

# WESTOVER CAPITAL ADVISORS, LLC

ASSET MANAGEMENT & INVESTMENT COUNSEL

H. MURRAY SAWYER, JR., ESQ.

Direct Dial  
(302) 427-6988

HMS@WestoverCapital.com

1220 N. MARKET STREET  
SUITE 800

WILMINGTON, DELAWARE 19801-2555

(302) 427-9600 Voice  
(302) 427-8900 Fax  
www.WestoverCapital.com

H. M. SAWYER, III, CFA

Direct Dial  
(302) 427-8080

Chip@WestoverCapital.com

## **Ms. Consumer, Mr. Investor: Wither Thou Goeth?**

In my Newsletter to you last quarter I was pretty bullish about both the economy and the market for the rest of the year. So were many economists and other prognosticators. Now, I'm not as sanguine.

The Dow Jones started the year around 10604 on January 4th. It dipped to a low in February of 9835 on the 5<sup>th</sup>, and then started a steady climb, reaching 11258 on April 26<sup>th</sup>. Since then it has bounced down, sometimes sharply. On July 16<sup>th</sup> it closed at 10097. The S&P 500 is off 3.49% for the year. Of more concern, all the major indices -- the Dow, NASDAQ, Russell 2000, S&P MidCap 400, S&P 500 -- are down more over the last four weeks than they are year-to-date, meaning the market's trend is a downward one.

Ms. Consumer makes up 70% of our economy. Her purchases are the fuel which determines the speed of our nation's growth. The latest survey from the University of Michigan/Thomson Reuters Surveys of Consumers showed consumers' intention to purchase durable goods, items like cars, fell to its lowest level in nine months.

July economic reports have been weak across the board: factory orders, retail spending, home sales, autos and manufacturing have all been below par.

Moreover consumer sentiment weakened to its lowest level in 11 months according to that survey. As I see it, uncertainty has to be a large part of the issue for the consumer. Will the \$862 billion stimulus work? When will we be in agreement on results? Was TARP and its \$750 billion commitment to the financial and automotive sectors successful? What will come of our nation's exploding and unsustainable deficit?

Will the massive health care law extending health benefits to millions and coverages previously unavailable to thousands actually save us money? Is that an economic magic trick?

Small business created 64% of all new jobs over the last 15 years, but they have cut five million jobs since the onset of the credit crisis. Will increasing income taxes on the entrepreneur and small business owner when the Bush tax cuts expire, those engines of private enterprise who are making over \$200k per year encourage them to further small business job growth?

FinReg has provided stronger regulatory power to those in Washington. Will that encourage or bring about faster growth in the financial sectors being regulated? Capitalism without failure is like religion without sin. The last few years we've seen so much failure in the financial arena that if Jim and Tammy Faye Bakker were bankers even they'd get another chance at redemption!

Through June we've shed an astounding 2.6 million private sector jobs since February 2009. When will those jobs return; when will the unemployment rate drop to levels closer to historical norms?

What will come of Europe's debt profligacy? Greece's? The UK's? Spain's? Ireland's? How about California? Illinois? Is there another unexpected, external shock like the BP disaster waiting for us just around the bend?

According to the consumer survey, both incomes and job prospects are weak for today and bleak for tomorrow. Current economic conditions are believed by consumers to have fallen to their lowest levels since last November.

In that regard then the stock market's performance isn't all that bad.

Nouriel Roubini, the New York University professor who accurately predicted the 2008 financial crisis, has said the S&P 500 index, currently at 1065, is likely to drop to 600 or lower this year as the global recession gets worse. That's a 43 or more percent drop. Most analysts see earnings of \$80 or more for the S&P 500 this year with a price-to-earnings ratio of 15 or so. Not Dr. No. He predicts earnings of \$50 and a PE of 12. No wonder he's called "Dr. Doom."

He's joined by Professor Gloom, Paul Klugman. This influential Princeton economics professor recently wrote two

op-ed pieces for the *New York Times* with these headlines: "The Third Depression" and "That '30s Feeling."

