



# Brookmont Capital Management

## Weekly Market Review

August 5, 2008

The markets continued their volatile fashion last week as earnings announcements and economic data point toward ongoing weakness for the second half of the year. While that may sound very negative for the markets, there appears to be pent up demand from investors who are willing to buy on any positive news. We saw that last month after Wells Fargo reported a positive earnings surprise, when General Motors announced a major restructuring, and the sudden decline we have seen in oil prices. Not only did it lift the stock price of these two companies, but also carried two beleaguered sectors higher as well.

The only problem was the positive report from Wells Fargo was followed by disappointing news from Merrill Lynch, and the rebound in auto stocks crashed and burned after Ford reported a loss of \$8.7 billion during the second quarter of the year. If energy prices should rebound and move sharply higher, we should expect the markets to fall just as quickly.

There are a few lessons to be learned from the market's gyrations over the past several weeks.

- 1) **Uncertainty reigns supreme:** if any "expert" claims that they know where oil prices will trade twelve months from now, what the stock market's return will be over the next year, or who will be our President after the upcoming election, make sure you get it in writing. The truth is, no one can accurately predict the outcome of these three variables, much less what will happen in the markets or economy over the next thirty days. The best anyone can do is make an educated guess, give each guess a probability of coming true, and then manage their portfolios accordingly.
- 2) **Today, uncertainty reigns King:** the bottom line is that no one really knows what will happen in the immediate future. Even the most visible market risks include many potential outcomes, which is apparent as the markets are trading on daily news stories.

Index	July	YTD
S&P 500	-0.84%	-12.65%
Dow Jones Industrials	0.25%	-14.20%
NASDAQ	1.42%	-12.30%
EAFE (International)	-3.20%	-15.60%
Russell 3000	-0.80%	11.76%

Unfortunately, we find ourselves in a rare period where so much uncertainty exists in the markets. Just add them up: a major election this November, the direction of energy prices, the depth of the sub-prime mortgage fiasco, inflation, corporate earnings, housing sales, value of the dollar, bank failures, and the health of the U.S. consumer are just a few of the uncertainties investors now face. It makes for a volatile market and explains the whipsaw effect created by daily events.

- 3) **You have two options:** either become obsessed about daily events, or take it all in perspective and know that these issues will work themselves out. As the saying goes, "Anticipation is far worse than reality."
- 4) **Diversify, Diversify, Diversify:** we cannot stress enough the importance of a diversified portfolio. To be diversified, investors must go far beyond simply allocating a percentage to stocks, bonds, and cash. Your equity positions must include small-large cap stocks, domestic and international, value and growth names, dividend payers, blue chips, and emerging growth. The bond holdings should come from government and corporate issuers, include multiple maturities, and derived from varying sectors.

*Then again....*

Sometimes, market predictions are highly probable simply because the law of averages dictate the situation. For example, our recent newsletters have warned about the exuberant behavior in the Energy sector and that investors

Sector	July	YTD	Earnings Growth
Energy	-14.00%	-7.01%	15%
Materials	-4.17%	-3.98%	3%
Industrials	1.75%	-13.10%	6%
Consumer Discretionary	0.42%	-13.49%	-87%
Consumer Staples	3.25%	-5.57%	11%
Health Care	4.93%	-9.20%	9%
Financials	6.80%	-26.19%	-85%
Technology	-1.27%	-14.52%	20%
Telecom	-6.81%	-24.42%	9%
Utilities	-6.28%	-10.34%	6%
S&P 500	-0.84%	-12.65%	-21.4%

should be cautious before jumping on the momentum bandwagon. Our warnings came true last month for no other reason than a "reversion to the mean" as the Energy sector has led the markets for the past six years. The outperformance between the Energy sector and the rest of the market was simply not sustainable as it has climbed more than 260% since 2002, versus a 15% return for the S&P 500.

Leave it to Wall Street analysts to prove that making forecasts (even short-term) is far from being an exact science. At the beginning of the year, analysts were expecting corporate earnings to grow around 4% during the second quarter of 2008. On April 1, that prediction was lowered to a -2% growth rate. As it stands today, second quarter earnings have fallen

21% (table above) compared to 2007. To be fair to Wall Street analysts, CEO's at Finance-related companies did not have a grasp on the severity of their problem loans. Without prudent guidance to the Street, it is really garbage in/garbage out when it relates to earnings expectations. This simply adds one more significant uncertainty in today's markets.

