



# North American Management

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## Mirror Mirror October 2010

Rapidly evolving global dynamics necessitate that we frequently retest our views, and that we question the assumptions upon which consensus decisions are made. This exercise helps us make sense of where we are now, and where we may be going. We often find that conventional wisdom fails to predict future events, maybe more so in 2010, a year of fits and starts, huge regulatory changes and political dramas that tend to cloud visibility.

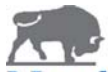
For example, consider four of the most prevalent views in January, 2010:

1. Fiscal stimulus would unleash job growth, causing unemployment to drop below 8%;
2. Rising economic activity, increased stimulus and growing sovereign debt would converge to raise inflationary pressures and interest rates;
3. Strong market performance from March 2009 lows (the S&P 500 was up 68% through 12/31/09) would heighten the utility of defensive sectors like Healthcare in a pullback;
4. The US consumer would be dormant for several years, and certain sectors would reflect this depressing “new normal.”

Ranked Returns: Index Groups		Page 1 / 2
Total: 10 Groups	Ret Period 10	Base Curr USD Adjust? N
All Group Performances	1) S&P 500 CONS DISCRET IDX	15.01
	2) S&P 500 INDUSTRIALS IDX	14.75
Index: SPXL1	3) S&P 500 CONS STAPLES IDX	5.90
Return: 4.28	4) S&P 500 MATERIALS INDEX	5.73
Start Date End Date	5) S&P 500 TELECOM SERV IDX	5.29
12/31/09 - 10/ 8/10	6) S&P 500 UTILITIES INDEX	2.25
	7) S&P 500 FINANCIALS INDEX	1.70
	8) S&P 500 ENERGY INDEX	1.38
	9) S&P 500 INFO TECH INDEX	.31
	10) S&P 500 HEALTH CARE IDX	-1.65

In all cases, consensus expectations have been wide of the mark, with implications for the way we view economic recovery. The limited effect of fiscal stimulus on job creation was disappointing, and slower growth has contributed to the yield on the US 10 Year Treasury dropping from a high of 4% in April to just below 2.5% today. Against this backdrop, the weakness of more defensive sectors, such as Healthcare (down 1.65% year to date), is stunning and almost without precedent. We have seen exceptionally strong performance from industry sectors more leveraged to the economy – with the notable exception of Financials (see the table above showing year to date sector performance through October 8, 2010). During the same period, Consumer Discretionary stocks were up 15%, with companies like the Limited up 56%, Macy’s up 46% and Wynn Resorts up 59%. It is a similar story for many Industrials, including Cummins, which was up 104%.

Our growth outlook has been a bit more constructive than the consensus view. This led us to raise exposure to a number of stronger performing sectors and geographic regions, notably Asia – though we confess we have been underweight Consumer stocks. These investments, combined with our bias toward securities that have dependable, rising dividend streams, have helped our client accounts, in aggregate, to outperform the overall market year to date.



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As we look forward to 2011, we believe that investor sentiment will improve, tempered to a degree by painfully slow progress in advancing employment levels. We have not given up on the eventual appearance of a multiplier effect from slow but steady increases in risk appetite from lenders, continued low interest rates and strength in corporate earnings. These factors drive our positive stance toward equities, and we see tactical support from several areas: 1) retail flows into equities are still dismal, 2) this election season may be a game changer, and 3) equity valuations relative to bonds are at their lowest point in almost 50 years.

*Source of chart and data: Bloomberg*

*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.*