

## An Update...

**W**e are pleased to announce a new face here at Hanson & Doremus. We changed our name back in January – that was a big deal – and now we have added Andy Bohlin as Assistant Portfolio Manager. Andy graduated from Middlebury College in 2005 and has been working in Boston with Keefe Bruyette & Woods, an investment banking group. Andy is a skier and hiker and the move to Vermont is a bit of a homecoming as Andy's wife's family lives in the Burlington area. Andy and Katie are in the

process of buying a house and settling in with their Swiss Mountain dog, 'Nui' (Tahitian for 'Big'). We are very happy to have Andy and we hope you meet him soon.

The rest of the staff remains the same. Anne and I are of course here and the first points of contact are still Deb (Healey) and Sven (Eklof). They can answer most questions and if they are not here you will get Kristen (Audy) or if all else fails, me! We look forward to your calls and to continuing to grow with you. Thank you.

### As the World Turns...

Investors are unusually nervous today. You don't need to be told this I am sure. We are getting a lot of calls along the lines, "Aren't we in for another big decline here?" We're more optimistic but let me explain.

It's natural to assume that after a big run up (March 2009 to March 2010 stock prices increased 70%) there is going to be a big correction. Add to this the fact that employment gains in the U.S. have been anemic and the housing crisis is still very much with us, and you get to a very depressed state (*see the consumer confidence numbers in the chart.*)

But there are positives to the story also. The global economy is recovering and we don't see the growth ending. The declining Euro is going to make European exporters a lot stronger and this will lessen some of the concerns about the weak members of the EU. The old adage still rings true - where you stand depends on where you sit. In the U.S. we are looking at a world through the lens of high unemployment, increasing delinquencies on mortgages and a budget deficit that is big and getting bigger. If you look at the world from Asia (see my comments on page 2) you get a completely



different take. Economies there are growing, trade is bouncing back sharply and the bigger issues are inflation and getting production out the door. And China? They are trying to slow things after a very successful stimulus program. Will they overshoot and cripple their own growth and the growth of the West? It could happen but they have a good track record and we are willing to bet their pragmatic, 'crossing the river by feeling the stones underfoot' strategy will work. We are still optimists on the global recovery.

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Hanson & Doremus Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.

### Stocks up, confidence down

The Standard & Poor's 500 rose 66.6 percent over the 52 weeks through March 5 - the largest 52-week gain for the index since the Great Depression. But U.S. consumer confidence remained at low levels. The table shows the eight previous cycles since 1968 when stocks climbed more than 35 percent, and the consumer confidence levels at the time.

52-WEEKS ENDED	GAIN IN THE S&P 500	U.S. CONSUMER CONFIDENCE LEVEL
March 5, '10	67%	46.0
March 5, '04	40	88.5
Sept. 3, '99	39	136.0
April 10, '98	51	137.2
Dec. 8, '95	38	99.2
Oct. 2, '87	40	115.7
June 17, '83	56	87.5
Oct. 3, '75	38	77.6
May 21, '71	40	82.3

# Is the Going Still Good? ...

**Quick, name a country that has not had a recession in 20 years? Let's see. It's not Iceland and it's probably not Greece. If you guessed Australia, have another Tooheys, mate. I took a business trip to Singapore recently and tacked on a visit to Australia. Australia is a blessed country today.** Thank you, China. The Chinese are importing everything that Australia has plenty of, from coal and iron ore, to cotton and wheat. Australia is the world's largest exporter



## Entrepot City

Singapore is the world's ultimate transshipment port. The city state sits at the very tip of Malaysia and at the entrance to the Malacca Straits. Every ship from Europe headed towards Asia goes right by Singapore. It is a major trade center, an enormous container port, a producer of its own goods and one of the biggest financial markets in Asia. Since independence in 1965 Singapore has been an exceptional growth story. Part of the reason is location, part is due to its hard-working people (approximately 70% Chinese, 20% Malay, and 10% Indian), and part the rules and regulations of the one party government. Singapore works incredibly well but as critics add, why shouldn't it, it is a civilized police state.

