# THE VIEW FROM PRINCETON

## *Market Commentary ♦ October 6, 2009*

Events of the past quarter had the effect of elevating the valuation of your shares. For stock market comparative references see the table in familiar format that follows. You can see that the big averages rose significantly in the quarter. Most unusually, there are such close results among these averages, showing broad uniformity for a three-month period. Many young small companies, not well represented in these averages, advanced more than large run-of-the-mill shares.

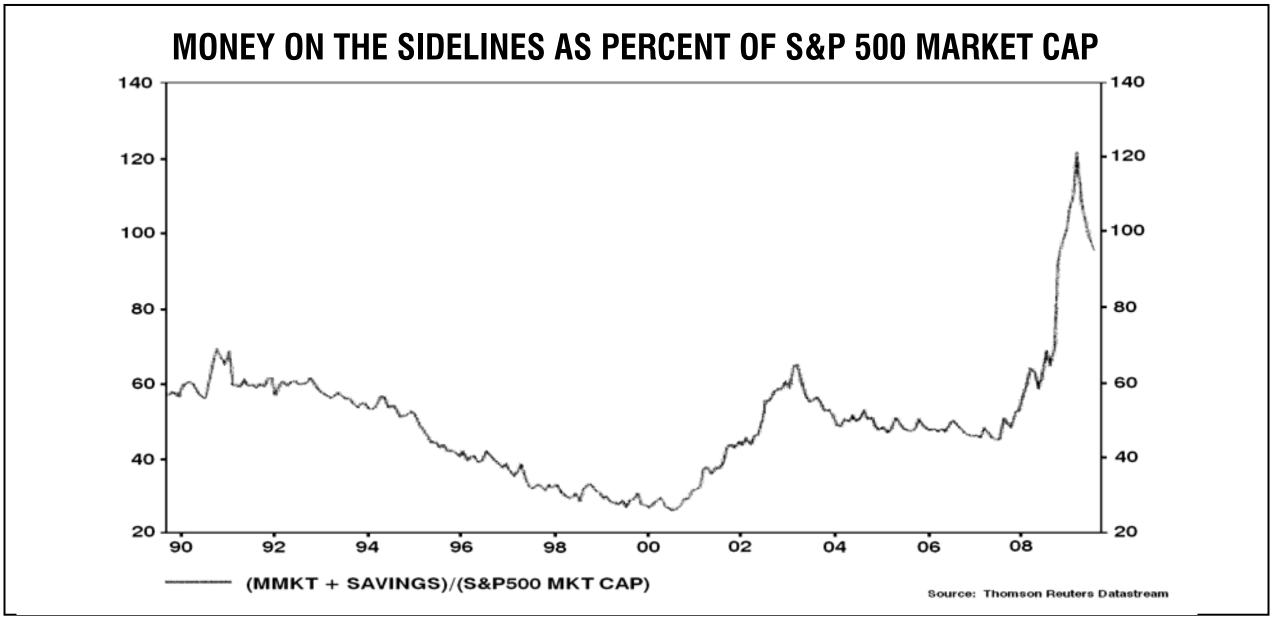
| | CLOSING PRICES | | | % CHANGE * | |
|---|---|---|---|---|---|
| **Name of Index** | **12/31/08** | **6/30/09** | **9/30/09** | **Last Quarter** | **Year To Date** |
| DJ Industrial | 8,776.39 | 8,447.00 | 9,712.28 | 14.98% | 10.66% |
| S&P 500 | 903.25 | 919.32 | 1,057.08 | 14.98% | 17.03% |
| DJ Wilshire 5000 | 9,087.17 | 9,424.92 | 10,911.69 | 15.77% | 20.08% |
| Nasdaq Composite | 1,577.03 | 1,835.04 | 2,122.42 | 15.66% | 34.58% |
| Russell 2000 Growth | 257.07 | 285.18 | 330.18 | 15.78% | 28.44% |
| Nasdaq Biotechnology | 729.54 | 749.58 | 839.61 | 12.01% | 15.09% |
| Nasdaq Telecommunications | 146.29 | 188.07 | 212.49 | 12.98% | 45.25% |

Data source: Telemet

*Not adjusted for dividends

Messages of formative forces — clear, definitive, but not yet conspicuously dominant — were provided out of the course of worldwide commerce during recent months. Some investors perceived and responded, as evidenced in the advances in these stock market averages. A follow-on bold advance seems prospective for the present quarter. The cost of cash resting on the sidelines, having fulfilled months ago its objective of protection, has become costly in real world terms. Cash is earning nearly nothing (below 1% for deposits) in its own right. If measured by the return on an alternate use of cash such as the quarterly gains shown above, cash was costly.

