

The third quarter of 2010 brought relief to equity investors. The month of September saw the largest increase in value since September 1939. For the quarter the S&P 500 was up 11.29% I know you will be pleased with the performance of your portfolio.

I wrote in my last letter to you about a tale of three cities, Micro, Macro, and Technical. Micro is the analysis of companies, Macro is the analysis of economies, and Technical is the analysis of prices. As suggested last quarter the fundamentals of businesses would win out in the struggle between the three. Indeed, sales and earnings continue to come through better than expected. Balance sheets are in great shape with some trillions in cash. The recent spate of takeover activity is evidence that corporate managers are finding value in shares of companies that fit strategic growth plans. It is cheaper to buy than build. With interest rates below dividend yields for many of these blue chip companies they can create positive arbitrage by issuing debt and buying back stock.

The fed has committed to provide substantial liquidity by expanding the balance sheet. They are prepared to purchase treasury and other securities in the open market. This monetization of the debt called quantitative easing is ultimately inflationary; however, there is so little inflation now that they have the flexibility. I think this puts a floor under equities and while the market will continue to be volatile and react to economic news the bias should be to the upside.

As I look across economic sectors at sales, earnings, cash flow, and the valuation thereof I find the best opportunities in global industrial companies who are sensitive to the export market. I have reported many times about the opportunities in emerging economies and the expansion of consumerism in regions such as China, India, and Brazil. The trend continues unabated. Large US based businesses that are selling into these growth areas are attractive investments in my opinion.

As we look out into the fourth quarter we have mid-term elections. The market usually rallies in the following 6 months. It is likely that republicans will take the house causing gridlock in Washington. If the tax cuts get extended we could have a big run in the markets. The market is cheap on several metrics. At 12 times 2011 earnings and with the 10 year treasury around 2.5% there is plenty of room for upside should some of the uncertainties currently plaguing investor psychology be resolved in a positive way.

We wish you a happy and healthy holiday season and hope that you can enjoy time with your families. As always please feel free to call or email bhutchens@hutchco.net with any questions.