

The Rest Of The Story

July 2011

From Leo Abel

I hope this letter finds you doing well. I am writing to provide you with an important perspective on the markets and the economy.

The Story Begins in 2009

Let's look back on an article I wrote in March of 2009.

When I wrote the following words, we were living through (in the financial markets) what one could accurately describe as an economic disaster. Reactions to my words ran the gambit of emotions ranging from appreciation to near violence. I wrote them, as I write any of the messages you receive from me, *because I believed them to be true.*

From the March, 2009, article:

"Nothing in this article attempts to minimize the cataclysm of the past fifteen or sixteen months. Rather, in my opinion, it provides insight into the fact that our country, the world, and the global markets have faced crises before which at the time seemed insurmountable. Obviously they were not.

"We find ourselves here again with all kinds of prognostications of the end of capitalism and the end of the stock market, etc., etc. Don't believe it. We will survive and thrive in the years to come."

Now - What I See Today in 2011

Problems in the global macro-economy are well documented: stubbornly high unemployment, continued softness in housing prices, argument over the debt ceiling, rising interest rates, the controversial health care legislation and other entitlement programs, predictions of higher income taxes in this country, possibility of default of European sovereignties and possible contagion from defaults, and the ever present reality of global terrorism.

Perhaps I've left some out, but I'm sure you get the picture.

As compared to 2009, though, the economy is in much better shape. Recall, the recession we were then living through had begun in the fourth quarter of 2007 and ended in the second quarter of 2009. Markets, as measured by the S&P 500, closed on March 9, 2009 at 676; today the index stands above 1300.

And that's why the article I am writing to you today is "The Rest Of The Story." Those well documented problems in the macro-economy are part of, but not the entire story. Virtually unreported is the following information about the great businesses in America and the world.

The growth of the middle class: a megatrend around the world.

The developing world is a low-cost source of manufacturing and services. But that is not where the story stops. The outcome is the rise of the middle class as consumers and, ultimately, as investors, which creates tremendous opportunities for American companies – ones which are more global. These trends can be seen in the operations of businesses in America.

The continued surge of corporate revenues, cash flows, earnings, dividends, stock buybacks, etc.

How can one explain the fact that today's prices for many equities are cheaper today than when I first wrote to you in 2009? To clarify, let's look at key details.

At its current level, around 1300, the S&P 500 is trading at about 13 times this year's earnings estimates and 14.5 times the past year's earnings. The average since 1991 according to Bloomberg was 20.5. Additionally, the index trades at roughly 9 times cash flow.

In March of 2009 the index was then trading at around 14 times earnings estimates. The reason company share prices are cheaper today, even after a doubling in the index, is that *earnings have surged even more.*

Further, company after company has announced dividend increases in the current environment. Through June 23, 2011, 261 companies on the S&P 500 made dividend changes. Of those changes *256 were dividend increases.*

Wal-Mart is an example. If any company should be facing economic headwinds it's Wal-Mart. Yet, the company increased the dividend 21% in March of this year and has announced another \$15 billion stock buyback. This announcement comes after the completion of a previous program of the same size.

It comes down to this: While headlines continue to be scary, the great companies persist in outperforming the macro-economy.

Consider fear to be your friend.

Messages of financial and economic distress continue to ring out from the media. They fuel doubt and insecurity and drive down prices of the great companies in America and the world. There, in lower prices and increased values, lie enhanced potential for the long-term investor. As investors, we must constantly remind ourselves that it is only during periods of fear and pessimism that we are able to purchase great companies cheaply.

Please call me at 225-408-4000 if you would like to talk about the potential found in "The Rest of the Story."

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