Developments around the world and within America support the prospect that the alternative cost of cash (in terms such as just referenced) will be even higher for the quarter just begun. We believe this will sponsor deployment of sequestered cash through immediate months. The sum of immobilized cash is huge. A graphic presentation by others (see following page) shows the amount of money market items plus savings deposits approximates the market worth of all shares of companies that make up the S&P 500, as illustrative. The graph shows the ratio of cash to market worth is down about 30% from its extraordinarily high early-year peak owing largely to an advance in share prices rather than to redeployment of cash. Who can recall a moment of comparable relationships? The shocking blow of 9/11/01 that shattered all expectations did not prompt cash hording to such extent.




The eighth anniversary of that date to remember — that day that can never be forgotten — was just commemorated with unmitigated astonishment and heartache. A most curious (and seemingly trivial) aspect was often referenced in the media. That is, the Dow Jones Industrial Average on 9/11/2009 was within pennies of the average on 9/11/2001. Other commonly used averages, with the exception of the significantly higher Russell 2000 Growth Index (small companies) were very close to their eight year old points. The road since 9/11/01 was not an easy one to travel in many respects, and it is more than merely interesting to see that in this eight-year interval we stand in such similar footprints from the standpoint of stock valuations. This curious factoid also constrains the frequently encountered viewpoint that the summer's rally brought shares too high too fast to reach overvalued prices; accordingly such shares should be sold now for later reentry.

Strong and sophisticated multinational companies have prospered in the eight-year interval, forming driving forces moving economies forward. Their strength is a far more important consideration than stimulus packages, or much of national policies.

The table of twelve companies on the following page summarily displays valuations of revenues and earning for the year ending 2004 and for the last twelve months. This shows valuations to be cheaper than five years ago. For all but DuPont, revenues increased while valuations of revenues decreased except for two that were unchanged (IBM and Campbell Soup). Recent valuations of earnings are lower for all but Deere, DuPont and Amazon, irrespective of the sharp drop and prospective recovery of earnings. These twelve stocks were chosen because they are prominent in their space, and because all are broadly familiar. You own more than one, and the rest you will know by name, and by their reputations. Such simple references as these are more conclusive than words: Shares of good enterprises are not expensive in terms of commonly used metrics, by and large, as these representative figures illustrate. Rather, recent reduced valuations seem to prejudicially discount prospects for improving business and for many months prospectively of low interest rates (the most pervasive of supportive factors). Moreover, in the five years from 2004 to 2009, the cash accumulation by these companies increased, while debt and shares were retired.

| | Revenue Growth | Valuation/Revenue | | Price/Earnings | |
|---|---|---|---|---|---|
| | 2004-2009 | 2004 | 2009 | 2004 | 2009 |
| General Electric Co. (GE) | 11.8% | 2.1x | 1.0x | 20.5x | 11.9x |
| International Business Machines Corp. (IBM) | 1.0% | 1.6x | 1.6x | 18.0x | 12.8x |
| Microsoft Corporation (MSFT) | 58.6% | 7.3x | 3.8x | 25.8x | 15.2x |
| AT&T, Inc. (T) | 203.3% * | 1.7x | 1.3x | 17.2x | 13.2x |
| QUALCOMM Inc. (QCOM) | 119.4% | 13.0x | 6.3x | 28.4x | 25.9x |
| Boeing Co. (BA) | 17.5% | 0.7x | 0.6x | 29.4x | 16.9x |
| Deere & Co. (DE) | 32.2% | 0.9x | 0.8x | 11.8x | 12.4x |
| Merck & Co. Inc. (MRK) | 1.4% | 2.5x | 2.3x | 16.2x | 11.8x |
| United Parcel Service, Inc. (UPS) | 30.1% | 2.3x | 1.2x | 26.1x | 19.9x |
| Campbell Soup Co. (CPB) | 6.7% | 1.5x | 1.5x | 16.7x | 14.9x |
| EI DuPont de Nemours & Co. (DD) | -1.0% | 1.5x | 1.0x | 18.4x | 21.9x |
| Amazon.com Inc. (AMZN) | 196.3% | 2.6x | 1.9x | 53.2x | 58.3x |
| **Average** | 56% | 3.1x | 2.0x | 23.5x | 19.6x |

