

Steve Cook's Daily Blog

7/25/07

Economics

fiscal profligacy (Government spending as a percent of GDP is too high and the looming explosion in entitlement expenditures will make it worse. There is no good solution save spending discipline.) On this year's Farm Bill:

<http://article.nationalreview.com/?q=ZmYzOGNiNmE2NWNmYTY2ZjM3YjFmMzZiZGQ1NTZkMTI=>

Politics

Domestic

This is a bit worrisome re: homeland security:

<http://michellemalkin.com/2007/07/25/blocks-of-cheese-with-wires-sticking-out/>

International War Against Radical Islam

The Market

Technical

Fundamental

Are we having fun yet? Yesterday was another brutal day and, again, one which the financial press attributed to earnings disappointments (Dupont and American Express) and the sub prime problem. With respect to the issue of earnings reports, we remain upbeat about the outlook for both the economy and corporate profits. Speaking of which, one third of the S&P 500 companies have reported second quarter earnings as of the close of business yesterday and thus far in aggregate those profits are up 7%--that has to be scored as mildly positive. Further, the global economy shows no sign of slowing. Yes, there have been some negative earnings surprises--but that happens in a 'soft' landing. Bottom line, as we said after Caterpillar's disappointing results, this is not a reason for concern about the Market.

On the sub prime market, which we think is what really got investors stampeding for the exits, was the comments accompanying the quarterly earnings report of Countrywide Credit, a mortgage finance company. In them the company basically said that it was experiencing mortgage payment delinquency problems among *some of its better quality home equity loans*, not just in the sub prime area. Now this is very worrisome. It is one thing for problems to develop in a small sector (sub prime) of a large market (mortgages) even if the risks are unquantifiable and quite another for the financial soundness of the entire sector to be in question. Of course, for the moment this

statement by Countrywide is the first direct evidence that there may be difficulties beyond the sub prime market; but it certainly does further raise our level of concern.

<http://bigpicture.typepad.com/comments/2007/07/countrywide-hom.html>

On the other hand, let's not forget that in our Valuation Model, the Year End Fair Value for the DJIA is 13000 and the S&P 1500; so to the extent that our Model is in the ball park for Fair Value, the sub prime problem aside, the Market is still slightly over valued--and it may be that all that is really going on is investors collectively bringing an over valued Market back to Fair Value with the sub prime problem simply serving as a convenient excuse.

That said, the potential remains for a Market related problem brought on by disruptions in the sub prime market; and as we said last Friday what makes us particularly uneasy is that any knowledge on the extent of the problem is dependent on lenders being forthright about the value of their assets which historically they haven't been. Unfortunately, we have no special insight into how to deal with what could be a festering problem in an otherwise healthy economy other than to stick with our current strategy:

- (1) pay close attention to our Price Disciplines in particular our Sell Half Prices
- (2) as a corollary, use the present heightened volatility to our advantage by taking profits when prices spike to the upside and buying the stocks of great companies when opportunities present themselves (did you notice the performance of the CLX and PG yesterday?),
- (3) continue to focus on improving the quality of our Portfolios by Selling the stocks either of companies that fallen below the minimum standards of our Quality Discipline or that have performed poorly over an extended period.
- (4) insure that our Portfolios can ride out any turmoil brought on by trouble in the sub prime market.

News on Stocks in Our Portfolios

C.R. Bard (Dividend Growth Portfolio) reported second quarter earnings per share of \$.91 versus \$.76 reported in the comparable period in 2006.

EPS: 2006 \$3.29, 2007 \$3.80, 2008 \$4.35; DVD: \$.80, YLD .7%

<http://finance.yahoo.com/q?s=BCR>

Linear Technology (Dividend Growth Portfolio) reported its fourth quarter operating earnings per share of \$.36 versus \$.32 in the prior year's fourth quarter. For the year earnings per share came in at \$1.39 versus \$1.37 in FY 2006.

EPS: 2006 \$1.37, 2007 \$1.39, 2008 \$1.70; DVD: \$.66, YLD 2.0%

<http://finance.yahoo.com/q?s=LLTC>

A.J.Gallagher (High Yield Portfolio) reported its second quarter earnings per share of \$.44 versus expectations of \$.45 and \$.37 recorded in the 2006's second quarter. The company's Board also authorized the buy back of an additional 7 million shares of stock.

EPS: 2006 \$1.40, 2007 \$1.75, 2008 \$1.85; DVD: \$1.24, YLD 4.3%

<http://finance.yahoo.com/q?s=AJG>

ConocoPhillips (Dividend Growth Portfolio) reported second quarter operating earnings of \$2.90 (excluding a \$4.5 billion charge for discontinued operations in Venezuela) versus expectations of \$2.68 and \$2.87 posted in the second quarter of 2006.

EPS: 2006 \$9.99, 2007 \$8.65, 2008 \$8.55; DVD: \$1.64, YLD 2.1%

<http://finance.yahoo.com/q?s=COP>

General Dynamics (Dividend Growth Portfolio) reported second quarter earnings per share of \$1.27 versus expectations of \$1.17 and \$1.03 recorded in the comparable 2006 quarter.

EPS: 2006 \$4.20, 2007 \$4.80, 2008 \$5.35; DVD: \$1.10, YLD 1.5%

<http://finance.yahoo.com/q?s=GD>

Praxair (Dividend Growth Portfolio) reported second quarter earnings per share of \$.88 versus expectations of \$.87 and \$.75 recorded in the last year's second quarter. The company also announced a \$1 billion stock buy back.

EPS: 2006 \$3.00, 2007 \$3.40, 2008 \$3.70; DVD: \$1.20, YLD 1.7%

<http://finance.yahoo.com/q?s=PX>

Medivation (10 Bagger) began trials on MDV 3100 its drug for the treatment of prostate cancer,

<http://www.marketwatch.com/news/story/story.aspx?guid={83EE7F16-AF5C-4364-9D62-B3ADE778034D1}&siteid=nbs&symb=>

Market Analysis

More Cash in Investors' Hands