



## North American Management

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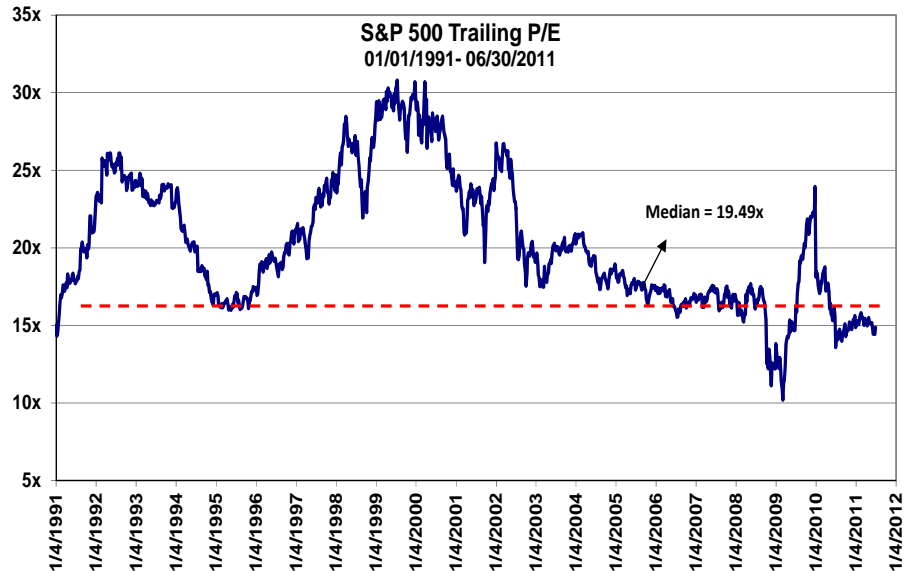
### Second Quarter 2011

#### The Recurring Nightmare

On the surface, the macro narrative in the second quarter of 2011 has been remarkably similar to the same period in 2010, but, thanks to a voracious rally the last week of June, without the losses among global equity indexes: the S&P 500 ended the quarter up 0.1%, European Stoxx 50 were up 0.9% and MSCI Asia rose 0.07%. By comparison, in the second quarter of 2010, the S&P 500 dropped 11.4%, the Euro Stoxx 50 dropped 9.6%, and MSCI Asia was down 9.3%. In each quarter, we experienced a global growth scare compounded by fears that a Greek default might spark debilitating contagion throughout Europe and beyond. This year, revolution across North Africa and a terrible tsunami that struck Japan late in the first quarter both reverberated through the global supply chain and led to a distinct slowing in the US, causing unemployment to drift higher to 9.2%. While these setbacks certainly exacerbated weak job creation and declining house prices, equity volatility and peak-to-trough drops intra-quarter were 50% of last year's levels – this after a 30.7% rise in the S&P 500 over the trailing twelve months. Why?

It seems plausible that low equity valuations have put somewhat of a floor on the market and dampened

volatility. The S&P 500 is trading at a 15x trailing P/E as of June 30 2011, a round trip back to 1991 (see graph). This is even more compelling when you consider that bank CDs were paying 8% and corporate bonds were yielding 10% at that time.\* Meanwhile, consensus S&P 500 earnings forecasts are projected to grow by 16% in 2011.\*\* In addition, many emerging equity markets are 14% off their highs (per the MSCI EM index, price change only) approaching bear



market correction levels while indicating similar earnings ratios and faster growth rates. In China, for example, continued tightening of liquidity has depressed stock prices, not earnings or growth rates.

Sentiment remains poor, and most investors are more concerned with downside volatility and catastrophe avoidance than long-term growth opportunities. We continue to believe the most inexpensive part of the

capital structure is the equity of well capitalized, globally branded companies with the capacity to fund a stream of rising dividends - some outpacing the rate of inflation on dividends alone. Many of these stocks are trading at high single digit or low teen P/E ratios, their dividends yielding 1.5x the S&P 500 yield, often greater than the US 10 Year Treasury. We are happy to own them while we wait for the next expansion to materialize, and we prefer it to taking interest rate risk while the guardians of our sovereign credit rating dither in Washington.

It seems to us that market participants are being forced to take uncomfortably high levels of political risk - likely one of the largest contributors to weak investor sentiment and overall risk aversion in the global capital markets. In Western, deficit plagued countries, where government policy (real or considered) is hindering capital formation to an extraordinary degree, rational investors are demanding a much higher risk premium, i.e. lower multiples, from equities. It is our view that a \$4 trillion "grand" budget deal, especially one that addresses both tax structure and entitlements, could easily catalyze a 10% to 15% rally in stocks and promote a healthy expansion of multiples - which would lead to more capital expenditure, including hiring. The headline problems of greater regulation and government interference might then be seen as less chronic and more cyclical, lifting (at last) bank lending. If the country can advance beyond the fog of political bickering, a new credit cycle awaits.

We are pleased to announce two new additions to our team in the second quarter:

1. Allison Popeo has joined us as a Vice President and Senior Relationship Manager. Allison spent the last five years in a similar function at GMO, an asset management firm with over \$100 billion in assets. Earlier in her career, she spent nine years at Fidelity Investments, including roles as a senior account executive within Fidelity's institutional division, Pyramis, and as client service manager for Fidelity Charitable Services. Allison began her career as an auditor with Price Waterhouse Coopers, LLC. She earned her BS from Bucknell University and her MBA from the F.W. Olin Graduate School of Business at Babson College. Allison is a member of the American Institute of CPAs.
2. Fraser McLean joined us in May as a Vice President and Director of Portfolio Management. Fraser will oversee and monitor the implementation of North American Management's investment strategies in individual client portfolios, with special focus on portfolio analytics, including performance attribution and risk controls. Prior to joining NAM, he spent eleven years on the portfolio management, portfolio construction and trading teams at Acadian Asset Management, where his responsibilities included improving the investment process, managing portfolios, and supporting marketing and client service efforts. Fraser earned his BS from Union College and his MS from Boston University. Fraser is a CFA® Charterholder and a CFP® professional.

In addition to being talented professionals who have worked successfully in highly demanding professional environments, Allison and Fraser are friendly, accessible people who are eager to meet with clients and contribute to our efforts. We welcome them to North American Management.

On an administrative note, as a result of amendments made to the SEC Custody Rule in 2010, we are required to engage an independent CPA firm to conduct an annual surprise examination of advisory accounts of which North American Management (NAM) is deemed to have custody. Examples of when NAM is considered to have custody of client accounts include where NAM or an employee (i) serves as a Trustee or General Partner, and/or (ii) where a client has provided NAM with online access information to his/her investment account(s). We have

engaged Wolf & Company to perform this surprise examination on or before December 31, 2011. The surprise examination requires the confirmation of certain information by the auditor directly with clients. Please note that Wolf & Company does not intend to review all of the accounts for each client relationship, only the specific accounts selected through its sampling process. In connection with the December compliance deadline, between now and January 15, 2012, you may receive a request via mail related to the surprise examination. Your prompt response to any confirmation inquiry/communication you may receive is greatly appreciated.

***Source of graph: Bloomberg***

***Source of data: Bloomberg***

***\* Source: Daily Wealth by Steve Sjuggerud***

***\*\* Source: Gluskin Sheff & Associates***

*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.*