



RICHARD BERNSTEIN ON THE US

Underlying economic data vs green shoots: the uncertain future

Bull and Bear points

Earnings continue to surprise on the upside

Inflation and interest rates move higher faster

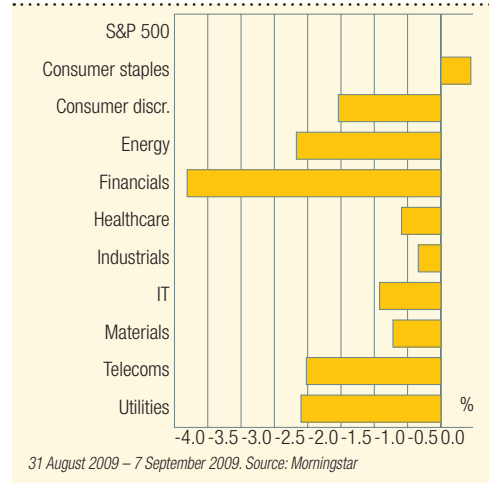
Inflation stays low enough to be a positive

Dollar comes under substantial pressure

Over the past few weeks, France, Germany and Japan reported GDP growth for the second quarter, which appears to indicate that they are now emerging out of recession.

Unsurprisingly, media attention has been focused on whether the 'green shoots' of the elusive economic recovery are real or imaginary. From our field work, we would offer the following observations. In most sectors, the economy appears to have stopped getting worse, but many businesses remain reluctant to take any risk yet, and as a result, inventories of all sorts of goods are still very low. Pricing, however, is beginning to firm in some important industrial goods, notably steel, and, when business psychology reverses, the turn in activity, pricing, and incremental

S&P 500 sector returns



31 August 2009 – 7 September 2009. Source: Morningstar

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margins for the average industrial cyclical could be surprisingly good.

Now that earnings season has passed and the fears of a complete economic meltdown have abated, America's economic debate has turned to the nature of the recovery. Optimists point to the government stimulus and its ability to jumpstart the confidence of the American consumer. Other observers are less sanguine. They are bracing for an extended period of slow to moderate growth, as debt-laden consumers rebuild their savings at the expense of an economy built on spending.

Both camps can find a statistic or chart that supports their current view of the world. Either way, our view is that the market is not expensive on a forward price/earnings basis, but it has

rebounded from its 'cheap' lows. A lot of stocks are fairly valued, and consequently, there is a need to be mindful of actively managing risk in today's market environment.

As more venturesome 'animal spirits' return, and activity levels and money velocity improve, we believe inflation will become a significant issue given the mountain of money created to solve the credit crisis. This development will have the effect of improving nominal asset prices and reducing the weight of liabilities, but it has implications for currency, interest rates and the valuation of assets.

Leveraged by huge monetary and fiscal stimulus, the growth in absolute profits could provide the mirror image of what corporate profits experienced over the last 18 months. We are working hard to position our portfolio for such a climate, and therefore its composition is as cyclically sensitive as it has been in many years.

Notwithstanding the market's advance from the depressed days of early March, we continue to work on intriguing ideas across a broad spectrum of industries. We are generally focused on high-quality companies and since the rally so far has been concentrated in lower quality names, we remain optimistic a return to quality is on the cards for the future recovery.

Richard Bernstein is manager of the Brown Advisory US Equity Value fund

(IMA) North America: over three years

Top 5	3yr % Chg	Rank	Volatility (monthly)	Fund size (m) (£)	Morningstar Rating™
Neptune US Opportunities A Acc	34.65	1	5.19	263.86	★★★★★
Schroder US Mid Cap Fd Acc	14.65	2	5.28	223.43	★★★★★
Jupiter Nth American Income Inc	10.27	3	4.71	199.35	★★★★
Threadneedle American Sel Fund 1	8.46	4	5.46	1119.42	★★★★
Allianz RCM US Equity A USD	7.09	5	5.59	13.96	★★★★
Bottom 5					
LV= US Growth Group Acc	-17.19	60	5.47	11.82	★★
IP US Equity Acc	-18.58	61	5.17	339.01	★
M&G Nth American Val A Inc	-23.4	62	7.7	95.47	★
Franklin Mutual Shares A acc £	-26.5	63	6.26	15.37	★
Legg Mason US Equity A	-35.09	64	7.37	106.52	★
Sector average	-5.16	64	5.45	164.155	

Performances calculated bid to bid, net income re-invested, GBP to 07/09/09. Data Source: © 2009 Morningstar, Inc. All Rights Reserved.