Don't Fear the Double Dip

Conference Call Webinar Slides

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Don’t Fear the Double Dip

- A double dip does not mean a repeat of 2008-2009
  - Last year’s corporate job and capital expenditure cuts have largely anticipated the current environment, so large further cuts will likely not be needed, even if growth stalls
  - Corporate profitability is at a record high
- The recoveries after the 1990-1991 and 2001 recessions were shallow and “jobless”
- However, the current employment situation is the worst since the Great Depression
- Recovery requires creation of new sources of employment and economic growth, which takes time
  - If entrepreneurs and business leaders fear the economic and regulatory outlook, then the investment necessary to create new jobs will not be made
- Financial markets will remain volatile over the next several years

"The Good Old Bad Days"

The US economy remains almost comatose … The current slump ranks as the longest period of sustained weakness since the Great Depression. … Once-in-a-lifetime dislocations will take years to work out. Among them: the job drought, the debt hangover,.. the banking collapse, the real estate depression, the health-care cost explosion and the runaway federal deficit.

- Time Magazine, September 1992

Source: Bloomberg Business Week September 6, 2010

- When this was published the economy was recovering - growing at over 4% in real terms
- Globalization and the productivity growth triggered by information technology led to a sustained period of economic growth
  - Emerging markets are growing much faster than in the 1990s
    - Focus is shifting from outsourcing to growth of local consumers
  - Information Technology will continue to deliver incremental productivity gains, but not at the level of the 1990s
  - Potential for major disruptive new technologies in medicine, energy and agriculture over the next decade
- Today total debt levels are approximately 50% higher than in 1990
- Demographics were a tailwind in the early 1990s, with the baby boomers entering their peak earning and saving years
  - Now entering retirement years, baby boomers face insolvent entitlement programs that will require difficult political choices to fix
    - This is an issue throughout the developed world, not just the US

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Deep Recession, Shallow Recovery

GDP CQOQ Last 1.6% 2Q S Next 09/30/10 08:30 Surv 1.8% Index G

GDP US Chained 2005 Dollars QoQ SAAR

GDP CQOQ Index | Edit | Actions | Bookmarks | Show | G 15 - Qtr GDP

GDP CQOQ Index : GDP US Chained 2005 Dollars Qo Quarterly 6/30/1947 - 6/30/2010

REC

15 10 5 1.6 0 -5 -10

49 1950-1959 1960-1969 1970-1979 1980-1989 1990-1999 2000-2009 201

- Shallow recovery is inline with the 1990-91 and 2001 recessions, although the current recession magnitude of the decline was much larger

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Construction and Manufacturing have been the Hardest Hit

Job Losses: January 2008 – August 2010

Sectors: Goods producing — Services — Government

Construction Mining Manufacturing Retail Wholesale Business Services Transportation + Utilities Finance Information Education Health care Leisure Other Federal + State

873.5

500

178.5

64

2

500

445

-374.3

309

411

171

651

-1,000

-1,132.6

-1,337

-1,500

-2,000 -1,880

-2,047

Total job losses (in thousands)

-7,640.1

Number of jobs per sector (in thousands)

Source: Wall Street Journal

- Companies continue to develop ways to improve productivity, which preserves profit margins and allows for greater long term income growth,
  - Despite the severity of the employment cuts, the immediate impact is that many job losses become permanent

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Consumers are Paying Down Debt

Household Debt Service Ratio

Household Mortgage Debt Service Ratio

14.00
13.00
12.46
12.00
11.00
10.52
10.00
9.00
8.00

1980-1984 1985-1989 1990-1994 1995-1999 2000-2004 2005-2009

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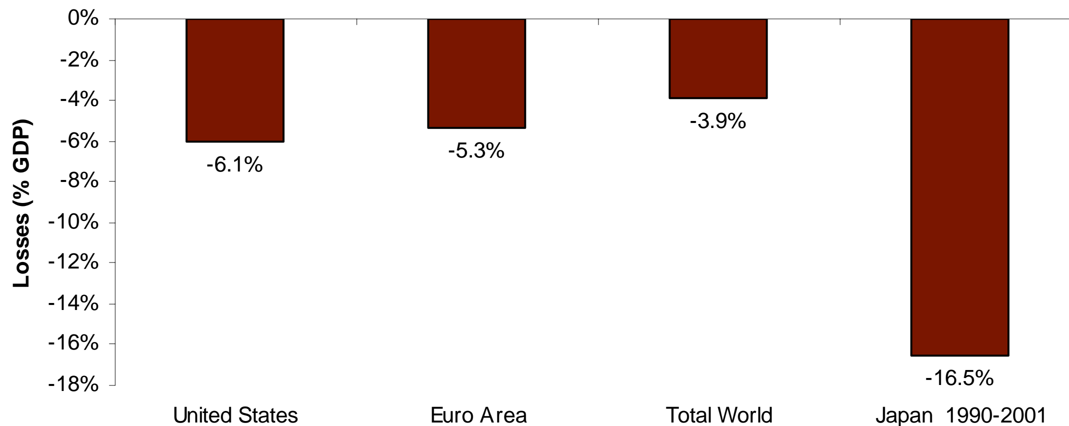
Total Consumer Debt Outstanding
(excludes Mortgages)

