August 2010

Pulse Research Partners

Monthly Independent Research Snapshot

Cirrus Research

Small and Mid Cap Strategy

Strong Q2 earnings and easing European banking fears led to July's broad-based rally. Mid Caps (+7.1%) slightly led other cap sizes: Small +7.0%, Micro +6.6% and Large Cap's best month in over a year at +6.9%. Risk appetites returned, fueling cyclical sectors and riskier factors.

Materials, Transports and Industrials saw strong results in July, casting a vote of confidence for global recovery. In Micro Caps, Energy held a commanding lead. Cyclical consumer groups also performed well. Defensives such as Health Care, Utilities and Telecom lagged.

Factor performance indicated a reversion to pro-risk, low-quality traits. High beta stocks, highly levered names and most liquid shares traded higher, while high ROE and high-priced companies trailed.

Active strategies were mixed. Hefty doses of Price Momentum and Business Momentum pillars benefited our Aggressive Growth and GARP blends as Growth models beat benchmarks. Short models lost less than their benchmarks gained, adding value to market neutral portfolios.

New Research

Short Interest Roll Call: Where have all the bears gone? The selloff since May coupled with some signs of economic lift may have scared the bears out of the equity market. This fade appears to be the case across all economic sectors based on our look at short interest "days to cover". This test for bearishness was applied to the 124 Cirrus industries and 14 economic sectors in our MSX (Mid, Small and Micro Cap) universe.

Europe Notepad: Industrials—Lofty Expectations; Tech Discounted: Earnings expectations for European SMID companies remain at historically elevated levels. This work delves into expectations to isolate sectors with highest and lowest levels of estimates revisions against the backdrop of valuation levels. Sectors exemplifying revisions concern are Industrials, Materials, and Consumer Services. Conversely, Consumer Services, Health Care, Technology and Financials represent the more conservative sector forecasts.

Food: Declining Marginal Benefits: With the depths of the recession now far behind us, the improving margin scenario for Food companies has come to a close. Nevertheless, Food companies remain an attractive and reliable source for quality growth, but it is time to become more selective and valuation sensitive within the group.

Energy Sector Workbench: Utilizes 30 years of data to illustrate key measures such as performance, earnings revisions, long-term growth forecasts, short interest and valuations. The information provided offers insight and historical context for industries in sector along with stocks that rank well in our Signature Blend Relative Value model.

Earnings Notepad: Special report produced each reporting season to monitor EPS surprises and revenue beats for Smaller Cap universe vs. Large brethren. Midway through the current period, Small Caps had pulled ahead to lead on revenue beats.

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Furey Research Partners, LLC

Furey Research Partners

Integrated Small-Cap Strategy

In the past month, Furey Research has published a number of pieces exploring the outlook for small cap stocks in 2H2010. We continue to believe that slowing economic growth has locked the small cap market into a Russell 2000 trading range of 550-670. We hope that pro-growth policies emerge from Washington post the November elections, but are taking a wait and see attitude for now. Three recent pieces worth mentioning:

ROIC in excess of cost of capital has averaged +40bps in the past decade, as compared to +217bps before '00.

In what's been one of our most provocative reports to date, we published the results of our examination of corporate economic spreads, or a company's ROIC less their WACC. The conclusion as stated above is that non-financial corporations have garnered much lower cost adjusted returns over the past decade than they have historically, which we think is a result of lower revenues per investment. We say this because the WACC over the past decade is actually 50bps below its pre-2000 historic average. So instead of investing in growth, we think many have chosen to just spend on cheaper productivity enhancements and machinery instead of hiring. When will it recover? Economic spreads have just recently climbed above zero and historically rising economic spreads are followed by payroll growth over the next 6-9 months as companies put some of this cash to work.

History says the R2000's decline is two-thirds done by the time a "Black Cross" occurs.

