



*"Unequaled Personalized Service"*

**December 2010**

## **Market Commentary: The Case for Large-Caps**

We've touched on this topic in several of our recent communications. Given our enthusiasm for the equity class we felt that it deserved a bit more attention. We would agree with our value investing cohorts that U.S. large-caps represent one of the best investment opportunities we've seen in nearly 30 years.

In certain of our styles of management we have historically tended to have a very modest level of exposure to large-cap stocks in favor of small- to mid-sized companies. This was a by-product of our fundamental, bottom-up analysis which led us to what we felt were undervalued, quality investments. That same analysis today leads us to a heavier weighting in large-cap companies; heavier than at any time we can recall in our history.

### **What We Like**

While we hesitate to over generalize, there are several commonalities. The large-cap companies that we are buying or own today in most cases offer at least one, and more often, more than one, of the following characteristics:

- Low price-to- valuation
- Strong balance sheets
- Stable earnings and cash flow
- Dividends
- International exposure

As a value-oriented manager an important criteria to any investment consideration is low price-to valuation. Large-cap stocks entered this decade at record high valuations (for example, recall the nosebleed prices for some large technology names in early 2000). Our exposure was therefore relatively small. Today, the average large-cap stock is reasonably valued and cheap in comparison to the average small- to mid-cap stock.

The strength of the balance sheets is most evident in the high cash balances we see. The market was recently boasting some of the highest cash levels ever recorded – \$1.93 trillion as of September 2010. As a percent of total assets, cash levels are the highest they've been in half a century, according to a recent article in the Wall St. Journal. This high level of cash is likely to provide stability to the companies in which we invest. Prudent management teams should have the ability to be opportunistic with their investments, which we expect would increase shareholder value. That better return to shareholders may come as a result of dividend payouts, share repurchases, acquisitions, investments in technologies or people, or some combination of the above. As the



legislative outlook becomes clearer, especially with regard to taxes and healthcare, management teams should be more willing to put that cash to work.

Larger companies tend to produce more stable earnings and cash flow, a feature that has value in these uncertain economic times. This stability can potentially lead to more consistency in their share price. Furthermore, U.S. large-caps have more leverage points and resources to navigate more challenging markets. Their international exposure can provide a hedge against dependence on one economy to produce results. During the recessionary period, most companies took aggressive steps to drive costs out of their respective businesses. In many cases they are positioned to drive a very high percent of incremental revenue growth to the bottom line – a good thing for us as shareholders.

Our investment process naturally looks to achieve high *total*, risk-adjusted returns. Ignoring the tax consequences, we are generally agnostic as to whether those returns come in the way of dividend payouts or stock price appreciation. There is strong evidence that dividend payouts and the growth of dividend payouts matter a great deal to that total return. Today, many high-quality companies have dividend yields that are quite appealing and rival (or best) the yields available in high quality corporate bonds or U.S. Treasuries.

As mentioned before, many larger sized companies – the U.S. multinationals – have global exposure. In fact, about one-half of the revenue dollars of the S&P 500 companies is derived from non-U.S. sources. Investment in these multinational companies means that shareholders gain exposure to, and likely benefit from, international economies.

## **Closing**

In summary, the combination of high quality, well capitalized large-cap companies with stock prices offered up at relatively cheap valuations in our opinion make for a compelling investment opportunity today. We believe that U.S. large-caps present one of the best investment areas we have seen in nearly thirty years. This is the case as we examine return prospects and, importantly, risk. This trend could shift course and we will naturally adapt the portfolio as appropriate and as reflected by our on-going bottom-up analysis of each investment opportunity.

We thank you for the continued opportunity to serve your investment needs and welcome any questions that you might have.

Our best wishes to you during this holiday season.

EUBEL BRADY & SUTTMAN  
ASSET MANAGEMENT

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