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*Despite the gradual economic recovery, investors have found it difficult to shake off the negative bias that has built up toward the stock market during these last ten difficult years. Is there anything out there that can reverse the market psychology? We believe there is: 2011 is a pre-presidential election year.*

S&P 500 data going back to 1933 shows that the pre-election year has been the strongest by far for the stock market in past presidential election cycles. Year One has averaged a +1.6% gain. Year Two, +4.0%; Year Three (*the pre-election year*), +10.5%; Year Four, +5.8%.

The table below shows that the pattern is especially dramatic when a first-term president enters a pre-election year, which is, of course, what we have next year.

### S&P 500 Performance in Year Three of a First-Term President

	Year	Return
<b>Franklin Roosevelt</b>	<b>1935</b>	<b>41.4%</b>
<b>Dwight Eisenhower</b>	<b>1955</b>	<b>26.4%</b>
<b>John F Kennedy</b>	<b>1963</b>	<b>18.9%</b>
<b>Richard Nixon</b>	<b>1971</b>	<b>10.8%</b>
<b>Jimmy Carter</b>	<b>1979</b>	<b>12.3%</b>
<b>Ronald Reagan</b>	<b>1983</b>	<b>17.3%</b>
<b>George H. Bush</b>	<b>1991</b>	<b>26.3%</b>
<b>Bill Clinton</b>	<b>1995</b>	<b>34.1%</b>
<b>George W. Bush</b>	<b>2003</b>	<b>26.4%</b>
<b>Barack Obama</b>	<b>2011</b>	<b>-</b>

Source: Strategas, 09/08/10. **Past performance is no guarantee of future results.**

The Standard & Poor's 500 Index (S&P 500) is a commonly used measure of the broad U.S. stock market. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

### Not Just a Coincidence

While our presidents from Roosevelt to Obama have each had their strengths and weaknesses, there is one area in which they have demonstrated great skill: they're proven experts on how to get elected. **Things got started when John Maynard Keynes advised FDR that the key to getting re-elected was a strong economy. And the key to a strong economy was powerful fiscal and/or monetary stimulus.**

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*Money flows out of stocks and into fixed income – one of the most dramatic in market history – have produced bond yields at their lowest levels in 50 years.*

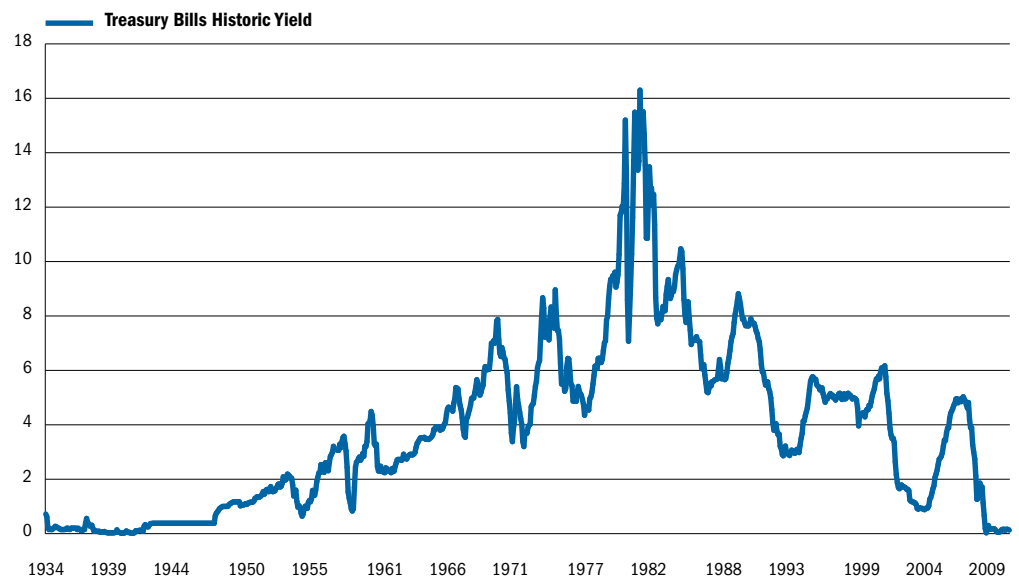
Our presidents also knew that it was important to get started early because it takes economists, not to mention the public, a long time to conclude whether or not the economy has come out of recession. George H.W. Bush, for example, lost his re-election bid to Bill Clinton, who ran on the slogan, “It’s the economy, stupid.” But a week after the election, economists in the Bush administration announced that the Bush recession had actually ended a year before Clinton won in November 1992.

### **Yields at Record Lows**

Money flows out of stocks and into fixed income – one of the most dramatic in market history – have produced bond yields at their lowest levels in 50 years. This phenomenon resembles the tech bubble of 2000 when investors were throwing their money into tech stocks that showed their highest valuations ever. Investors were then too optimistic about stocks and too pessimistic about bonds. Today, the situation is completely reversed.

### **Treasury Yields Have Reached 50-Year Lows**

Monthly Data 12/31/1934 – 9/30/2010



Source: Board of Governors of the Federal Reserve System. Last data point 10/01/10. Treasury yields represented by 3-Month Treasury Bill: Secondary Market Rate.

