THE VIEW FROM PRINCETON

Market Commentary ♦ July 2, 2010

The news in immediate weeks will provide the reporting of revenues and earnings for the quarter just ended by most corporations whose equity shares are publically traded. Pay attention. These reports will have more meaning for investors than anything that might be included in these pages. The past quarter marks the fifth consecutive quarter in which revenues increased very well and earnings advanced by larger percentage increments (reflecting increased disciplines of costs). It is an odds-on bet that the second half of 2010 will add another two consecutive quarters — not with comparably sized increments; nevertheless, a continuation of a generalized upward pattern.

This is extraordinary. Yet few, if any, could believe there has been so much supportive good news from television reporting and commentary, nor from the many “seers” of the street — and surely not from a confused, evidently nervous, hyper-kinetic stock market.

The table of indexes below (in customary format as reference for your results) shows that the advance and fallback of the central body of the stock market added to a loss in the first half of 2010. Note especially that the index for electric utilities lost 10.12%, in utter disregard of the cheapened valuations through recent years that result in extraordinarily high dividend yields — either historically referenced or relative to yields from investment quality bonds. Meanwhile, the Russell 2000 Growth (small companies) index scarcely changed.

	CLOSING PRICES			% CHANGE*	
Name of Index	**12/31/09**	**3/31/10**	**6/30/10**	**Last Quarter**	**Year 2010**
DJ Industrial	10,428.05	10,856.63	9,774.02	-9.97%	-6.27%
S&P 500	1,115.13	1,169.43	1,030.71	-11.86%	-7.57%
DJ Wilshire 5000	11,497.48	12,160.97	10,750.05	-11.60%	-6.50%
Nasdaq Composite	2,269.15	2,397.96	2,109.24	-12.04%	-7.05%
Russell 2000 Growth	343.24	368.71	334.27	-9.34%	-2.61%
Nasdaq Biotechnology	843.57	939.02	799.94	-14.81%	-5.17%
Nasdaq Telecommunications	216.86	227.41	187.33	-17.62%	-13.62%
DJ Utility Average	398.01	378.82	357.74	-5.56%	-10.12%

*Not adjusted for dividends   Data source: Telemet

As always, a spread of indexes comprises “signs of our times”. Writing in *Barron’s* in the June 14 issue, Michael Santoli sets the present moment from the standpoint of valuations in a ten-year time perspective as: “The S&P 500 is down by one quarter since 2000, while its companies’ profits have doubled and long-term interest rates have been halved.” Most of these same companies have huge cash tills as never before, and are functioning confidently in an internally self-sufficient expansionary mode, providing societal leadership far beyond the leaderships of government. The same might be said for many multinational companies resident elsewhere as well. This is the stuff on which investors can rely (that is, those who can look out a year or longer) while traders will continue to play the "risk on and risk off" trade utilizing headlines, sound bites, and volatility, and to move in and out of markets.

We do not intend to be facetious in advising investors to view the contemporary state of confusion as a friend. It is causal to the unusually high frequency of undue discounting of shares, rather than the capitalizing of reasonable prospects. Therein are significant portions of today's opportunities. While confusion might have friendly aspects by way of bringing bargains to attentive investors, inconclusiveness is no friend to anyone. Call America's traumatic morbidity of temperament what you will, "contentiousness", "disappointment", "confusion", or "hypochondria" (as we did in recent commentary). Contemporary incongruities bring to mind the parody on Rudyard Kipling's "If": "If you can keep your head, when all about you are losing theirs — look around, Jack, you might not know what's going on." So, we have looked around, out into the physical world, sometimes referenced as the real world. Indeed, that is what we commonly do for a living. The binding, or supporting, reality for long-term investors is in the physical world, not in the financial playing field (which is not to be overlooked, nor trusted).

It seems useful at this time to view the world in the dichotomy of the financial and the physical. Though these truly belong together, there is always some degree of freedom to diverge. Divergence in recent years has been dramatically and terribly overdone by the growth in mobile financial assets, and the hyperactivity of financial entities. No one needs to be reminded that the difficulty experienced in the last years of the 2000 decade in America and Europe was sponsored by, and centered in, the financial fields of excesses and misconduct. And in recent months the "crises" of the members of the European Monetary Union were financially centered and aggravated. Having been built, or staged slowly, this was made kinetic (and socially and politically damaging) for the capricious interests of financial entities.

So, what was the G20 meeting of nations in Toronto, Canada to do about all this? Well, they met, talked, stood for photos and agreed that something should be done — later. Students of the markets and history might easily have heard echoing through the hallways the voices (circa 1930-32) of President Herbert Hoover and Andrew Mellon (Secretary of the Treasury throughout most of the 1920's) counseling governments to cut spending and reduce debt. Such resonates well in some ears, and conjures fears of another economic dip in the minds of others.

Apprehensions on the eve of the G20 meeting might properly have turned into relief as representatives sat, and talked, and dined. Good!! There is too much to do to attempt correction of financial practices now — not nation-by-nation, rather coordinately and sympathetically for smaller nations that are subject to being mauled by gargantuan trading entities.

Across the variegated body of shares we select for clients, the progress of enterprises has rarely, if ever, been so supportive as now. This coordinates with prospects for sustainable economic growth, with neither inflation nor deflation likely to be virulent. Interest rates will stay benignly low, with short-term market rates rising from near zero to a normalized, compatible scale. Such an evolving environment will correct eventually for America's contentious-provoked, confusion-smothered lack of comity, and for its self imposed hypochondria, leading persons to deploy the doubt-sequestered buildup of abundant liquidity. As a matter of physics, (independent of forecasting) such funds cannot re-enter without lifting these reduced prices of equities.

With every good wish, sincerely,

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