June 2009 Quarterly Review

Top Ranked Search Results June 2009

"One of the more common mental biases that affect people is 'recency', the tendency to consider the most recent information as more important when making a decision. This cognitive trap can be especially harmful to investors because it causes people to extrapolate the most recent trends into the future without considering the likelihood that the trend will reverse." - Morningstar Financial 2006

And such it is with the current recession. Doom and gloom is in vogue, and the most popular searches on Google and Yahoo are solidly on today's economic crisis. There is compelling empirical evidence that when the consensus is on one side of the street, you can improve investment success by shifting your theme or focus to the minority opinion. Today, nearly every analyst is calling for a muted "L" or "W" shaped recovery taking several quarters, if not years, to unwind. However, there is mounting evidence for a "V" shaped recovery and a continuation of the stock market rally that started in March 2009.

The ISI Group has brought up a rational thesis that we believe is worth considering, writing in their June report *"…* ***while the past two recoveries were "jobless recoveries", we may see a "job-full recovery" this time around. As it is, the correlation between recession-depth and recovery-pace is almost 70%, and the correlation between recover-pace and employment-growth is 97%. In other words, deeper recessions lead to faster recoveries, and faster recoveries lead to speedier job growth.*** *"*

It is broadly accepted that one of the most dangerous things you can say in our business is "it is different this time." We agree with this maxim when it comes to valuations, panics, bubbles and the fundamentals of accounting. Where we disagree is that there have been structural changes in the global economy over the past two decades that have caused several "it is different this time" events.

What is certainly different *this time*, and still difficult for investors to get their arms around is how U.S. companies, domestic interest rates and our GDP fit in the new global economy. The financial forecasts, charts, and analyses that were valid for 1950's thru the 1990's may prove inadequate with the growth and sustainability coming from emerging economies, especially Brazil, Russia, India and China. For most of the last century, the American economy was the driver of global demand. In 1980, for example, our economy represented over 40% of global GDP. Today, the world is much flatter, and our entire economy only commands about 25% of world commerce and 15% of global equity capitalization. We do expect American companies to continue to play an important role on a global level, but this time driven by emerging economies as much as by a domestic recovery.

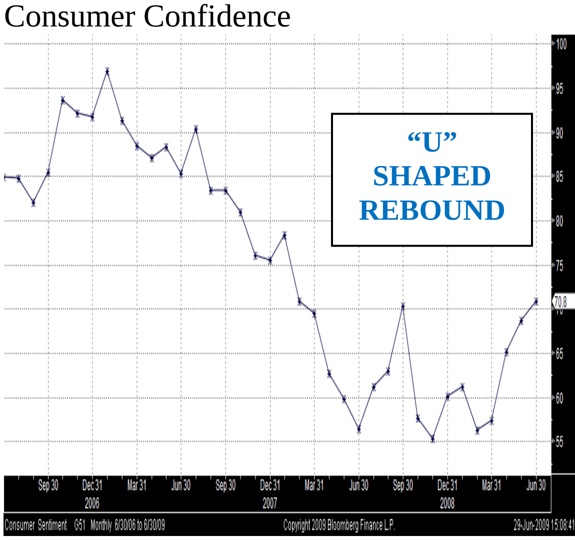
The consensus forecast for a multi-year period of sub-par growth has been well broadcasted through the media. The markets have had ample time to digest this school of thought, and it should be efficiently priced-in to most equities. KCM believes there is a potential to surprise on the upside and the next recovery will be stronger than consensus.

We have chosen a series of early stage economic indicators that show a "V" shaped rebound from their recent lows. Only time will tell if the trends continue, but if they do, the recovery will start sooner and be much stronger than current consensus thinking.

