

INVESTMENT THEMES FOR A CHANGING INVESTMENT ENVIRONMENT

Looking forward, there is a good chance that the rate of long-term economic growth of developed nations will slow to levels less than we have witnessed over the last several decades. As populations in these countries age, there will be a reduced rate of savings and a slowing growth of the labor force. Increased taxes will be required to cover massive government deficits and the rising liabilities of social security, government sponsored health plans and state and local pension funds. This, coupled with the high level of consumer and sovereign debt, could result in lower levels of consumption and hence lower economic growth. However, we think stock prices have largely adjusted to this new environment and there will continue to be areas of attractive investment opportunities. In order to help us identify these opportunities we have developed seven longer term investment themes with areas of anticipated above average growth and investment attraction. These investment themes are expected to persist for some time and are outlined below.

Evolution of Emerging Economies

Global economic growth will continue to shift away from the west and towards the south and east, as an increasingly educated workforce and a coordinated pattern of favorable government policies spur commerce and result in rising living standards. Younger populations and increased labor force participation due in part to large-scale migrations from rural areas to urban centers will also contribute to sustainably stronger output and demand growth in many emerging economies relative to developed ones. As these emerging economies grow, the purchasing power of their burgeoning middle class will rise. Western consumer product companies that establish a presence in these developing countries will enjoy strong demand as the emerging middle class desires branded products.

Global Infrastructure

The development of infrastructure to support emerging economies as well as the need to maintain and improve infrastructure in developed economies will drive significant investment spending in coming years. Transportation, energy, telecommunications, housing, and water/sewer infrastructure spending will significantly increase. Improving the quality and supply of clean water will also be an ongoing global need as will be the project management and financing expertise to complete these improvements to the infrastructure.

Energy

Energy continues to be an important component in economic growth. Producers of fossil fuels will benefit from increasing global demand as will sources of energy alternatives including nuclear, solar, wind, and bio-fuels. Recent events in the Gulf illustrate the need for technology driven improvements in energy exploration, production and refining for better safety in addition to maximum yield. Energy efficient materials, energy efficient products, and the management of energy distribution will continue to grow in importance and opportunity.

Demographics

Aging populations in the developing world including the U.S., Europe and Japan will provide both economic challenges and investment opportunities. Countries with aging populations tend to have lower productivity growth and a propensity for asset deflation. The primary challenge will be meeting their commitment to provide healthcare and retirement benefits. Investment opportunities will arise from new consumer products and services; changes in information delivery; technologies that improve manufacturing processes; and new medical services, treatments, and technologies.

Digital Distribution Platforms

Global technology will continue to advance at a rapid pace. The continued development of broadband technologies will further change how, when, and where data will be stored, retrieved, and communicated. Smartphones with strong browsers and processors are enabling increasingly sophisticated applications to mobile platforms. Mobile search is the next growth driver for the Internet as the mobile installed base is larger than the PC installed base. Consumer behavior is changing and accessing the Internet via a mobile device is becoming a frequent activity. We are seeing evidence that increasing mobile browsing activity will spur the entire Internet, including search, eCommerce, payments, travel services, online financial services, subscription services and even restaurant information, which should provide greater advertiser demand on mobile devices.

Large High Quality Global Stocks

Large, high quality stocks have underperformed the general market over the last eight to ten years. Many mutual funds, hedge funds, pension funds, and endowment funds have reduced their holdings of quality companies and emphasized riskier assets. Ten years ago, quality companies such as Microsoft and Walmart sold at over thirty times estimated earnings. Today many of the same companies sell at under 12.5 times earnings. Larger multinational companies with strong balance sheets, good cash flows, solid earnings, and global growth prospects are expected to outperform as they return to more “normal” valuations.

High Yield Equity

Historically, dividends have provided a significant portion of the return on equities. Our focus is on companies that have a greater chance of consistently increasing their dividend payment. In addition, companies with a solid income component will help reduce the volatility of the equity portion of an investment portfolio.

✧ September 2010 ✧

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