And our Mr. Investor isn't far behind Dr. Doom when it comes to putting his money where his mouth is. He's putting \$6 into bonds for every \$1 he puts into stocks right now. According to Lipper FMI net inflows by investors into bond funds through July 7 were \$152 billion while equity funds saw net inflows of just \$24 billion. Last year was even more skewed. In 2009 \$384 billion went into bond funds and just \$5 billion into stock funds.

But if Dr. Doom sees the S&P 500 at 600 by year's end, Bob Doll, Chief Investment Strategist at BlackRock, one of the country's preeminent investment houses, sees the S&P 500 at 1200 to 1250 by then. So there's your range. Feel free to throw your own dart. Let me know your number. Me? I think Mr. Doll is on the right path. I don't think Armageddon is around the corner. I do think slow progress will be made on healing our economic wounds. Our economy and the global one are fragile, susceptible to exogenous shocks and policy mistakes, but on balance I remain an optimist.

The Fed's broadly accommodative policies will continue for the foreseeable future as will Washington's monetary ones. Further tax incentives like cash for clunkers and for house purchases could be in the offing. Certainly no tax increase will be imposed on Joe Six Pack any time soon (although long term when the Simpson-Bowles Commission reports in December things for Joe Six-P will change).

Inflation is low, low, low. Indeed "core" inflation, that inflation measure which strips out volatile food and energy prices, rose only 0.9% over the past year. That's below the Fed's inflation target and has core prices holding at a 44-year low. Although at a slow pace, nevertheless the private sector has stopped shedding jobs and has added them over the last six months. Bad as credit may be, it's better than a year ago. You may be surprised, but all stock market indices are up and by double digits over the last twelve months.

The old saying claims that it's darkest just before morning's first light. Well, it surely is dark right now. Pessimism toward US stocks is extremely high, both by the investment professionals and by Mr. Investor.

Bloomberg reported on July 10<sup>th</sup> that the weekly market index of the National Association of Active Investment Managers was the lowest since March 2009 when the bear market in stocks finally ended. Additionally, that same week the American Association

of Individual Investors had the fewest reported "bulls" in its last 16 months of issuing reports. Those are two solid contrarian signals for my money, and therefore good for the future of the stock market.

So while Ms. Consumer has pulled in her horns, I think we're in a pause. This fall should start to see us climb back up toward that 1200 S&P 500 level. Elections, this November, will also play a critical role in setting our stock market's course.

Here at Westover we're looking hard for assets which are uncorrelated to the broad, blue chip S&P 500 companies. Bonds serve our purposes well of course; especially short term corporates and intermediate municipals. We don't intend to go out too far on the maturity scale, since we typically hold our clients' instruments until they mature. Additionally, we believe in diversity, so that all our equity stocks are not in the same basket. Emerging market ETFs along with REITs should help the diversification challenge.

Minnows and whales are both fish but they don't swim in the same sea. So for us, small- and mid-cap minnows with no exposure outside the US which are the antithesis of the large, multinational equity behemoths of the Dow and S&P are a good counterpoint to the Dow-S&P 500 whales for our clients' long-only portfolios.

Remember, the fun as well as the challenge is in the journey, not in making it to the finish line. We've still got a long way to go. Keep the faith.

#### **THESE ARE NOT YOUR WARREN BUFFETT INVESTORS**

It used to be that conventional investment wisdom held that you conducted fundamental research on a handful of companies and, having found some with good balance sheets, competitive moats, strong management, you bought when their price was low and held on ... for one, three, five or ten years. The Oracle of Omaha was the Maharaja of this school. Many investors worship at his feet. But not all.

Recently the traditional investor has been introduced to a world inhabited by so-called "flash traders." A *New York Times* article in May described the 100 to 200 firms in this side of the investment world "scattered from the canyons of Wall Street" who make trades in the snap of the fingers.

Tradeworx is typical. Located above a Restoration Hardware store in the shore town of Red Bank, New Jersey, employees in their 20s and 30s dressed casually in jeans and T-shirts watch over powerful, high-speed, high-tech computers that typically buy or sell 80 million shares of stock a day.