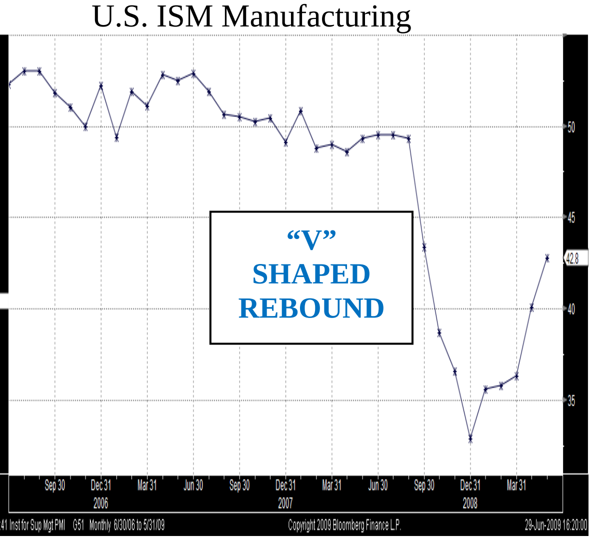
In our March Quarterly, we attributed the stock market rally to the "rate of change decelerating", the economic numbers were all "less worse." In order to sustain the current rally, we need to see global economic activity actually get better, not just "less worse." Yield curves around the world are positively sloped, and a historically reliable indication of future economic growth. The charts that follow, all from Bloomberg, also support our "Better Than Estimate" forecast.

We thank you for your support and confidence. Managing money for our clients and friends is a responsibility we take seriously.