Recently we published the second in a series of essays on the predictive power of well known technical patterns and explored the "Black Cross", ie a negative 50/200 DMA cross. Our conclusion: the July 28th negative R2 cross should not cause much concern. Our work suggests that half the time after a negative 50/200 DMA cross the index fails to decline much, if at all. Almost a quarter of the time, the cross happened AFTER the low had been achieved. And, looking back over the 17 negative crosses going back to 1998, the data tells us that 2/3 of the decline is already complete by the time the cross takes place. What's more rare is the S&P 500 experiencing a negative cross prior to the R2000. In fact, before this past July, only twice (in Jul '06 and May '94) has the S&P 500's 50 DMA crossed below its 200 DMA before the R2000's own negative cross. And in those instances, the R2000 had already achieved or was within 4% of its final low when the cross occurred.

In years when real household debt growth has been below 4%, median GDP growth is +1.9%.

In a Special Study of a recent Small Cap Mosaic report, we attempted to quantify the effect of consumer deleveraging on GDP by examining the relationship between household debt and GDP, and GDP and corporate profits. What we found is that there have only been 7 years since 1948 that real household debt actually declined y/y ('08 and '09 were two of them). As one might expect, corporate profits also tend to move in line with GDP growth. Since 1953, there have been 14 years in which real GDP grew between 1-3%, corporate profit growth in those years averaged +4%, while posting below-10% growth in 11 of 14 years. So why has the market been acting so well in the near-term? We believe talk of a second round of quantitative easing (Fed President Bullard's paper and interview) and potential tax cut extensions may have made the market more optimistic, in addition to an even better than expected earnings season.

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Industrials/Building Materials

PIP dollars for May were similar to previous month's results: Residential markets struggle to make a comeback, Public markets hit record highs, and Non-Residential markets continue a dramatic slide. While the expiration of the federal tax credit program made an obvious impact on much followed housing statistics, Residential May PIP dollars were up nearly 12% YOY. TRG's five Public components are seeing record spending, and TRG findings show ARRA spending picking up dramatically in the past couple of months. Non-Res, while still horrific, showed the first signs of life as ABI data posted the first 50+ reading in the commercial/ industrial market in 29 months. We are hearing anecdotes of life related to hospital, schools and alternative energy.

KEY POINTS:

- **Residential –** May PIP came in at $270.2B, up 11.9% YOY. Expiration of the federal residential housing tax credit, however, took its toll on the housing market. New home sales fell 18% YOY, housing starts were up 7.8% (after two months of 20%+ YOY increases), and permits broke a string of 5 consecutive months of double-digit increases. Despite the gloom, we still see reason for optimisim.

- **Public –** PIP numbers hit a record high in May. TRG's components of public construction PIP came in at $173.7B (an increase of 7.9%YOY), the highest measure on our records dating back to January 2005. All five public components hit calendar year highs. Weekly ARRA spending in our key states has picked up dramatically in the past several weeks.

- **Non-Residential** – Non-Res (NR) construction proved no better in May. PIP construction slid to $397.8B, down 22.4% YOY. May represents the 18th consecutive monthly YOY decline and tenth consecutive double-digit decline. This is the lowest Non-Res PIP number since May 2006. ABI data posted its first decline in four months at 45.8. The index's Industrial measure, however, rose to 51.3, the first reading above 50.0 in 29 months.

CONATIX LLC Consulting. Mindfully.

Together with its research partners, Conatix applies multiple methodologies to its coverage of the environmental and sustainability sector. This month we again wish to highlight recommendations we have adopted in cooperation with Intelligent Recommendations (www.IntelligentRecommendations.de) in Hamburg. We have culled recommendations of companies active in various environmental segments from IR's self-regulating online investment recommendation system. Intelligent Recommendations harnesses the power of collective intelligence to aggregate stock recommendations from hundreds of users. These crowdsourced recommendations perform better than those of the majority of fund managers. Each month since its inception, the IR collective model stock portfolio has outperformed benchmark indices for equities and equity funds.

