

TIME TO BUY AMERICAN

EMERGING OPPORTUNITIES



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GUTT CHECK

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“...rather than making a forecast about where things ‘should be,’ we invest with the averages on our side and we monitor them as a measure of risk.”

The Steps to Success

At MGG, we believe success occurs more often when paired with a well-defined strategy. A strategy serves as a road map that guides its users where to go and how to get there. As the market becomes more volatile and the world situation more uncertain, it is easy to be overcome by the emotion of the moment, lose sight of the goal, and make poor decisions. Following a well-defined investment strategy is imperative for success during times like these and at MGG, we have a great one.

Don't Ignore History

We pay attention to history. Long-term cycles help one understand the risks inherent in any investment. This is true for stock markets as well as individual companies. It is difficult for a stock market to outpace its historical rate growth. Likewise, it's difficult for a company's stock to outpace its historical economic per-

formance. When markets dramatically get ahead of historical growth rates, the risk levels are elevated. Similarly, when a stock price moves dramatically ahead of its company's fundamentals, a correction is likely.

Prices Indicate Expectations

We use prices. Consumers buy things – a car, for example - because they have an expectation of how those things will perform. In similar fashion, a buyer of a company's stock expects a certain level of performance from the company. As a result, prices provide an objective summary of performance expectations. When people expect great things they will push prices higher. When investor expectations about the future are negative, they tend to sell. The resulting price contains valuable information. Mathematically speaking, a stock price is a sum of cash flows or earnings over time. A lower price implies an expectation of less cash or lower earnings. A high

price means an expectation of more cash and higher earnings. For MGG, opportunities emerge when expectations are well below what history argues is reasonable. Conversely, when prices indicate expectations are well above what history supports, we are cautious.

Beware of Forecasts

Financial “experts” tend to reduce a complex world to a single point (i.e., the market will go to 1300) and thus, are often wrong, though their predictions are taken seriously. In 2000, for example, many predicted the market's run would continue. Their strong faith in this forecast caused them to willingly ignore things as referenced in *Figure 1* (next page). Starting in 1995, the market began to pull ahead of its historical average. By the end of the '90s, no one knew when the party would end (it **had** been a great five years), but it was *very* obvious the market was well above historical averages. Forecasts

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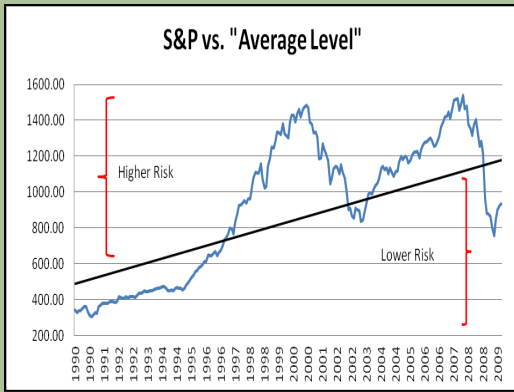


Figure 1 - Source: Standard & Poor's

RYAN GUTTRIDGE EARNED HIS BA IN MATH AND ECONOMICS FROM ALBION COLLEGE IN 1989 AND HIS MBA FROM INDIANA UNIVERSITY IN 1991. IN ADDITION TO ACQUIRING HIS CHARTERED FINANCIAL ANALYST DESIGNATION IN 2001, HE IS A MEMBER OF THE BALTIMORE ANALYST SOCIETY AND HAS COMPLETED THE FINANCIAL INDUSTRY REGULATORY AUTHORITY SERIES 7, 63, AND 65 EXAMINATIONS.

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of continued growth didn't highlight this risk. The longer the market stayed above its long-term average, the greater the risks became. At MGG, rather than making a forecast about where things "should be," we invest with the averages on our side and we monitor them as a measure of risk.

Think Long-Term

Mathematically speaking, our strategy is based on the statistical concept called "reversion to the mean." This is one of the most important statistical concepts in Finance and one of the few with a strong track record. In practice, by focusing on history, paying a price that reflects performance below historical norms and eschewing forecasts, our strategy seeks to minimize the risks of permanent losses in capital. However, there is a catch. It can take a long time for things to revert to their averages, both on the upside and downside. This means MGG

has a long-term perspective. Secondly, we must not assume that past relationships never change. It's important to identify compelling reasons why the reversion to the mean will or will not occur. As a result, we are patient and willing to wait for our investments to work.

Made in America

With its recent selloff the US stock market has been pushed to levels where long-term averages argue for positive rates of return. From a price standpoint, investors seem to expect zero growth from many US companies over the next decade. Yet, over the last ten years, corporate America has been prudently saving, cutting debt, and growing earnings. Additionally, many now offer a growing dividend yield in excess of +3%. Yet, based on stock prices, investors don't expect much. The overall low level of expectations is demonstrated by investors eagerly buying US Treasury bonds earning 2.0% for ten

years. Investors seem to believe the US based companies will never grow again and as a result 2.0% per year for 10 years is a "good" rate of return.

MGG Strategy

While the market will continue to be volatile, and it's possible the dire forecasts will prove to be correct, history argues strongly against it. First, the market has turned in one of its worst 10 year performances in history. After such a period, the market has always generated positive returns in excess of current expectations. Second, US companies are in excellent financial condition and are world leaders. Given that the alternatives don't share these characteristics, stocks seem to be poised for strong relative performance. Over the last few weeks, we've been adjusting our allocations to take advantage of this opportunity and will be in touch should your model need to be adjusted.

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