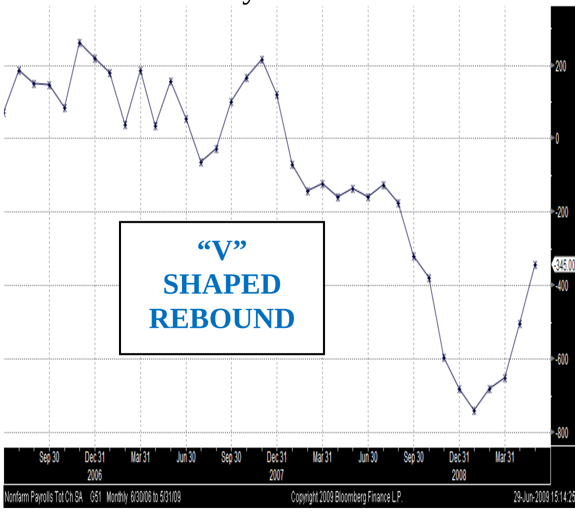
Consumer Confidence



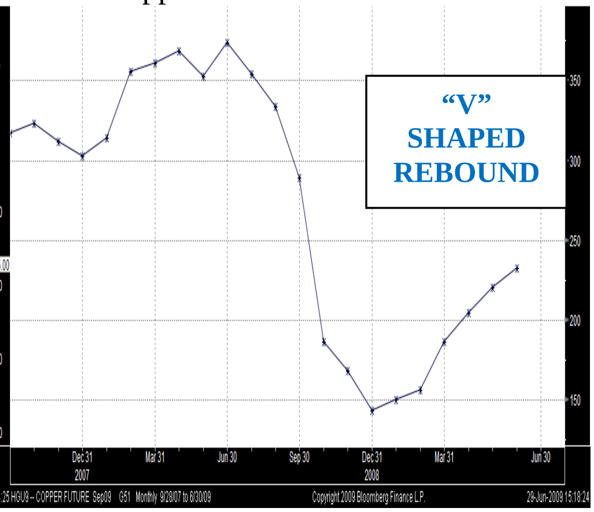
U.S. ISM Manufacturing



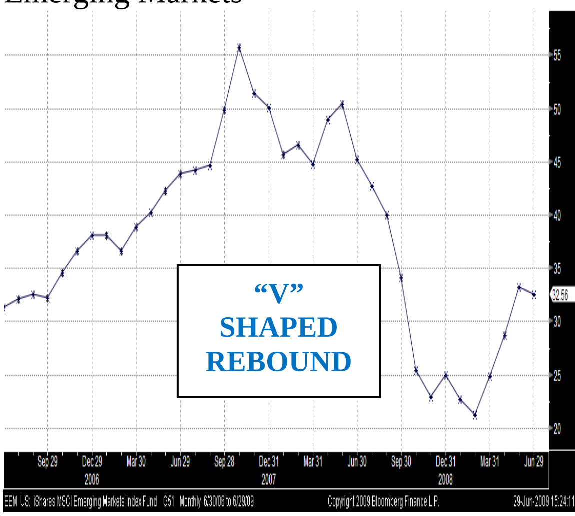
U.S. Non-Farm Payroll



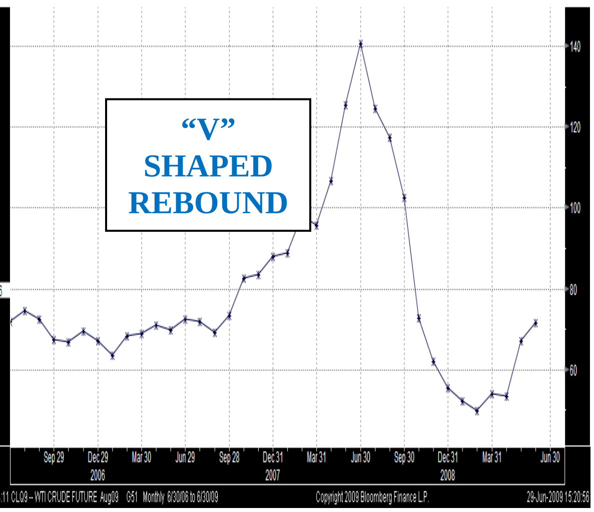
Copper



Emerging Markets

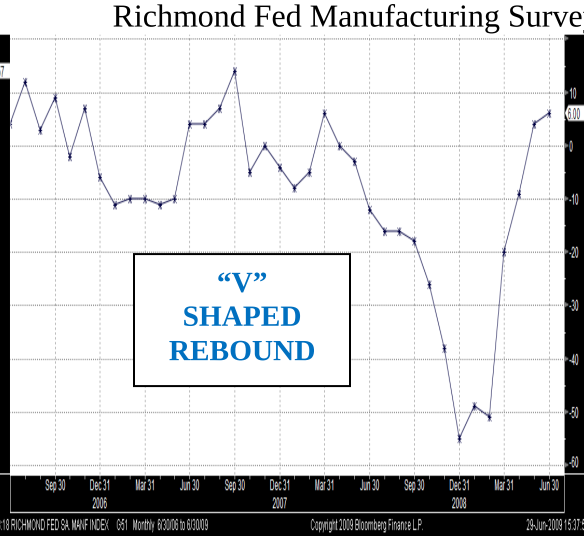


Crude Oil

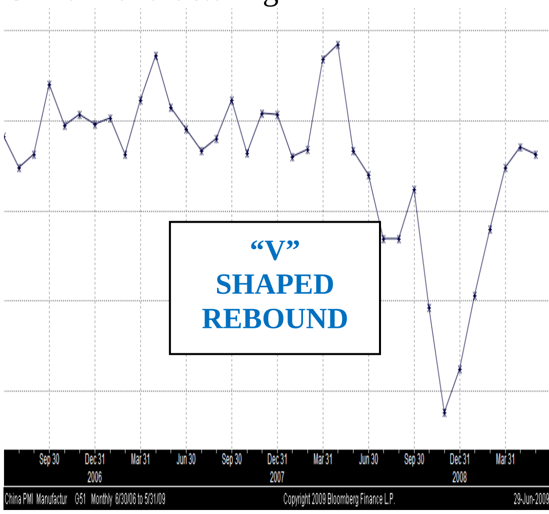


Bloomberg Global Confidence

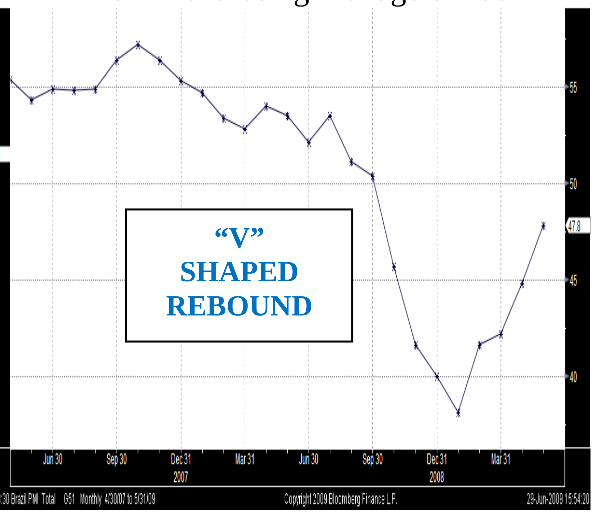