Mid Line 2418.87
High on 07/31/08 2581.86
Average 2409.75
Low on 09/30/04 2160.14

2600
2500
2418.87
2400
2300
2200

2004 2005 2006 2007 2008 2009 2010

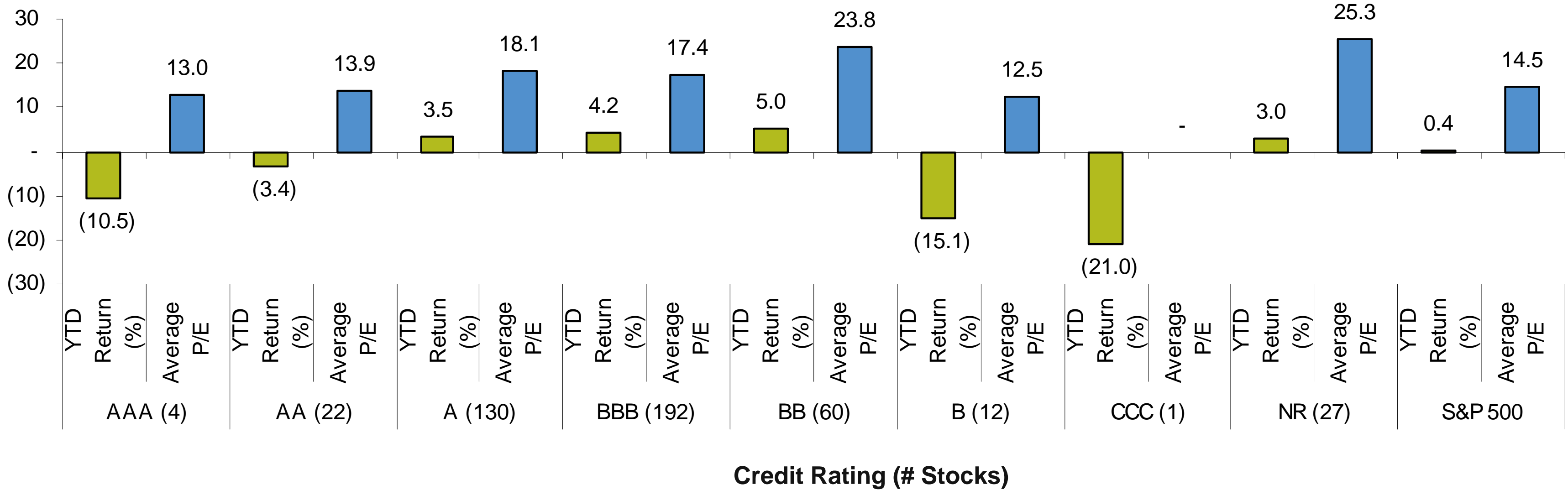
Is the US like Japan in the 1990s?



Yes, but…

- Loan losses from the credit bubble estimated at 6.1% of GDP vs 16.5%
- More dynamic economy
- No demographic time-bomb

High Quality Stocks have Lagged, but look Attractive



Stocks with “AAA” & “AA” credit ratings significantly cheaper than “BB”

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Higher Quality Stocks have Better Long-Term Performance

