



Mid-Quarter Newsletter

November 15, 2009

From My Corner

Jeff Mengis – President

Market Comments: Over the past year, there has been a strong inverse relationship between the value of the dollar and the stock market. In other words, as the value of the dollar has fallen, the stock market has risen and vice versa. In recent months, the weaker dollar has decreased the price of our exports significantly, which has provided a tailwind to larger multinational companies that have a higher percentage of international sales. With about 48% of the revenues derived from abroad in the S&P 500, the expected increase in international sales has played a part in moving stock prices higher. On the other hand, a lower dollar also drives import prices higher, most notably the price of oil. Higher energy costs have the potential to put a drag on the recovery. We expect the dollar to remain relatively weak, however, we would not be surprised by a temporary bounce given the lopsided conviction toward a weaker dollar.

Currently, developing nations represent about 70% of the world's population and only 20% of its GDP. These emerging markets present an enormous long-term opportunity for multinational companies, especially when combined with the weaker dollar. After attending a recent conference highlighting industrial companies, we came away impressed with the amount of business that is being done overseas and the strong cash flows they are generating. We are favoring companies, like those discussed in the right-hand column, that can use cash flows to expand their business, pay down debt, buy back stock or increase dividends.

We will be sending your 2009 tax information along with our 4th quarter reports in January. If you have had an unusual or significant tax event, you should contact us soon. This will allow enough time to make the appropriate portfolio adjustments if necessary. Included in this newsletter is our Mengis Capital 2010 pocket calendar for your convenience. We hope that you enjoy your Holidays with family and friends and look forward to working with you during the New Year.

Investment Focus:

In this quarter's investment focus, we are highlighting three companies that we favor at Mengis Capital.



With locations in 119 countries, **McDonald's (MCD)** is a brand that is recognized in almost every corner of the globe. In good times and bad, this company has a strong track record of growing its business through innovation and strong management. In fact, despite the deepest recession since the Great Depression, McDonald's has used new products like McCafe coffee to grow sales year over year. With 65% of sales coming from abroad, McDonald's stands to benefit from a weaker dollar as well. The October sales report showed a 3.3% increase in same-store sales internationally and a 10.3% jump in total sales due in part to the currency tailwind. The strong balance sheet allowed the company to increase their dividend by 10% in September, resulting in a yield of 3.5%.

CISCO SYSTEMS



Cisco Systems (CSCO) makes networking gear that allows for faster and more efficient communication between computers. While sales of Cisco's products certainly dipped during the recession, it has likely created pent-up demand going forward. Cisco's CEO John Chambers has pointed to an uptick in bookings and orders during the 2nd and 3rd quarter as evidence that they are turning the corner on the recession. In developing countries like China and India, Cisco is seeing strong interest for their networking products. Sales abroad accounted for around half of 2009 revenues. The company recently used a portion of its \$30 billion cash war chest for acquisitions to capture market share. Cisco is trading at a historically low multiple of 14.5X 2010 consensus earnings.



British Petroleum (BP) is one of the largest integrated oil companies in the world. The company recently announced a major find in the Gulf of Mexico that will significantly add to their proven reserves. That find, combined with projects in Indonesia and Russia are helping BP to be one of the few major oil companies currently boosting their output. If a global recovery takes shape, BP should be well-positioned to benefit from the resulting increase in the price of oil. In addition to their encouraging growth prospects, the company pays a healthy 5.8% dividend. BP currently trades at about 5.5X 2010 forecasted cash flow and about 10X next years forecast earnings, making the price historically attractive.