

## US/Global Comment

### Coordinated Rate Cuts Say Scale into Equities

Here are our latest thoughts as of 300pm EST, Wednesday October 8.

**The cut last night in interest rates by the central banks around the world is an important repair step. We now believe it is time for patient, long-term equity investors to start to commit funds to those top-quality companies that have been beaten down so badly.**

**Much fundamental bad news is still to come – earnings disappointments, job losses, slower growth, more financial sector unrest and volatility – but at least the central banks are on the case. We also know that the credit crisis has driven down equity prices of even world class companies more than the fundamentals would suggest.**

**When the credit crisis subsides, as it will, and the over-night coordinated rate cut is the most positive sign yet, the recovery in equities of those standout companies will be even stronger than is usually the case.**

**US DATA SET TO DETERIORATE.** First the bad news. We look for terrible US economic data probably into mid-2009 – retail sales, housing, capital spending, earnings, growth, everything. And there is a case for considerable P/E compression even with sketchy earnings. In short a lot of bad news to work through. But equities regularly do that. The global situation is also deteriorating with real GDP growth the lowest in 2009 in a decade. But equities are being taken out of weak hands. And the policy makers have the full court press on. Both count for something. Combine that with the equity market damage, repairable, from the credit crisis and investors need to begin to shop. Interest rates and inflation are down. Commodity and oil prices are way down, headed lower.

**EUROPE'S DIFFICULTIES SPREAD.** Europe is now fully engulfed in the credit crisis and they have now recognized that fact. Europe has 15 (or so) different countries, 15 governments, 15 financial-sector regimes, 15 fiscal policies, 15 cultures, 15 languages, 15 risk-caution preferences and one fragmented monetary policy. As we are seeing, this has not been conducive to decisive, coordinated repair action.

Rather than one common approach, it is every government for itself, explaining in large measure why the dollar has been so strong versus the Euro. My expectation is that the difficulties in Europe will deepen before they are resolved. It is a preservation of capital environment still in our view. Anyone that has watched the birth and operation of the ECB and/or the European Commission knows that diversity and independence of action rules.

**MORE DIRECT EUROPEAN ACTION COMING.** But now the ECB, the UK, Switzerland and others have joined with the Fed on a 50 basis points rate cut. We expect more direct action in Europe as well to directly address the mortgage problems and the freeze-up in the credit markets. Both will (would) be extraordinarily positive.

**CHINA ALSO CUT RATES AND RESERVE REQUIREMENTS.** It was also constructive that China cut its interest rates by its usual increment of 27 basis points, and cut reserve requirements by 50 basis points. Don't overplay this. China is trying to be a good global financial citizen, but would not have done this if it was not consistent with their basic concern that growth is slowing too much. Since July 1, China has been of the view that the biggest risk is growth too slow, not inflation too high. So they get credit in the global community -- and proceed in their own narrow best interest as well.

We believe China will cut rates and reserve requirements several times more into 2009, credit crisis or no credit crisis.

**WILL 'POLICY' CREATE THIS EQUITY MARKET BOTTOM?** Every market watcher must be impressed at the pace and breadth of the recent decline. The Fed and Treasury act again and again and the problems get worse, or pop up somewhere else. So the next day there is another surprise move. Seemingly even great companies (strong balance sheets, superb management, top products, an industry leader, big market share, etc.) are getting absolutely taken apart. That is the first indication that a bottom is approaching – when there is no place to hide. Long term investors love to see such conditions develop.

There is still much volatility and bad news to work through. Usually when anyone is looking for a bottom, it is not there. Down 800 intraday on Monday followed by down 350 says there is still a lot of fear mixed in with the hope. A bottom usually needs all fear, no hope. But this bottom, I believe, is going to be driven by a consensus forming on the credit crisis ending more than on a consensus that the economic numbers are going to turn up. I believe this process is now underway. Usually policy is not what makes a bottom, but this time I think so.

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**EVEN BETTER FUNDAMENTAL EQUITY BARGAINS THAN USUAL.** Most equity declines over the last 50 years have come from worsening fundamentals -- EPS, inflation, recession, business, interest rates, etc. They are often overlaid with some sort of policy or geopolitical concern. This time, it is the credit crisis problems that have been the prime culprit, now being supplemented by fears of slower growth, declining EPS and the massive debt overhang. This will take time to resolve. There is no doubt that these recent financial sector problems are the most severe since the 1930s.

But when the credit crisis ends, as it will, company, industry, sector and macro fundamentals again will start to dominate. It will take some time for the confidence to return and wipe away the fear that has developed in the financial markets. But when it does, the snapback in those battered but surviving equity market leaders will be even more explosive than usual.

**SCALE INTO THIS MARKET.** For the long-term investor, in our view, it is time to start to scale into this market. Expect a rocky ride for a while. Perhaps a 25% position to start, watch and wait, and proceed with another 25%, etc. as developments seem to dictate. When the fear is gone, the quality companies will still be quality companies and you will own them at prices that you did not imagine possible just a few months ago.

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