Annual Returns for S&P Quality Ratings 1990-2008

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Risk-Adjusted Return	
A+ 4.5%	A+ 49.6%	B+ 14.9%	B 23.4%	A 5.7%	A+ 42.0%	B 27.4%	A 43.3%	A+ 33.6%	C & D 103.2%	A 4.0%	A- 2.0%	A- -6.8%	C & D 52.9%	B 17.1%	B- 11.6%	A- 22.0%	B 12.1%	A+ -22.1%	C & D 56.2%	A+ *(Highest)* Return 8.8% Risk 14.6%	0.60
A 2.5%	C & D 42.3%	B- 13.6%	B- 22.6%	A+ 2.4%	B- 39.0%	B+ 23.5%	A+ 39.3%	B+ 29.8%	B+ 27.9%	A+ 3.2%	A -2.2%	A -19.8%	B- 37.6%	A- 16.3%	B 9.1%	B+ 18.3%	B+ 8.5%	A- -33.9%	B- 45.3%	A *(High)* Return 7.5% Risk 15.3%	0.49
A- -3.2%	A 35.7%	A- 13.5%	C & D 18.7%	B 0.3%	A 38.9%	A+ 23.2%	A- 38.4%	B 24.5%	B- 27.5%	A- 0.8%	B- -6.4%	B+ -20.1%	B 37.0%	B- 12.8%	A- 6.8%	B- 17.1%	B- 4.7%	B+ -36.8%	B 43.6%	A- *(Above Average)* Return 10.1% Risk 14.3%	0.71
B -8.2%	B+ 33.3%	C & D 11.2%	A- 13.5%	C & D 0.1%	B 37.2%	A 22.5%	B+ 30.0%	A 21.7%	B 26.5%	B+ -4.6%	B -8.8%	A+ -20.4%	A 34.0%	B+ 11.1%	B+ 6.3%	C & D 15.7%	A- 2.1%	B -37.9%	B+ 29.1%	B+ *(Average)* Return 8.6% Risk 16.0%	0.54
B+ -14.1%	B- 25.2%	B 10.7%	B+ 12.8%	A- -0.5%	A- 36.4%	A- 21.8%	B 25.4%	A- 19.2%	A+ 17.9%	B -14.9%	A+ -9.8%	B- -23.6%	B+ 28.3%	A+ 8.7%	A 2.6%	B 13.9%	A 1.9%	A -38.9%	A- 17.0%	B *(Below Average)* Return 9.3% Risk 16.9%	0.55
B- -17.8%	A- 23.7%	A 6.9%	A+ -0.3%	B+ -1.2%	B+ 33.2%	B- 15.7%	B- 24.0%	B- 17.0%	A- 12.8%	B- -19.7%	B+ -17.1%	B -26.0%	A- 25.2%	C & D 3.4%	A+ 1.8%	A 13.2%	A+ -3.7%	B- -40.5%	A 15.8%	B- *(Low)* Return 7.7% Risk 19.7%	0.39
C & D -27.5%	B 20.4%	A+ 2.7%	A -4.6%	B- -1.8%	C & D 21.9%	C & D -2.1%	C & D 0.9%	C & D 7.0%	A 1.1%	C & D -22.2%	C & D -30.9%	C & D -45.2%	A+ 19.6%	A 2.3%	C & D 0.3%	A+ 9.5%	C & D -4.6%	C & D -52.2%	A+ 6.1%	C & D *(Lowest)* Return 1.6% Risk 27.9%	0.06

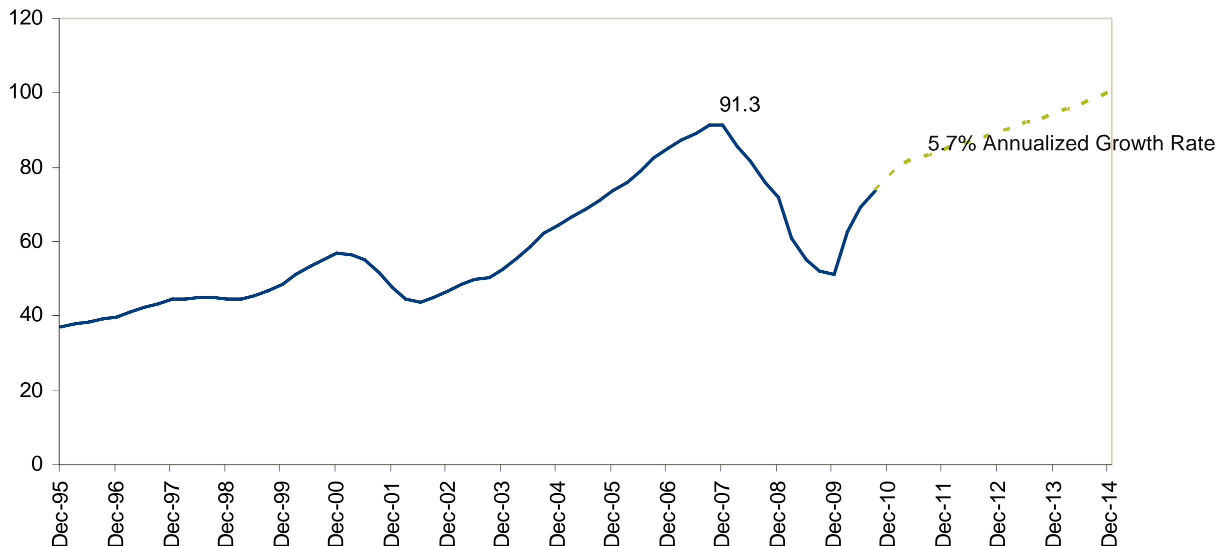
1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Risk-Adjusted Return	
High Quality -2.6%	*High Quality* 35.7%	*Low Quality* 12.0%	*Low Quality* 22.6%	*High Quality* 1.1%	*High Quality* 37.2%	*High Quality* 22.9%	*High Quality* 36.6%	*High Quality* 27.0%	*Low Quality* 30.2%	*High Quality* 0.1%	*High Quality* -8.3%	*High Quality* -17.6%	*Low Quality* 39.7%	*Low Quality* 13.6%	*Low Quality* 8.3%	*High Quality* 15.8%	*Low Quality* 8.6%	*High Quality* -32.9%	*Low Quality* 45.1%	*B+ or Better (High Quality)* Return 8.8% Risk 14.0%	0.63
Low Quality -12.3%	*Low Quality* 22.8%	*High Quality* 9.1%	*High Quality* 5.7%	*Low Quality* -0.4%	*Low Quality* 36.5%	*Low Quality* 22.4%	*Low Quality* 23.9%	*Low Quality* 21.8%	*High Quality* 15.6%	*Low Quality* -17.4%	*Low Quality* -10.2%	*Low Quality* -27.8%	*High Quality* 25.7%	*High Quality* 9.9%	*High Quality* 4.5%	*Low Quality* 15.2%	*High Quality* 2.8%	*Low Quality* -39.7%	*High Quality* 18.8%	*B or Below (Low Quality)* Return 8.2% Risk 18.1%	0.45

