

Despite low consumer confidence and high unemployment, a rally is possible says Chew

Depression is still far cry from minds of recession-stricken fund managers

By Lawrence Gosling

While it is undoubtedly clear American consumer confidence is low and unemployment is rising, the economy has not slipped from recession into depression according to Paul Chew, head of investment strategies at US equity investor Brown Advisory.

Unemployment, currently just at 8% is still below the level of the 1981-83 recessionary period when it hit in excess of 10% and, although Chew expects unemployment to rise further, it is a long way below the 25% level of the Great Depression.

Chew says one factor which is completely different in this recession from previous cycles is the '24-hour news culture' which means every bit of economic and business news is analysed, commented on and debated quicker and in more depth than ever before.

He says: "The effect of this can be fairly major as in certain cases too much emphasis is put

on specific data points, such as the car sales figures. Production was slashed so aggressively that even in this industry which is going through such a torrid period, we are now seeing demand exceed production.

"Consequently we saw a slight uptick in the ISM production index in January and February – as businesses had worked through some of their inventories. This is a positive sign and we believe it will be manufacturing that leads us out of this mess."

Brown Advisory believes some of the value metrics it looks at are beginning to indicate long term buying opportunities emerging in the market.

The 10-year moving average of US large cap stocks (which is a measure of the nominal returns on a rolling 10 year period) measured back to 1836, shows the current decade being at an all time low, well below comparable periods in 1974, the 1920s and three periods in the 1800s. From all previous lows, stocks saw big

moves higher over the following few years.

Chew says such a rally is possible from the current lows and the group points towards companies like Google currently on a P/E of 11.5 times or pharmaceutical company Merck on a very low P/E and a yield of 7%, both with very strong balance sheets.

He says there is much focus today on S&P earnings and what they might be in 2009 and 2010. The peak 2008 earnings for the whole index was \$91.87 compared to a 2009 estimated of \$62.74.

In 2008 the financials and energy/commodities sectors contributed \$39.20 to S&P earnings – however, today it is estimated these sectors may only contribute around \$18.00.

Although Chew believes the earnings estimates in 2009 could still be a little high – he says that on a more normalized basis you could envisage the S&P earnings (ex-financials and energy/commodities) getting back to around \$50.00 (still below their 2008



Chew: continue to look forward

peak) – then if you assume that financials & energy/commodities will never get back to their peak earnings of \$39.20 – but might earn \$20 on a more normalised basis – then S&P earnings could easily be around \$70. Apply a 14 or 15 multiple to these earnings and you could easily see the S&P up above 1000.

He adds: "We continue to look forward. We see opportunities, not obstacles. We continue to search for the survivors; the companies that have the potential to come back even stronger once the CDOs, MBOs, and SIVs are finally put to rest.

"The real estate boom has come and gone. Like any market cycle, it has taken its due time. And like any remarkable innovation or historical economic trend, the initial stage inherently attracts excess supply in the face

of limited demand. Eventually, when the dust has settled, consolidation occurs, fears wane and the legitimate businesses forge ahead to see another day."

The group's Dublin Ucuts III vehicle has four funds – US Equity Value, US Smaller Companies, US Equity Growth and The American Fund, which is a combination of the group's three in-house equity funds.

It launched its umbrella fund in 2006, opened a London in 2008 and currently manages in the region of \$750m for non-US clients through the umbrella and separate accounts.

Brown Advisory has its roots in the US's oldest investment banking firm Alex Brown & Sons, and it became a separated independently owned company in 1998, and has group assets under management of \$14bn.