PERSPECTIVES

American Trust Investment Advisors

If you can't beat 'em…

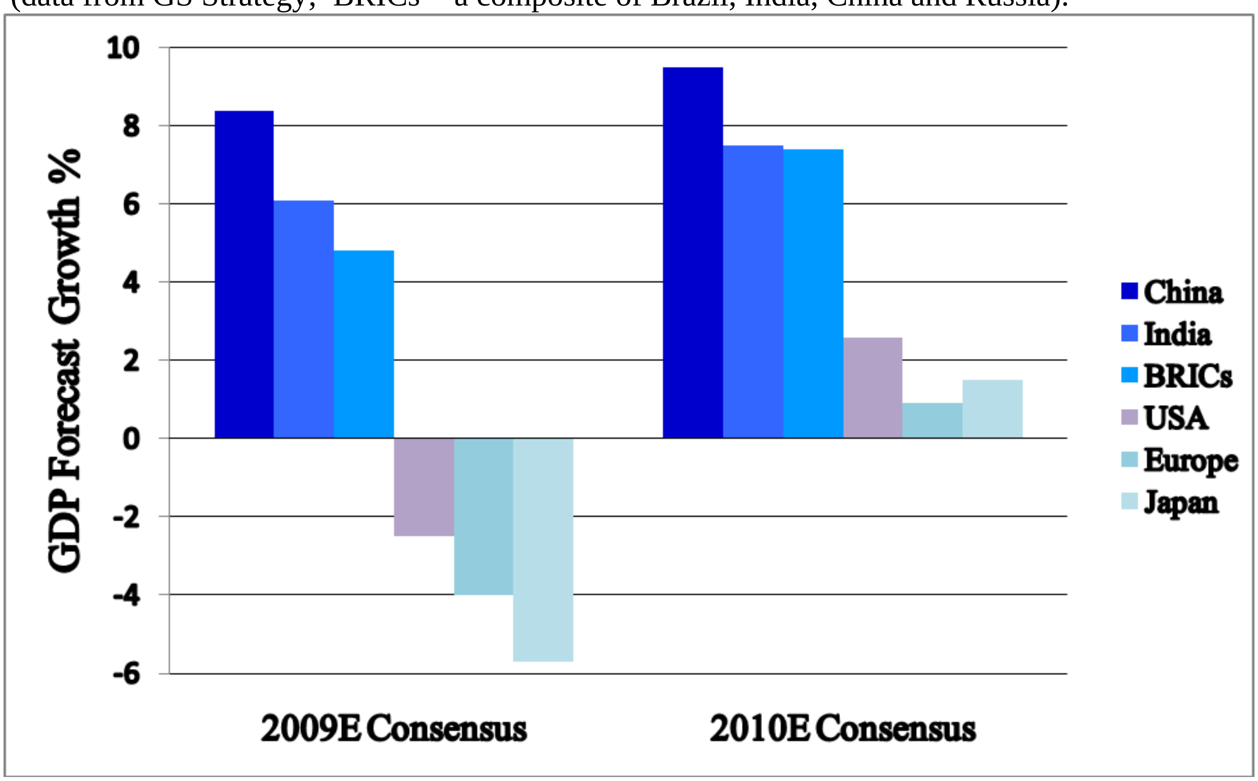
December, 2009

Where in the world is growth? Like the elusive Elvis Presley, "growth has left the building." True, we are in a recovery and the U.S. economy is now growing modestly after a year and a half of recession. Yes, the stock market has soared, suggesting better times are ahead. But a closer examination of the economy and stocks gives us pause.

The nascent growth we are experiencing in the U.S., Europe and Japan is anemic and fragile. A massive fiscal stimulus, surging money supply and powerful inventory cycle are kicking in to produce growth in the U.S. But longer term, towering debt, especially in the U.S., represents a huge long term claim on our resources and a drag on growth. Unemployment still has the potential to pull us into a "double dip" recession.

Stocks have been on a tear, up 26% so far this year and a whopping 67% off the lows. While the rebound heralds good tidings from the economy, bear in mind the market is still off over 25% from its highs. Some of the enthusiasm reflects surprisingly strong profits. Third quarter profits for 56% of the S&P 500 came in ahead of expectations. But a closer look shows that over half of the positive surprises owed to better cost control, not better growth in revenues. And while cost cutting can help a company's profits in the near term, you can't cost cut your way into prosperity. We need growth.

Where in the world is growth? See below.
(data from GS Strategy; BRICs = a composite of Brazil, India, China and Russia).



The better economic prospects of emerging markets such as these have not gone unnoticed. Year-to-date Chinese shares have soared 79% versus the 26% advance of U.S. stocks. Brazilian equities are up even more – a remarkable 83%. Shares of these countries' stocks are no longer cheap. In fact they have gone from being relatively inexpensive compared to the developed world to relatively expensive in the past nine months. We are not afraid to pay more for growth, but it strikes us that there is a better way.

In our last newsletter we shared with you that we are keen on the shares of companies with a large proportion of international business, owing to their better growth prospects. We have sharpened our focus in this area, and share with you the profiles of three new investment ideas below. The advantages to this approach are several: 1) an opportunity to own best in class companies with a significant presence in emerging market economies that should yield superior growth in earnings; 2) these stocks often trade at a discount to emerging market peers; and 3) we believe that these U.S. and multi-national companies have less corporate governance risk, better accounting, and are more easily traded.

Capsule summaries of three such companies that we have invested in recently follow:

Millicom International Cellular – a fast growing emerging markets cellular phone operator, founded by the same team that founded Vodafone; Operates in 17 countries in Africa, Central & South America with 300 million people in their service area; Lots of room for growth and a reasonably priced stock. High profit margins and good cash flow.

Cummins Inc. – Leader in truck engine technology and systems; Over 30% of revenues and 45% of engine production in emerging markets; #1 truck engine maker in China, India & Brazil; New environmental regulations worldwide for diesel a catalyst for growth; Valuation discount relative to peers despite leadership position and technology superiority.

Molex Inc. – Well-respected #3 global player in electronic connectors with strong technical and manufacturing base; Over half of business is in Asia, and over 40% in emerging markets; Big earnings potential in a cyclical recovery for PCs and consumer electronics. Strong balance sheet and cash flow characteristics.

A focus on growth has always been a hallmark of our investing at American Trust. We are also keenly aware of risk, and that our clients have varying degrees of comfort with risk. Our direct exposure to emerging markets for most of our clients is small, but our indirect exposure through ideas such as those outlined here is much more substantial. It will be a continuing focus of our investment work. As the saying goes, "If you can't beat 'em… join 'em." We continue to have enormous confidence in the U.S., but the higher growth overseas is compelling and we seek out attractive U.S. and multinationals positioned there.

Please let us know how we can help you with any gifts or disbursements you may wish to make before year-end. All of us at American Trust wish you a happy holiday season, and a prosperous 2010. We look forward to working together with you in the New Year.

Paul H. Collins, President — Carey Callaghan, CIO