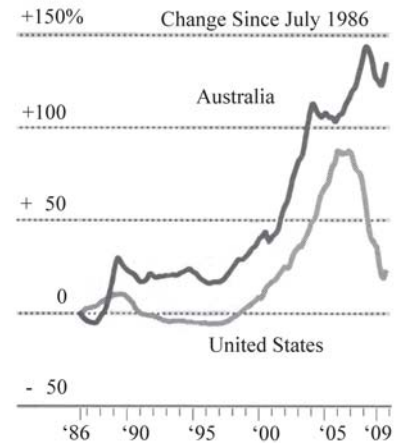
As a one party country Singapore can do things others can't. For instance when the government thinks the mix of business is too low end, they increase the minimum wage dramatically driving out whole industries. Today Singapore is focusing on high end sectors like biotech research and financial services.

Singapore grew 12% last quarter an almost unimaginable number compared to our 2-3%. Here in the U.S. we don't hear much about intra-Asian trade (Japan to Malaysia for

## Hot property

In contrast to the U.S. housing market, house prices in Australia were mostly unaffected by the global credit crunch.

House Prices Adjusted for inflation



Source: International Herald Tribune; Australian Bureau of Statistics

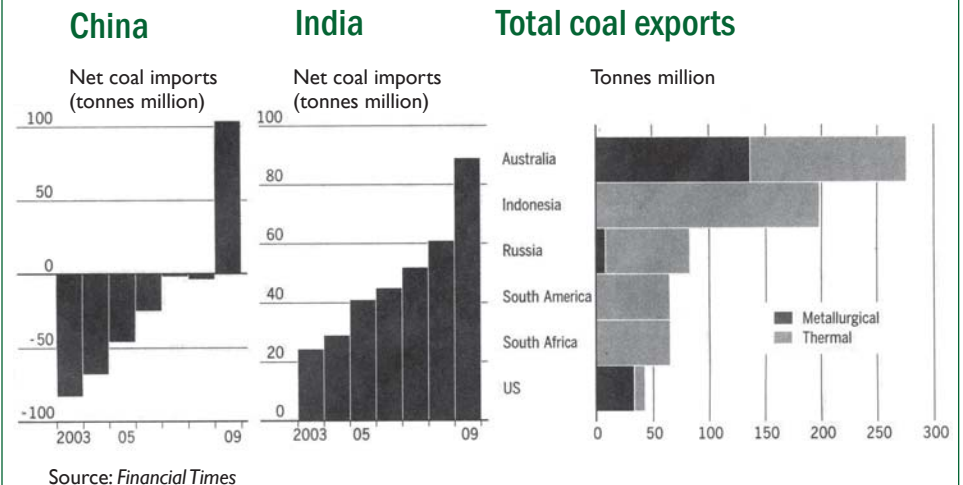
instance) but this is what is booming and Singapore is at the hub of this especially for South Asia and the India market. Funds management in Singapore is second only to Japan in Asia and the Singapore stock market has attracted 150 Chinese companies looking for an overseas listing. If you want to invest directly in non state owned Chinese companies, the best listings are in Singapore, Hong Kong and the Nasdaq here in the U.S. The going is still good in Asia.

of coal and China produces 70% of its electricity from this source.

The big drawback is that Australia is expensive now. The Australian dollar has appreciated more than 25% against the U.S. dollar the past year. The reason is obvious, the economy is hot and the housing boom knows no end. Interest rates have been raised six times since last October in an attempt to cool the economy. We would kill for some of these problems.

Sydney has to be one of the most beautiful ocean side cities in the world. The stunning Opera House lives up to its reputation and the bays, beaches and nearby mountains are a wonder. Well worth the trip.

## Nice Work If You Can Get It



# Here Be the Future...

**I realize we write a fair bit about emerging markets and it may get somewhat tedious but this is really where we see the future. It is estimated that the share of global GDP (at purchasing power parity) in emerging markets has gone from 36% in 1980 to 45% in 2008 and is on its way to 51% by 2014.**

*The Economist* recently did two long pieces on emerging markets, one on innovation and one on emerging market banking.

## The tops

Emerging-market banks and Western banks with an emerging-market presence  
As of April 28th 2010

Bank	Market cap, \$bn	Global rank	Country
Industrial and Commercial Bank of China	226	1	China
China Construction Bank	187	2	China
H S B C	176	5	Britain
Bank of China	145	7	China
Citigroup	126	8	US
Santander	98	9	Spain
Itaú Unibanco	84	11	Brazil
Sberbank	58	20	Russia
Bradesco	54	24	Brazil
Standard Chartered	54	25	Britain
Bank of Communications	53	26	China
UniCredit	50	29	Italy
B B V A	47	32	Spain
China Merchants Bank	45	33	China
Banco do Brasil	42	34	Brazil
Al Rajhi Bank	33	43	S. Arabia
State Bank of India	32	44	India
China CITIC Bank	32	45	China
VTB Bank	27	48	Russia
Shanghai Pudong Development Bank	26	50	China
DBS Group	25	53	Singapore
Standard Bank	23	54	S. Africa
ICICI Bank	23	55	India
China Minsheng Banking	22	57	China
United Overseas Bank	22	58	Singapore