IR summarizes user recommendations in a model stock portfolio that recommends stocks in different time horizons and risk classes. Users declare their preference for one of five risk classes:

1) **risk-loving** (100 percent "risky" investments, 0 percent "safe" investments)

2) **risk-tending** (75 percent "risky" investments, 25 percent "safe" investments)

3) **risk-balanced** (50 percent "risky" investments, 50 percent "safe" investments)

4) **risk-averse** (25 percent "risky" investments, 75 percent "safe" investments)

5) **risk-shunning** (0 percent "risky" investments, 100 percent "safe" investments).

Users make recommendations independently of each other, so that they cannot see the recommendations of other users. Each user only sees the collective recommendations after making his or her own individual recommendations, which are then added to the collective. This helps the system to avoid enabling speculation.

Recommendations in the collective model stock portfolio for all risk classes and for all stock indices (including mutual funds) regularly outperform comparable indices. Stocks comprising the IR collective model stock portfolio as of July 2010 outperformed comparable indices over the previous eighteen-month period by 26.5 percent.

We have selected companies from each risk class of the IR collective model stock portfolio that are active in one or more environmental/sustainability segments to highlight this month.

In the **risk-loving** risk class, 3M Company http://solutions.3m.com/wps/portal/3M/en_US/About/3M/ which was commended by the US EPA Climate Leaders Program in 2008 for exceeding its greenhouse gas emission reductions goals, was recommended by IR users for the time horizon of 0 to 2 years. Since this stock was first adopted by IR users and included in the collective stock portfolio in February 2009, it has gained 82.7 percent, in comparison with a 42 percent gain by the DowJones Index during the same period.

In the **risk-tending** risk class, BayWa http://www.baywa.com/ including BayWa green energy was recommended for the time horizon of 0 to 2 years. Since BayWa was adopted into the model stock portfolio in November 2009, it has made gains of 12.7 percent, vs. 16.4 percent gains by the MDAX index during the same period.

In the **risk-balanced** risk class, KWS Saat http://www.kws.com/, for the time horizon "no time horizon" has a past gain of 2.6 percent since being adopted into the collective model stock portfolio in January 2010 (compared to a better but still disappointing performance by the SDAX index of 14.6 percent since January 2010).

In the **risk-balanced** risk class, Nordex http://www.nordex-online.com/en, was recommended for the time horizon "no time horizon." Nordex has moved -0.4 percent since being adopted into the collective model stock portfolio in June 2010 (compared to a better but still disappointing performance by the TecDAX index of 1.7 percent since June 2010).

In the **risk-averse** risk class, Conergy http://www.conergy.com, adopted by the IR collective model stock portfolio in July 2009 for the time horizon of 3 to 6 years has shown gains of 5.8 percent—worse than the 14.9 percent performance of the TecDAX during the same period.

In the **risk-averse** risk class, the mutual fund Meridio Green Balanced http://www.meridio.de/fileadmin/user_upload/Green_Balance/20100531_GreenBalance_engl.pdf, adopted by the IR collective model stock portfolio in April 2010 for the time horizon of 3 to 6 years has moved -4,5 percent, better than the -9 percent performance of the MSCI World during the same period.

In the **risk-shunning** risk class, there was no environment-related stock in the IR collective stock portfolio as of July 2010.

Users of the IR collective intelligence platform can also choose their own asset allocation which then becomes part of the aggregate asset allocation in the IR collective model stock portfolio. More information (in German only at present) about the collective asset allocation is available on: http://www.intelligentrecommendations.com/index.php?path=presse .

For more information and English-language summaries of the present collective asset allocation, or to subscribe to the collective model stock portfolio (and to join the crowd and participate in the formation of collective wisdom about the performance of environment-related and other securities), please contact David Lehrer, Conatix david.lehrer@conatix.com or Corvin Schmoller, Intelligent Recommendations cs@IntelligentRecommendations.de .

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About Our Organization…

The Pulse Research Partners is a unique alliance of securities research firms that provides buy-side investors with an extensive range of "best of breed" independent research, together with the trade execution capabilities of Pulse Trading. Note that each research providers' services can be paid for through a variety of sources, including Pulse Trading.

The PRP platform provides a variety of benefits to its members, including the following:

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