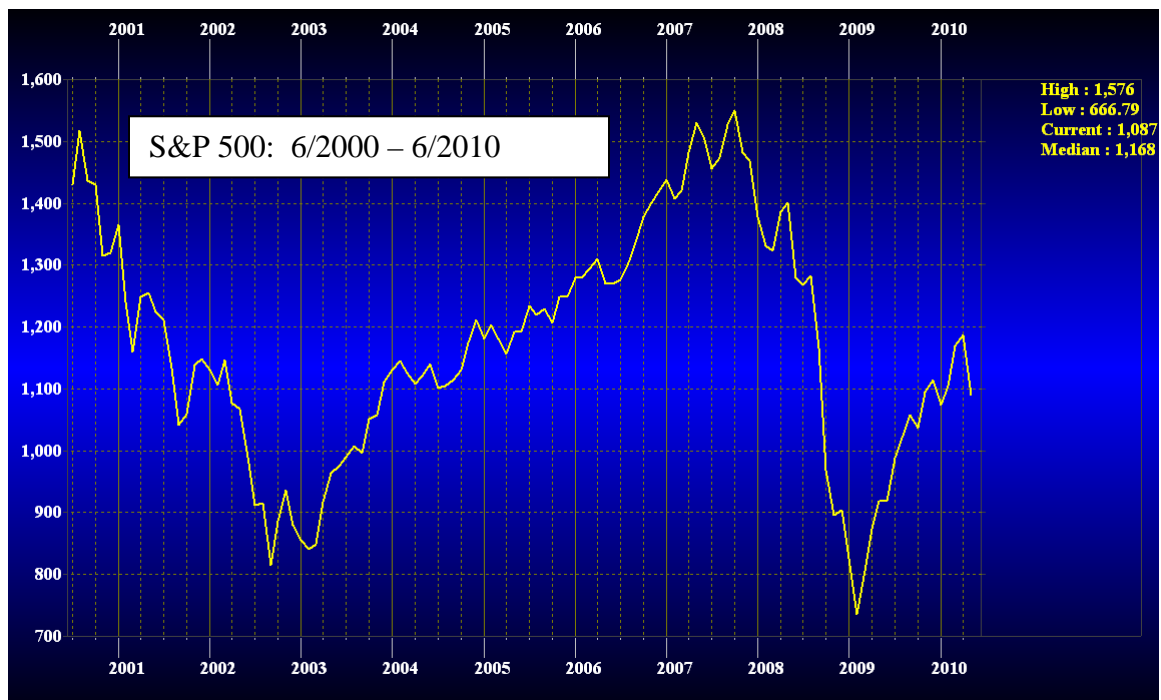




A study of the S&P 500 Index from 1927 – 2008 reveals that the stock market has had negative returns only 3% of the time over a rolling 10-year period. Unfortunately, we have experienced this 3% over the past couple of years. The good news is that the market has never shown negative returns over a rolling 20-year period. Yet, despite reasonable valuations and strong corporate earnings, many analysts are fearful of another bear market and continue to advise steering clear of equities.

The years 2000 – 2010 could be viewed as a “lost decade” in the stock market. In 2000, the S&P 500 Index was trading at 25 times its earnings with an earnings yield of 4%; that is, if all of the companies distributed 100% of their earnings, it would still only be a 4% dividend yield. Today, following ten years of declining stock prices and higher earnings, the Index is trading at just 12.5 times earnings or an earnings yield of 8%. Contrast this to an average corporate bond yield of 3% and the value of this market becomes quite evident.



For good reason, the bear markets of the past decade are still quite fresh in investors’ minds. The 50%+ decline from late 2007 to early 2009 was the worst market decline since the crash of 1929 - 1931. The belief that the market’s increase from the bottom was too fast misses the point that corporate earnings have kept pace with the market’s

increase. Indeed, the price-to-earnings ratio of just 12.5 today is lower than at any time in the past 30 years, save for the very bottom of the bear market.

Corporate earnings have improved steadily over the past year with the latest quarterly earnings up 52% from one year ago. At this point in the economic cycle, we should expect hiring to accelerate. Growth of earnings always precedes hiring, as companies need to feel confident in spending money on labor. Thus far in 2010, we have seen over 1 million jobs created in the private sector. The unemployment rate is still at an elevated level of 9.7%; however, this has peaked and will slowly come down.

Consumers are still exhibiting caution in spending and they are saving more. Short-term, this can be detrimental to economic growth; longer-term, as consumers rebuild their balance sheets, this is a very healthy change to our economic system. Banks are lending to qualified customers; the more consumers have saved, the more qualified they will be for all types of loans.

We believe the latest decline is just a temporary pause in the recovery. The economy is on very solid ground and the stock market is very reasonably priced. Now is the time to buy the best companies in the various industries. Stock prices may not rise immediately, but they will rise over time as the economy continues to heal and companies continue to grow both their earnings and dividends. The “lost decade” for the stock market is behind us and, in all likelihood, we will see a very strong stock market over the next ten year period.

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