Source: *The Economist*

In the 'old' days say twenty years ago it was thought that western multinationals would be the big winners in emerging markets. We would develop exciting new products here, dumb them down a bit to cut costs and sell zillions to China, India, Brazil, etc. It was also thought that the largest companies in the emerging world were way overextended. A consumer company there might also

be in pharmaceuticals while at the same time running a bank. The thinking was these companies were just setting themselves up for failure.

Well conventional wisdom has not rung exactly true. Western companies have benefitted from the emerging world but much of the best innovation today is coming from over there, not over here. In medical equipment GE has had to take lessons from the Chinese in how to make inexpensive but still good electrocardiogram machines (ECG) for under \$1,000. Western companies are setting up big R&D centers in Asia as a way to tag along with emerging market developments. Jeff Immelt the GE chief calls this 'reverse innovation.'

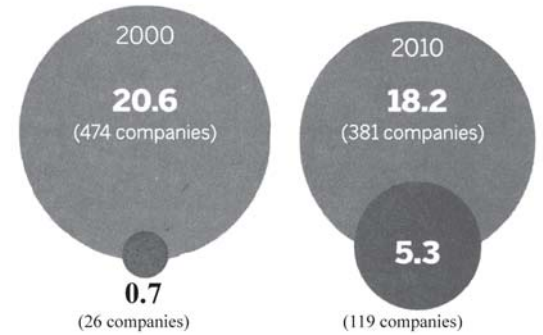
On the question of emerging market conglomerates they have generally succeeded so far but the jury is still out. Some like Samsung have done great but Lenovo the Chinese computer company which bought IBM's laptop business has had its ups and downs. Management quality and depth is going to be the Holy Grail for every emerging market company large and small going forward. This is where analysts really need to spend their time.

In most of the world today things are changing at lightning speed. Not so in emerging market banking. Local banks have plenty of business in their own backyard and they will not soon be going on the global stage. Western banks on the other hand if they aren't already in emerging markets will find it difficult to get there (read: the locals will eat their lunch.) As the head of HSBC investment bank said recently, "you

## The pendulum swings

Market capitalization of FT400 companies (\$'000bn)

● Developed country companies ● Emerging market companies



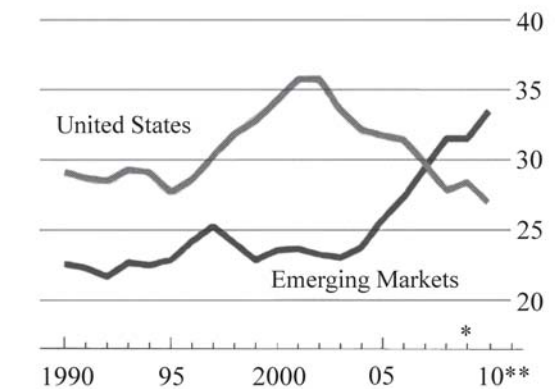
Source: *Financial Times*

kind of needed to think about this (expansion into emerging markets) thirty years ago."

The global banks that are strong in the emerging world are in a unique position. The four big ones are HSBC, Citigroup, Santander and Standard Chartered. Citigroup is a very interesting case. Investors are focusing on the bank's U.S. problems (not insignificant) but very little on its enormous power in the emerging world from Mexico to Asia to Africa. Investors may be missing a diamond in the rough here. Santander a Spanish bank has so integrated itself in a number of South American countries that it has in effect, 'gone native' as *The Economist* says. Interesting opportunities.