Finance stocks are not completely responsible for the downturn in earnings growth as disappointing results have come from every market sector. General Motors and Ford posted \$24 billion in losses during the second quarter, and blue chip companies like ExxonMobil and Sony also missed their earnings targets.

Company	Rank	Current Market Value (Mil \$)	Market Value 2007
Exxon Mobil	1	465,652	511,887
General Electric	2	266,030	379,826
Microsoft Corp	3	220,339	333,054
Chevron Corp	4	205,039	197,061
AT&T Inc	5	200,152	252,051
Procter & Gamble	6	185,652	228,016
Johnson & Johnson	7	181,322	190,879
Intl Bus. Machines	8	162,798	190,879
Apple Inc	9	147,619	190,349
ConocoPhillips	10	145,592	183,068

The major decline in the Finance sector is reflected in the S&P 500 and its ten largest components. The energy and tech sectors count three members in the top ten, followed by one member of the telecom, health care, staples, industrials, and health care sector. It's been a long time since a finance company has not made the list.

*Better Days Are Coming*

The good news is that the second quarter will probably represent the bottom of the earnings cycle. Comparisons become much easier for the rest of the year and earnings growth should return to positive territory by the third or fourth quarter. Earnings are expected to post an 8% growth rate during the third quarter, but that comes with the caveat that analysts were estimating a 17% growth rate four months ago and an 11% growth rate just one week ago. No surprise, the drop in earnings estimates is coming from the Finance sector which is now expected to post a 28% decline.

## International Markets are Underperforming

2008 Returns			
<b>China</b>	-47%	Philippines	-28%
<b>Japan</b>	-15%	Australia	-23%
<b>India</b>	-28%	Argentina	-16%
<b>New Zealand</b>	-18%	Brazil	-13%
<b>Spain</b>	-25%	Sweden	-23%
<b>Germany</b>	-21%	Switzerland	-17%
<b>France</b>	-24%	Turkey	-22%

Proving that there are few places to hide these days, the global markets have underperformed the U.S. as economic growth slows around the world. Latin American markets were the most recent casualty as commodity prices appear to have peaked for this business cycle. Falling copper, cocoa, and lumber prices have hit Chile, Brazil, and other South American countries. Other foreign markets were simply overvalued and have fallen by their own sheer weight. The most obvious examples would include China, India, Russia, and most other emerging markets around the world.

## The Federal Reserve Meets Again

The Federal Reserve meets today and there are several reasons why we expect them to remain steady with short-term interest rates. For starters, it is nearly unheard of for the Fed to hike rates when unemployment is rising. The July labor report indicated a growing weakness in employment as the number of Americans who are unemployed or working a part-time job increased by 24% during the past twelve months. Secondly, inflation data has retreated during the past week as crude oil prices have dropped 15%, natural gas is down 33%, and agriculture prices have fallen by 14%. This takes the pressure off the Fed to raise rates in the face of higher inflation.

## The Bottom Line

While uncertainty remains high in the markets and economy, investors should not react to the daily events that have resulted in large swings in stock prices. However, completely ignoring your portfolio during uncertain times is not a prudent strategy for investors to make. Patience, diversification, and conviction will always be your best strategy regardless of the investment landscape. If you need assistance sticking to it, we are here to help.

### Robert Bugg – Principal and Chief Investment Officer

214-932-6696

### Neal Scott – Principal and Fixed Income Manager

214-932-6647

### Bill Leonard – Director of Client Relations

214-932-6855

### Suzie Begando – Portfolio Manager and Compliance

214-932-6712



Disclosure: The articles and opinions in this publication are for general information only, are subject to change, and are not intended to provide specific investment, legal, tax or other advice or recommendations for any individual. We suggest that you consult your attorney, accountant, tax or financial advisor with regard to your individual situation. Although information has been obtained from sources Brookmont believes to be reliable, we do not guarantee its accuracy and it may be incomplete or condensed. Brookmont is not liable for any typographical errors or incorrect data obtained from reliable sources of factual information. Any securities that are listed or described in this newsletter are: 1) Not insured by the FDIC 2) Subject to investment risks, including possible loss of the principal amount invested 3) And are not deposits or other obligations of, nor guaranteed by Brookmont Capital Management or our Custodian. Any security mentioned in this newsletter is for informational purposes only and is not intended to be a buy recommendation. This is a service notification for your benefit. This is not a marketing or advertising communication. Please be assured that we respect the privacy of our subscribers. To remove your name from future mailings, please reply to this message with UNSUBSCRIBE in the subject line.