

Gaining Perspective Market Insights from Cadence Capital Management

Potential Silver Linings in the Current Turmoil

10/01/2008—Cadence Capital's Bill Bannick shares his views on the long-term prospects for domestic growth stocks.



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Credit crisis could stall main driver of growth

The fundamental worry during this dramatic and emotional time is the possible feedback effect of the credit crisis on the global economy. There is an immediate need for ample infusions of credit to keep the machinery moving. With consumer spending likely to be constrained, corporate earnings are expected to suffer. As a result, estimates are probably too high for 2009.

Another impact on business will come from the curtailment of leverage, which will decrease return on equity. Going forward, however, less leverage will make balance sheets healthier and should ultimately boost profits.

Possible surprises to the upside

The deep pessimism currently roiling U.S. stock markets suggests that we may be nearing a trough, creating favorable conditions for future returns.

- The sharp falloff in stock prices has lessened re-entry risks considerably.
- P/E ratios have come down quite a bit, uncovering potential value for earnings-focused, bottom-up stock pickers.
- Real returns for the S&P 500 Index are well below long-term historical norms.
- The U.S. dollar should benefit from slowing global growth.
- With leverage generally off the table, long-only portfolios may be the asset class surprise.

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Allocation strategies stand firm

History has demonstrated that it's a mistake to alter one's investment strategy based on brief distortions in the market, no matter how dramatic. As earnings are revised downward, a focus on earnings growth, upward revisions and valuations should prove beneficial to investors.

Expectations for the following sectors continue to appear attractive:

- Information technology, particularly large providers of hardware and services.
- Healthcare companies focused on innovation, such as biotechnology and medical technology.
- Global infrastructure, taking advantage of growth in China and elsewhere.
- Energy producers, which will continue to benefit from high global demand. In Cadence's view, the current headwind for energy stocks reflects a cyclical pause in a secular upturn.

U.S. growth stocks poised for a turnaround

To all appearances, domestic growth stocks may be the market's most shunned asset class: the 10-year annualized return for the Russell 1000 Growth Index as of June 30 was under 1%. That's sharply out of line with its historical returns of 9% or 10%. As investors' appetites for risk—particularly levered risk—diminishes, however, the appeal of good-quality growth companies should be restored.

We are without a doubt witnessing extraordinary events, but Cadence believes that market shocks must be put into their proper context. Markets have a tendency to correct every decade or so. While declines are painful to experience, they have also been opportune times for disciplined investors.