*Time period: January 1, 1990 – December 31, 2009. Included in the Table, seven model portfolios range alphabetically from the Highest Quality companies ("A+") to the Lowest Quality companies ("C&D"), each capturing the long-term growth and stability of a company's earnings and dividends in a single measure. The High and Low Quality portfolios are provided to compare the aggregate of all companies with High Quality Rankings (B+ or Better) to those with Low Quality Rankings (B or Below). Each model portfolio is ranked in order of best to worst calendar-year performance. The cumulative annualized rate of return, standard deviation, and risk-adjusted returns are calculated over the 20-year period to test the benefits of investing in high quality companies over full market cycles. The universe includes all Russell 3000 Index constituents with S&P Quality Rankings and prices greater than $1. Portfolios are formed and rebalanced monthly, and rates of return are calculated using a market capitalization-weighted methodology.

Sources: Standard & Poor's, Wilshire Atlas, Atlanta Capital. The material is based upon information that S&P, Wilshire and Atlanta Capital considers to be reliable, but neither S&P, Wilshire nor Atlanta Capital warrants its completeness, accuracy or adequacy and it should not be relied upon as such. This information should not be considered investment advice. The Russell 3000 Index is a widely-accepted measure of the broad U.S. stock market performance that includes approximately 98% of the U.S. market. Indexes are unmanaged and it is not possible to directly invest in an index. Performance during certain periods reflects strong stock market performance that is not typical and may not be repeated. Past performance does not predict future results. Reproduction or redistribution of this page in any form without express permission from Atlanta Capital is prohibited.

Source: Atlanta Capital

Earnings Drive Stock Returns



Calendar Year-End 1600 S&P 500 is reached

	2013	2014	2019
Years	3.25	4.25	9.25
Annualized Return	13.4%	10.6%	5.9%

Assumptions: 2% dividend yield, 16 ending P/E ratio

Calendar Year-End 1400 S&P 500 is reached

	2013	2014	2019
Years	3.25	4.25	9.25
Annualized Return	9.0%	7.3%	4.4%

Assumptions: 2% dividend yield, 14 ending P/E ratio

- Fortunately, stocks are priced to deliver acceptable returns with modest earnings growth expectations
- Comparable Yields for 10 year bonds:
  - Treasuries: 2.7%
  - AA Corporate Bonds : 3.1%
  - BB (junk) Corporate Bonds: 6.4%

Comstock Investment Themes

- Focus on Quality
  - High quality stocks have delivered excess returns without commiserate risk
  - While quality is a generally recognized concept, it resists simple quantification
  - Relative valuations today are attractive
  - Financial strength matters in the “New Normal”
- Emerging markets have the highest growth potential
  - Already discounted into valuations in many cases
  - Markets are mature enough to warrant multiple investment strategies
  - Avoid closet indexing
- “Rifle-shot” approaches to low-grade credit
  - An alternative to stocks, not investment grade bonds
  - Higher default rates and lower recoveries will likely be the new norm

Comstock Investment Themes (continued)

- Hedge Fund Beta
  - Research shows most hedge fund returns represent "beta" (fair returns for risk taken) vs. "alpha" (unique skill of money manager)
    - Does not justify 2% management fees + 20% performance fees
  - Lower cost alternative to many hedge fund strategies are available in mutual funds
    - Strategies such as convertible and merger arbitrage have attractive risk / return characteristics at the lower fee levels and without the operational risk of limited partnerships or LLCs
- Quality Real Assets
  - A diversified portfolio of MLPs can yield 6%+ with 3-5% dividend growth
    - Core energy infrastructure with limited exposure to commodity prices
  - Timber & Core Real Estate represent other opportunities

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