The founder of Tradeworx is Manoj Narang, a 40-year old graduate of MIT where he was a math and computer science major. Neither Mr. Narang nor any of his traders have any idea about the fundamentals of any stock his company buys or sells, and what's more, they don't care. Rather, the Tradeworx computers secure price quotes from the various stock exchanges, conduct a risk analysis, decide how they will trade and generate a buy or sell order ... all in 20 microseconds.

Just as an unregulated shadow banking system had grown up over the last ten years offering mortgage-backed securities, CDOs, synthetic this and obfuscated that and all manner of exotic financial instruments with often unintended and disastrous consequences, so now the SEC is probing to see if the shadow flash trading system contributed to the precipitous 1000 point 15 minute drop in the Dow Jones industrial average on May 6<sup>th</sup>.

Various estimates place the flash traders' responsibility for the trading volume of shares of stock on every stock market in the country at 40 to 70 percent. These folks barely existed a decade ago.

All trades are short-term. And I do mean short-term. The founder of Tradebot, a Kansas City, Mo. flash trader told students in 2008 that his firm generally held stocks for 11 seconds.

Profits come in slivers of a penny, but reaped over and over all day long. This can make for vary challenging times for traders from the more traditional investment school.

At Westover, we try to add value for our clients through many avenues, one of which is to call on the experience of our Vice President Chip Sawyer and his multi-year trading experience for a multi-billion dollar West Coast-based mutual fund company when purchases or sales of securities for our clients are called for. We strive to find the best execution for our clients' trades.

The good news for us is that our philosophy is closer to Mr. Buffet's than to Tradebot's with regard to the time we intend to hold our instruments ... Years, not months, not weeks, not days, not seconds and certainly not milliseconds.

Neither Warren Buffet nor we could care how Coke's price compares one second to the next, but we do care how it will do in a global economy over the next five years.

Buffett started to buy Coke in 1988 and has held it ever since; it now comprises over 8.6% of his Berkshire Hathaway holdings.

Mr. Narang, on the other hand, won't even know whether it was Coke that his company bought, but he will know how the price of his purchase, whatever it happened to be, moved over those ten seconds.

As the saying goes: Different strokes for different folks.

### **LISTEN TO THE MUSIC**

Margie Starnes is a lawyer-turned-mom of two daughters, aged six and eight. Her husband Ben is Chief of Vascular and Endo Vascular Surgery at the University of Washington Medical Center and a national expert in aortic aneurisms.

Margie knew the six Vice Presidents who preceded Vice President Joe Biden and put them in their correct chronological order, enabling her and Ben to enjoy the world famous Pike Place Market in Seattle with their gift certificate. Just goes to show the reach of Westover's client base, but actually the Starnes' home on Mercer Island, WA is our western most client locale today.

This quiz was inspired by Ed Stegemeier, the Executive Consultant of Southern Wines & Spirits and former President of Delaware Importers, Inc. who sent me an email which forms the basis for your test.

Recognizing that many of my readers are old enough to be the parents of Phil Mickelson, (the only American to win one of golf's three Majors this year with his Masters victory), and thus are suffering from the vicissitudes of aging, I challenge you to correctly match the real title with the artists who sang these six '60s-'70s eras songs.

Fun, Spoofed Titles:

"How Can You Mend a Broken Hip?"

"The First Time Ever I Forgot Your Face"

"I Can't See Clearly Now"

"Fifty Ways to Lose Your Liver"

"A Whiter Shade of Hair"

"Mrs. Brown, You've Got a Lovely Walker"

Artists: (Note six are impostors who never sang these songs, and are meant simply to create a little uncertainty with your analysis). Remember, internet sleuthing for answers is a Westover Honor Code violation, while checking with friends and colleagues is encouraged.

Paul Simon  
Johnny Taylor  
James Taylor  
Art Garfunkel  
Natalie Cole  
Procul Harem  
Andy Gibb and Barbra Streisand  
Herman's Hermits  
The Monkees  
Roberta Flack  
The Bee Gees  
Peter and Gordon

Match the singer and the song, giving me the ACTUAL title of the ditty along with the artist. All correct responses will go into our Westover hat with Jenn and Cat pulling the winner's name in thirty days. Remember you need not be a client to win; you just have to be on our mailing list or have read this missive.

Have fun; don't obsess about the market and enjoy the rest of your summer.

July 21, 2010