*growth increased by acquisitions

The state of corporate wellbeing and their strategic planning has driven the recent increase of mergers and acquisitions. IBM's several purchases during recent years to create a broad and massive software service team has been imitatively followed in recent announcements as Hewlett Packard purchases EDS, Dell purchases Perot, and Xerox purchases Affiliated. These equipment providers now have large-scale systems software capabilities. There were large mergers and acquisitions in other industries. Merck just completed the purchase of Schering-Plough, Abbott is spending over $7 billion to purchase the pharmaceutical division of Solvay, which follows Pfizer's mega purchase of Wyeth. A huge Cadbury purchase is prospective, and there are other large ones also in the wings, to be sure. This is sufficient evidence to let all know that big companies are moving on their opportunities, deploying their cash, their energies and their inventiveness on a worldwide playing field in order to grow their revenues and their fortunes. Shareholders of these acquired companies will be reinvesting in other shares to some extent. The scale of even a small portion of those surrendered shares would be a lifting force for many other share prices.

All such supporting metrics within the market combine with larger background messages that come out of the course of worldwide events of the last several months.

(1) Several other nations have declared their recessions are over.
(2) American citizenry has, it seems, begun its informal one-by-one process of declaring its recession is over. At least, the decline has ended, and indications seem to point to a self-sustaining upgrade, perhaps accelerating slightly as the fourth quarter progresses.
(3) Corporate earnings will modestly exceed expectations, a highly specific supportive factor.
(4) The very large, broadly defined electronics industry that has already increased production will receive continuing support from:
  (a) a replacement cycle in personal computers
  (b) new enhancements and lower prices generally (as inherent and usual) for much of consumer electronics
  (c) high definition broadcast of television and radio, and
  (d) all the enhancements that are ever ongoing from more connectivity in the communications realm
(5) Health care and agriculture, two of our largest of industries, are inherently strong and growing, though buffeted by cross currents now.

Worriers have not far to look for matters to worry about. We can all feel concern over the dollar's cheapness. There is a chance that such could produce competitive national currency devaluations, especially since the White House stunningly announced an increase in tariff on Chinese tires (of all things?). Newspapers report a tariff is being considered also on Chinese solar panels. Together, this appears as adults fighting over a toy. A weak currency is not the best way for America to address the rest of the world, especially if it be sponsored by national policies instead of by natural forces.

Moreover, there are those who worry about the bloated condition of the Federal Reserve System in terms of its own health, and worry further about the enormous sums that were urgently pumped into the banking arena to save banks from themselves. Many a curbstone conversation turns toward how the Fed can withdraw the money to keep this from being inflationary, or, conversely, to keep it from being deflationary on withdrawal. This is a conundrum that ensuing events properly perceived can take care of. The Federal Reserve System has made it clear they shall leave short-term rates at a low level from their sponsorship until the economic recovery has gained strength to ensure credibility of its endurance.

That is not likely to happen this year. But it seems probable for next year. Then, short-term rates will no doubt rise from these imposed low levels. We do not expect this to communicate a significantly large rise in long-term interest rates because corporate demand for funds in total (net) is slight, and will likely stay that way for a while, owing to their self-sufficiencies. Consumer credit is being repaid. And new use of residential mortgage debt (always the largest, by far, in use of long-term capital) has been much reduced. Meanwhile, scheduled repayments ever rise introducing the prospect of net repayments. If so, as expected, net repayments of residential mortgages would be a first on this side of World War II. Reduced private debt usage leaves plenty of room for prospective huge borrowings by the Federal Treasury and among those of the fifty states within the Republic whose budgets are in poor state.

Surely, the prevalent lack of civility in our social and political discourses is also debilitating in spirit, and thus in expectations. We would also add the lack of intelligence in so much of public commentary has become an evident deleterious matter of serious proportions. As a factor in valuations of financial assets, it is difficult to gauge other than to know it is a negative influence, and one that adds to volatilities in valuations. Also, this further aggravates by hindering national governance, and America's ease of rapport in the community of nations.

Sustained and spreading growth in the incipient recovery will provide the leaven to ease anxieties, and reduce the stridency in our voices. As always, the fortunate aspect of seeing the half full glass to be half empty is that glass is transparent. This will eventually allow all to see the elements of strength prevail over weaknesses.

With gratefulness for your friendship and trust, as ever,

Sincerely,

James Fitzpatrick        R. Hugh A. Fitzpatrick