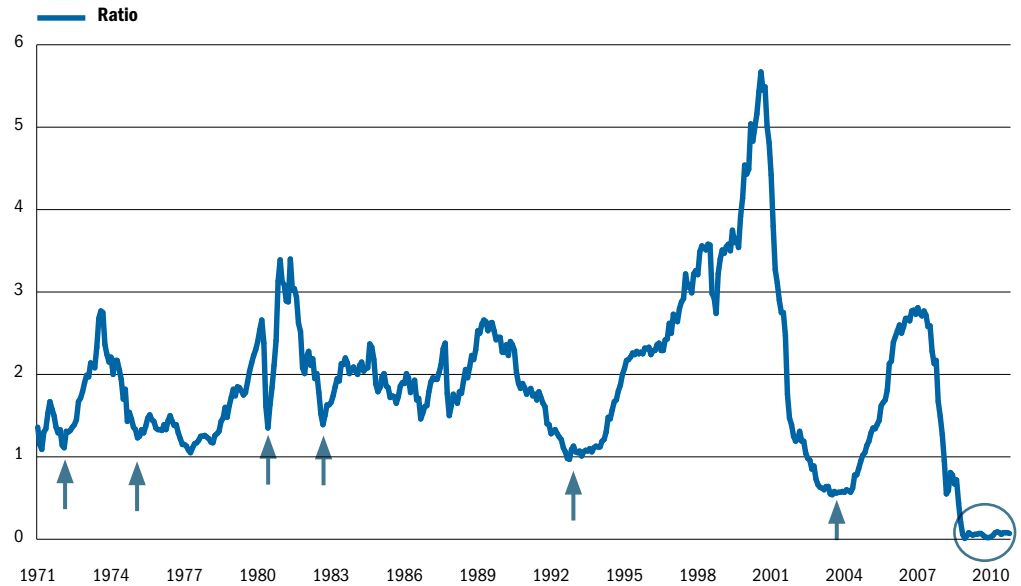
*Not only are bond yields low, but they are low relative to stock dividend yields. Today, equities are even more undervalued.*

Not only are bond yields low, but they are low relative to stock dividend yields. The chart below shows that all the low points in the past 40 years (when bond yields were at or below dividend yields) were signals for long-term value investors to buy stocks. Today, equities are even more undervalued.

## Bond Yields are Low Relative to Stock Dividend Yields

### Ratio of T-Bill Yields to S&P Dividend Yields

Monthly Data 1/01/1971 - 10/01/2010



Source: Board of Governors of the Federal Reserve System. Last data point 10/01/10. Treasury yields represented by 3-Month Treasury Bill; Secondary Market Rate. The Standard & Poor's 500 Index (S&P 500) is a commonly used measure of the broad U.S. stock market. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

## Today, Equities Are More Undervalued

### Returns for Value Stocks after T-Bill Low Yields

Year	Annualized Returns Bottom 20% by P/E
1971-75	12.4%
1975-79	34.3%
1981-85	26.5%
1983-87	18.9%
1992-96	17.9%
2003-07	17.3%
2010-14	-

Source: S&P 500/SCCM, 12/31/09. **Past performance is no guarantee of future results.** The Standard & Poor's 500 Index (S&P 500) is a commonly used measure of the broad U.S. stock market. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

*So the question became: Once a recession ends and a recovery has begun, is it too late to buy stocks? The surprising answer was that it didn't make much difference for value investors.*

## Trading Range: Advantages of Long-Term Investing

We have often advocated the use of rolling 5-year periods to measure performance. We have also showed investors that the best 5-year periods for returns have tended to begin, not surprisingly, in the middle of a recession. But with the current recession declared officially over, we have been looking at the behavior of typical post-recession markets.

First, there's been the big and surprising bounce off the bear market lows. This has produced a 50% to 100% gain over the average six to twelve month period. This is traditionally a period of time when speculative fever tends to run high and the market is driven by short covering (like last year).

Next, there have been periods like the one in which we presently find ourselves, with a trading range that takes many forms and tends to last for at least six months and possibly a year or more. The economic news is still bad, though companies and earnings have started to do better. Eventually the market breaks out of the trading range and into a new up cycle. **All of a sudden the comfort of cash and bonds doesn't feel so good.**

So the question became: Once a recession ends and a recovery has begun, is it too late to buy stocks? We studied the relevant rolling 5-year periods to find out what happened when one started to invest a year after a recession ended. Was there was a big difference in performance? The surprising answer was that it didn't make much difference for value investors. (See the Appendix on page 6 for all rolling 5-year periods including those periods that begin with a recession year.)

