vacillated between 50-60% of the total capitalization of the US equity market and today stands at 110%.



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We will continue to focus on raising equity exposure opportunistically, where appropriate, with a particular focus on investing where we can capture income to complement long-term growth.

**Source of graph: US Federal Reserve*

*** Source: Clough Capital – March 2010*

The information in this discussion is taken from sources that North American Management believes to be reliable. Notwithstanding, North American Management does not guarantee the accuracy of the data.