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Can stocks predict what the future will look like?

On a daily basis Wislar Wealth Management, LLC spends, at a minimum, an hour screening and researching companies to stay up on what we currently own for clients and ourselves, or may buy in the future. We have several tools where we can input criteria for screening, such as forecasted earnings growth, share repurchases, dividend yield, dividend growth, the growth rate versus the Price Earnings ratio and much more. These screens produce probably 100 plus names daily, though the list changes slowly over time. With this list we go to step two. After studying Warren Buffet for years, we developed a worksheet to score companies future prospects and possible investment return. The worksheet has a possible high score of 100, though the highest a company ever scored was 90 which was United Health in late 2003 which did extremely well for us over the next few years. No company goes into a portfolio unless it scores at minimum 50. By the way, the S&P 500 currently scores a 22. Part of the worksheet includes the estimated total return over the next 10 years including price appreciation and dividend yield. To make the cut, a company's estimated total return needs to exceed 15% per year, though on average we have higher expectations for most additions.

Let's look at trends that are currently showing up in the screens that may suggest what the economy might look like going forward. Shoppers have and will continue to move to cheaper alternatives. There is a large disparity between retailers; the middle and upper middle class shoppers have moved down channel to the discounters such as Ross Stores, TJX Companies (TJ Max) and Dollar Tree. As an example, Ross Stores recently reported their same store sales increased by 12%. The super wealthy continue to shop as always, but the lower middle and low income shoppers continue to visit the discounters, but are spending less; Wal-Mart just warned about future growth. This suggests that Americans are still feeling the economic downturn, including the significant job losses over the past couple of years and are looking to rebuild their balance sheets by reducing debt and increasing savings. People are getting by with less.

With the large increase in unemployment and fear of job loss, people are going back to school in record numbers to better their marketability. We currently own two publicly traded education companies and several more continue to show up in our screens daily. Over the past decade, DeVry grew their annual earnings on average 14%, but are expected to increase earning this year by 40%, likewise per share earnings are expected to grow by 88% at Corinthian Colleges. It's great that people are bettering their abilities, but suggests that the consensus feels that the future job market will be significantly more competitive.

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The Pharmaceutical and Biotech indexes topped nearly a decade ago. The Biotech index has recently surpassed its high made in 2000, but the Pharmaceutical Index is still 32% below its 2000 high. For the Pharmaceutical industry the past decade will be remembered as the decade of patent expirations; the Biotech's saw their sky high valuations come back to earth. Our screens are suggesting better times for both going forward. Some of the Mega Cap (\$50 billion or higher market capitalization) Pharmaceuticals now trade at upper single digit Price Earnings ratios, pay hefty dividends; have rising future growth rates and stellar balance sheets. The Biotech Industry has come of age with some trading at market Price Earnings ratios but significantly higher growth rates and many with no debt. This suggesting that healthcare reform will not pass or pass in a form that is not significantly detrimental to these two industries. Also, though we needn't point this out, people want to live longer and with the highest quality of life possible.

The Emerging Markets in general have weathered the past couple of years significantly better than the Developed World. Just a couple decades ago the Developed World sported pristine balance sheets and watched some of the Emerging Markets countries nearly pull several of the Wall Street Banks under as they defaulted on their debts. I remember well as Russia went under in 1998 causing a several month panic in the world stock markets. They did learn from their mistakes and as a group, the Emerging countries have significantly less debt today than the Developed World. Studies indicate that a countries growth will slow as their debt burden grows; this will most likely be the case going forward. In almost all sectors our screens are returning a much larger proportion of Emerging Markets companies, they are showing the best growth outlook, better valuations and better balance sheets. The average U.S. investor has less than a 2% allocation to Emerging Markets missing great opportunities.

An area that has bounced hard with the market, but has faltering fundamentals is what we'll call the "deep cyclicals". In this group we include Steel, Mining, Petroleum, Building Materials and Transportation, though there are others. This lack of growth suggests that the current deleveraging process will continue for an extended period of time. Companies and Joe public will get by with what they have until they're sufficiently repaired their balance sheets. Though the recession ended in 2009, we see an extended period of below normal growth within the U.S.

There is too much to be said for the Financials, so we'll just cut to the chase. After the Technology wreck a decade ago, the group went sideways for eight years. We expect the same from what we'll call "The Big Ugly's" in the group. Some of the smaller institutions avoided the financial crisis and will do fine going forward. We currently own New York Community Bancorp and have enjoyed a significant gain, but in general our work suggests a long repair process for Financials in general. With this, don't expect to see easy lending for several years; cash will be king.

One of the scoring criteria on our Warren Buffet worksheet is called "Earnings Yield". The formula is simple; divide the companies per share earnings by its current price. Historically, the "Earnings Yield" for the stock market has been a full percentage point below the ten year U.S. Treasury yield. The thought for this discount is that stocks offer future growth while bonds do not. Today, the average "Earnings

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Yield” for S&P 500 companies is 5.33% while the ten year U.S. Treasury yields just 3.80%. There are several possible scenarios to correct this outlier - earnings could drop, bond yields could go higher, or a combination of the two. Our stock research shows us there’s a major divergence, but it doesn’t tell us how it’s going to be resolved. Now we need an opinion. Interest rates have declined for nearly three decades, history shows that when interest rates bottom they will bounce along that bottom for six years on average. Yields were at this level on the ten year Treasury in the middle of 2003, seven years ago. The process should be slow, but expect higher interest rates in the future.

By the way, the 20 stocks that comprise the “Core List” enjoy an average “Earnings Yield” of 7.82%.

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