### Long-Term Value Investors Saw Little Difference When Buying Post-Recession

Recession Period	Market low	Recession Ended	Months Between Market Low and the Recession	5-yr Period Starting a Year After a Recession Ended	Annualized Performance
1969-70	06/70	01/71	7	1972-76	<b>+17.8%</b>
1973-74	11/74	05/75	6	1976-80	<b>+24.7%</b>
1981-83	09/82	12/82	3	1984-88	<b>+18.2%</b>
1990-91	10/90	01/91	3	1992-96	<b>+17.9%</b>
2001-05	10/01	01/02	3	2002-06	<b>+17.3%</b>
2007-08	03/09	06/09	3	2010-14	-

Source: S&P 500/SCCM, 12/31/09. **Past performance is no guarantee of future results.**

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*With stocks clearly cheap relative to bonds and with plenty of money on the sidelines, we believe the stage is set for a strong pre-election year in the market.*

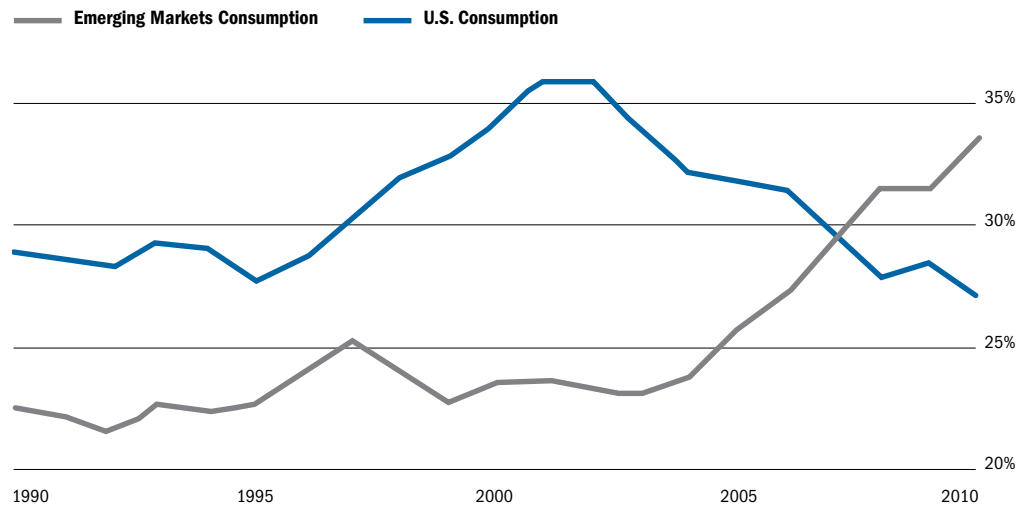
## The Current Recovery

Many economists have labeled the current recovery as weak, but in fact, **corporate profits have already recovered to all time record highs, and we have witnessed one of the fastest profit recoveries of the post-war era.**

How did this happen? Corporate earnings have been stronger than GNP growth because corporate America has been selling into the global marketplace. The dramatic and telling chart below compares emerging market consumer spending against U.S. consumer spending as a percent of the world total over the last decade.

### Uneven Recovery: Consumer Spending in Emerging Markets Surpassed Spending by U.S. Consumers During the Crisis

1990 - 2010



Source: JP Morgan Chase. Last data point 9/30/10. **Past performance is no guarantee of future results.**

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## Summary

With stocks clearly cheap relative to bonds and with plenty of money on the sidelines, we believe the stage is set for a strong pre-election year in the market. In fact, the day after the midterm elections, Ben Bernanke, with great fanfare, announced a stimulus package consisting of \$600 billion of quantitative easing. So it appears that the administration has already started rolling Obama's pre-election band wagon.

Finally, emerging markets have helped to boost corporate earnings, but those markets are also a source of volatility. Accordingly, we feel that now more than ever, it is prudent for the long-term investor to stick to the disciplines of price to earnings, price to book, and dividend growth.

## Appendix

### Rolling 5-Year Performance: Bottom 20% of the S&P 500 by P/E

#### Annualized Rates of Return

Period	S&P 500 Bottom 20% by P/E	Period	S&P 500 Bottom 20% by P/E
1968-1972	9.66%	1987-1991	10.53%
1969-1973	0.00%	1988-1992	15.37%
1970-1974	1.11%	1989-1993	14.54%
1971-1975	12.44%	1990-1994	10.10%
1972-1976	17.81%	1991-1995	23.17%
1973-1977	17.02%	1992-1996	17.92%
1974-1978	24.71%	1993-1997	22.01%
1975-1979	34.30%	1994-1998	17.79%
1976-1980	24.67%	1995-1999	18.22%
1977-1981	18.20%	1996-2000	13.90%
1978-1982	22.18%	1997-2001	13.26%
1979-1983	24.53%	1998-2002	4.74%
1980-1984	26.07%	1999-2003	12.14%
1981-1985	26.46%	2000-2004	16.01%
1982-1986	27.63%	2001-2005	15.39%
1983-1987	18.92%	2002-2006	15.98%
1984-1988	18.22%	2003-2007	17.3%
1985-1989	16.29%	2004-2008	-2.6%
1986-1990	6.14%	2005-2009	4.0%

Source: S&P 500/SCCM, 01/10

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**Dividend Yield** is a financial ratio that shows how much a company pays out in dividends each year relative to its share price.

**Price-to-Book Ratio** is the ratio of a stock's price to its book value per share.

**Price-to-Earnings Ratio** is the price of a stock divided by its earnings per share.

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