Richmond Fed Manufacturing Survey



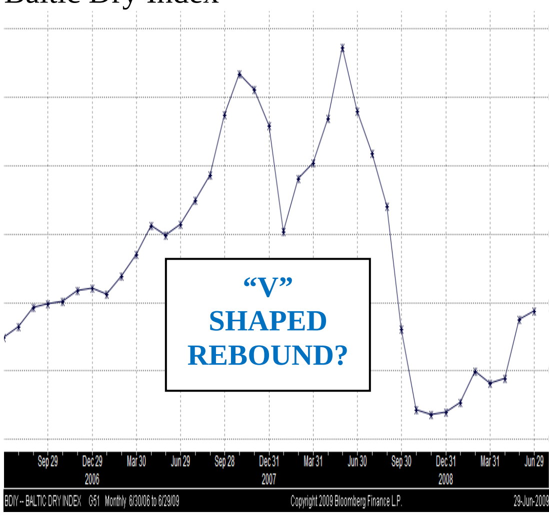
China Manufacturing



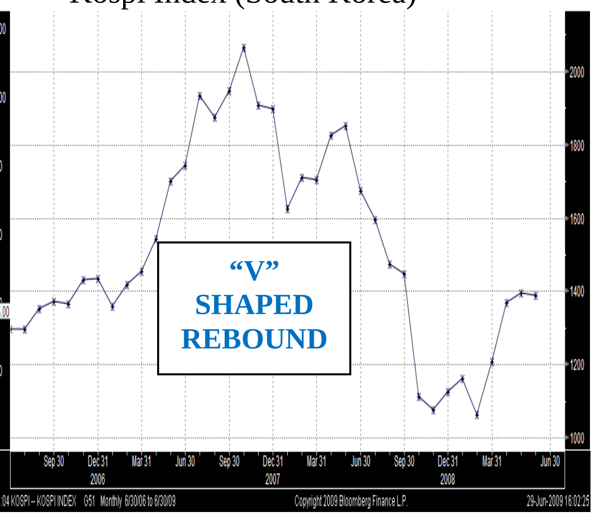
Brazil Purchasing Managers Index



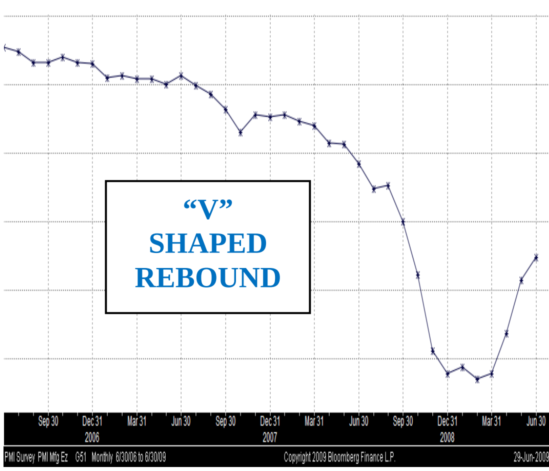
Baltic Dry Index



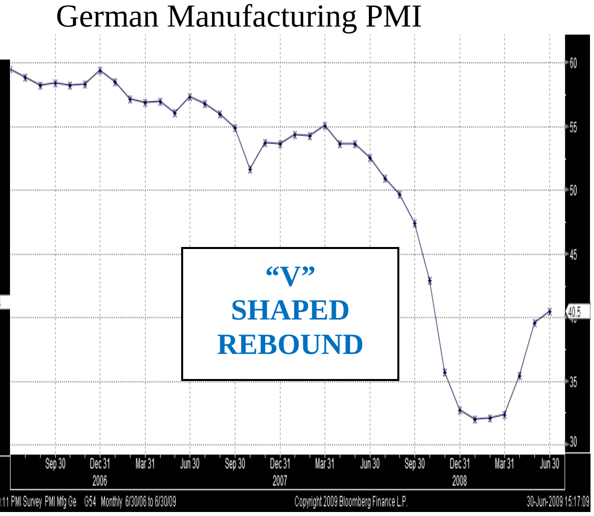
Kospi Index (South Korea)



Eurozone Manufacturing PMI



German Manufacturing PMI



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