Courier Capital Corporation

Market Review & Update

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INVESTMENT COUNSEL

Bruce Kaz

Randy Ordines

William Gurney

Thomas Hanlon

Brian Geary

Edwin Miner

David Bard

Alan Abels

976 Delaware Avenue
Buffalo, NY 14209
Phone (716) 883-9595
Toll Free: 1-800-783-1086

214 West Fifth Street
Jamestown, NY 14701
Phone: (716) 484-2402
Toll Free: 1-877-484-2402

Exactly one year ago, noted Wharton finance scholar Jeremy Siegel, whose major works focus on long term equity investment and valuation, penned an editorial to the Wall Street Journal entitled “The Great American Bond Bubble”. He, like Warren Buffet, Bill Gross, Barton Biggs and John Bogle were prescient in their realizations that bonds had become historically expensive, particularly when set next to domestic equities, which at that juncture were trading at multi-decade low valuations. They were all perfectly correct in their observations and analysis, and then it got even worse. Let’s talk about this, because this time, it is indeed everything…

If markets were run by math and spreadsheets then all the irritating wonks I have worked with over time could just press the buttons and go home. It was noteworthy that the aforementioned notables all cited one common caveat, to paraphrase “market tops and market bottoms are driven by emotion and are therefore, nearly impossible to predict”. I’m quite certain, that absent a family bomb shelter test over the last few months, that all of you are painfully aware that we have been in the midst of the text book case study of this very human phenomenon. I would understand if you never want me to use the terms Fear & Greed ever again, but they rule everything a human chooses to do. From the girl you were afraid to ask to the prom, the candy bar your “friend” got caught pilfering, major purchases, weddings, and ad infinitum, fear and greed is all there is… And what’s worse, we get even worse when we’re in a gang. If you think I invented this, wrong! There was a popular text of this behavior entitled “Popular Delusions and the Madness of Crowds”, which could have scripted the political discussion of this Summer to an exclamation point. It would be much less of a millstone to our psyche if this text weren’t authored in another country, in 1841!!! Like you think Alan Greenspan invented irrational exuberance…

Supply and demand create rational marketplaces, not quite. Supply is real, it’s a number, demand, however is whimsical and the manifestation of all we think, desire and fear. At the extremes it displays the worst we have to offer, as the political discussions surrounding the economy, unemployment and the deficits are dredged in political avarice. And since the extremes of these herd activities bring out the worst of our irrationalities, whether exuberant or panicked, the boys of summer showed us how herd mentalities devolve. Attitude begets attitude. If you want to revive a struggling economy and reinvigorate the job market, then you’re a very mistaken lad if you think you’ll get there by warnings of calamities, like telling seniors their SSI checks may not arrive! Why, if you do that enough you can even create a recession where none exists! Scare the bejeezus out of folks and they forestall that big purchase. Confuse a company as to your strategic vision (insert guffaw here…)and that historically high hoard of cash ain’t getting spent on capex. Bad, bad, bad boys and girls on capital hill…Mom would’ve whacked ‘em with a rolled up newspaper. Often, and with fervor… We’re grateful for the passing of the 3rd Quarter. Volatility in August averaged 351 points per day occasioned by fear of Greece contagion and the shameful display of political opportunism with utter disregard for statesmen-like leadership. The latter earns you a downgrade… As Huck Finn said “What’s the

Figure 1: Record Corporate Earnings at Bargain Levels

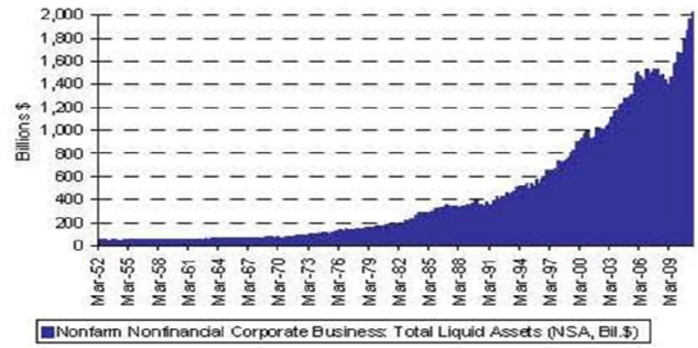
Source: Haver Analytics and CIRA – U.S. Equity Strategy use you learning to do right, when it's troublesome to do right and ain't no trouble to do wrong, and the wages is just the same?" Perhaps government needs to go on incentive based pay…

Elephants in the room…

I mentioned in the past that eventually the world would begin to tire of the aforementioned hyperbolics and refocus on fundamentals. Well, it happened. Since the end of August the equity markets have rebounded nearly 15% and the 10 year Treasury has lost 5% of its value after reaching an all time low yield below 2%. We just completed the best October since 1987. Investors recognized the elephant as corporate earnings surprised positively in a quarter they we assumed to assuredly disappoint. More than 70% of companies beat estimates scoring 13% growth overall, in line with our estimates. (see Figure 1) S&P 500 earnings now stand at an all time high.

We now have the Gang of 12 working behind closed doors to bring responsibility to deficit reduction while delivering stimuli to a domestic economy everyone needs to grow a bit faster. The President's job package struggled to find $300-400 billion to aid in job creation. This brings us to the big elephant in the room, corporate cash. All the aforementioned earnings are piling up. A year ago we talked of record corporate cash at $1 trillion. That sum has now doubled! (see Figure 2) There is $2 trillion for the Gang of 12 to grasp for job creation, to do so requires two key elements. First, create an environment that makes business confident enough in tomorrow to invest that cash in plant, equipment and humans. And most important, bring that cash home without penalty to assure that it is invested here, as most of these earnings lie offshore, where the money has been made. The process, to date, has so shockingly avoided this giant, that it reminds me of a parable from India I first read when I was 3. A group of blind men are led into a room containing a giant pachyderm. They are each asked to describe what they feel.

Figure 2: The Big Elephant-Record Corporate Cash



Grasping different parts, the responses ranged from snake to tree. We hope the President and the Gang of 12 rise beyond this ode:

And so these men of Hindustan,
disputed loud and long,
each in his own opinion,
exceeding stiff and strong,
though each was partly in the right, and
all were in the wrong.
So oft in theologic wars, the disputants I ween,
rail on in utter ignorance,
of what each other mean,
and prate about an Elephant,
not one of them has seen…
(the latter may well just get you another downgrade…)

Errata

Best quote from the debates, to date- "my neighbor's two dogs produce more shovel-ready projects than this administration!"

Earnings up 13%, record cash, GDP at 2.3%. Recession? Really??

Valuation-it should be noted that the 12 months after every occurrence in which the dividend yield of the S&P 500 exceeds that of the 10 yr Treasury, market performance has averaged 20%.

After 30 years in the same location, Courier will likely be moving a couple blocks down the street. It still surprises me that you can buy a nice building in WNY for less money than you can lease average space. More updates on this as it progresses…

We'll talk to you soon…