



## Mid-Quarter Newsletter

May 14, 2008

### From My Corner

*Jeff Mengis – President*

As Spring is blooming and summer is fast approaching (but not quickly enough), many investors are uncertain about our economy and the market. We do not claim to have all the answers, but we did want to share some of our thoughts on today's economic environment.

#### **Q: Is the U.S. economy in a recession?**

It's possible that we're in one already, but recessions are typically declared after the fact. Much of the recent expansion was a result of increased consumer spending as Americans cashed in on the equity of their homes. With a tighter credit climate and no equity to draw from, that spending growth is gone. Still the majority of homeowners refinanced into historically low interest rate loans, and should be able to continue to make payments if the job market doesn't significantly deteriorate. Uncle Sam is hoping that tax credits will spark consumer spending this summer. The Fed has also pumped unprecedented liquidity into the system and has lowered interest rates by 3.25% from 5.25% to 2%. Much of the stimulus from the lower rates is only now beginning to trickle into the economy. In addition, there may be added stimulus from corporate spending, with strong corporate balance sheets and historically high levels of cash. That said, there could be worse days to come for real estate.

#### **Q: What is driving the oil/commodities boom?**

Earlier in the year, the accepted wisdom was that oil and precious metals kept rising because the value of the dollar kept falling. But the dollar has since strengthened and the price of oil has continued to climb, while metals have fallen off their highs. As oil supplies have built over the last few months many economists say that the fundamentals don't support current prices. However, that doesn't mean the price of oil won't continue to climb on speculation of long-term supply constraints. One potential catalyst for declining oil prices could be slowing global growth. It remains to be seen whether the rest of the world has "decoupled" itself from the American economy, or if the saying still holds true: when America sneezes, the world catches the flu. If global growth does slow, energy prices will likely decline, which should give our economy some relief.

#### **Q: What stocks should do well in this environment?**

We have had a focus on energy stocks as well as stocks that have growing sales abroad and are poised to benefit from the weaker dollar. At the same time we are diversified into companies that would not feel as much pain if global growth were to slow like health care and pharmaceutical companies that stand to benefit from America's aging demographic.

### Investment Focus:



**DuPont (DD)** is a science and technology company that serves over 70 countries across a variety of industries including Agriculture & Nutrition, Coatings & Color Technologies, Electronic & Communication Technologies, Performance Materials, and Safety & Protection.

In its most recent quarter, DuPont reported nearly 24% growth in earnings over the same period in 2007 resulting largely from growth in its agricultural segment and strong international sales. It is likely that DuPont will continue to benefit from international sales as 60% of their revenue comes from sales abroad, which stand to benefit from the weak dollar. Analysts believe that DuPont will see continued strength in its agricultural segment amid increasing global food demands and soon-to-be released products that aim to improve farmers crop productivity.

During a period of increasing material inflation, DuPont has seen improved margins due to cost-control measures. There is a risk that the expense of raw materials, such as oil, will negatively affect their bottom line. However, DuPont has been successful to-date in passing that increased cost onto their customer. The company's earnings per share have increased from \$2.01/share in 2002 to an estimated \$3.50/share in 2008, yet the corresponding stock price has moved from a mean of \$41 in 2002 to \$49.58 today. The stock currently trades at a PE multiple of 13 while yielding 3.3%. Ultimately, we feel that DuPont is a well-run company that will benefit from pricing power and segment diversity within the company.