## Consumers of first resort

Consumer spending, % of world total



Source: *The Economist*

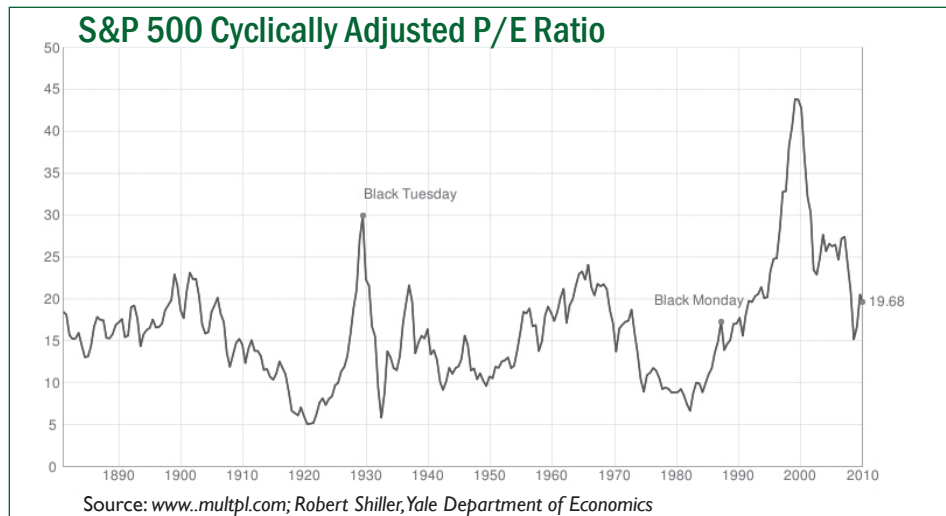
\*Estimate \*\*Forecast

# Retirement Planning Revisited...

**T**oday's generation of investors has been schooled to believe that stocks produce inflation beating returns over the long term. And while the rebound in stock prices over the last twelve months has been impressive, longer term results have not been. Ten year returns on the S&P recently fell into negative territory. Will stocks continue to provide the high octane returns investors need to achieve a secure retirement?

From 1926-2009, large company stocks produced a 9.8% average annual return. But this is an incredibly long period of time and most investors looking to fund retirement or a college education have much less time to accumulate funds. For more relevant data, take a look at the chart below. From 1926-2009, there were 75 overlapping 10 year periods and in 71 of these, large company stocks produced positive compound annual returns. More importantly, in 84% of those periods either small or large company stocks beat out the returns offered by bonds and cash.

Cynics among us would respond to this data by saying, "yeah, but this time is different." There are many reasons to believe that U.S. stock returns over the next 5-10 years may indeed be below long-term historic levels. Future stock returns will be driven by corporate profits and valuation levels. Corporations have done an excellent job repairing profitability



over the last year but future gains will be harder to come by as consumers and the government pay down their historically high debt burdens. And as the chart on stock valuation (P/E levels) above shows, stocks are not particularly cheap today. Finally, historically about half of stock's returns have come from dividends and today the 1.9% yield on the S&P 500 is quite low by historic standards.

Despite the muted outlook for stock returns, I would avoid the temptation to dump them in favor of bonds, cash or some other asset class. Why? Historically, the best time to buy an investment is after a period of underperformance. And as the data shows, investors who hold stocks for 10 or 20 years have the odds decidedly in their favor. Second, while the outlook for stocks appears less than rosy, the likelihood for rising interest rates also tempers the outlook for the most obvious alternative, bonds.

So what is an investor to do in the current environment? Below are a few retirement planning tips.

**Stick to a long-term strategy.** While the idea of selling at the top and buying at the bottom remains alluring, volumes of studies have shown the limited success

of this market timing approach. The most recent one in the *Journal of Financial Economics* tracked the flow of funds into and out of mutual funds. This work by Avi Wohl, Azi Ben-Rephael and Shmuel Kandel found that as the stock market rises, investors tend to transfer money from bond funds to stocks funds. Further, the study showed that an investment strategy that bought stocks when the average mutual fund investor sold and sold stocks when they bought actually outperformed a standard buy and hold approach.

**Take advantage of growth outside the U.S.** While economic growth prospects here at home look anemic, there are plenty of areas of the world that are going gangbusters. Over half of the market value of stocks in the world today trade outside our borders. Avoid the "home bias" temptation and take advantage of opportunities in faster growing developing economies.

**Remember to control what you can – SAVE!** Many of the factors that drive asset class returns, such as the future level of economic growth or the direction of interest rates, remain unknown. But investors can control one of the most powerful factors determining their future financial security and that is the amount of money they salt away. Developing a diversified, long-term investment strategy and staying focused on what you can control will greatly enhance your chances of achieving a financially secure retirement.

## Compound Annual Returns For Stocks over 1, 5, 10 and 20 Year Holding Periods (1926-2009)



Source: Hanson & Doremus; Morningstar Ibbotson S&P Yearbook