

MARKET SNAPSHOT

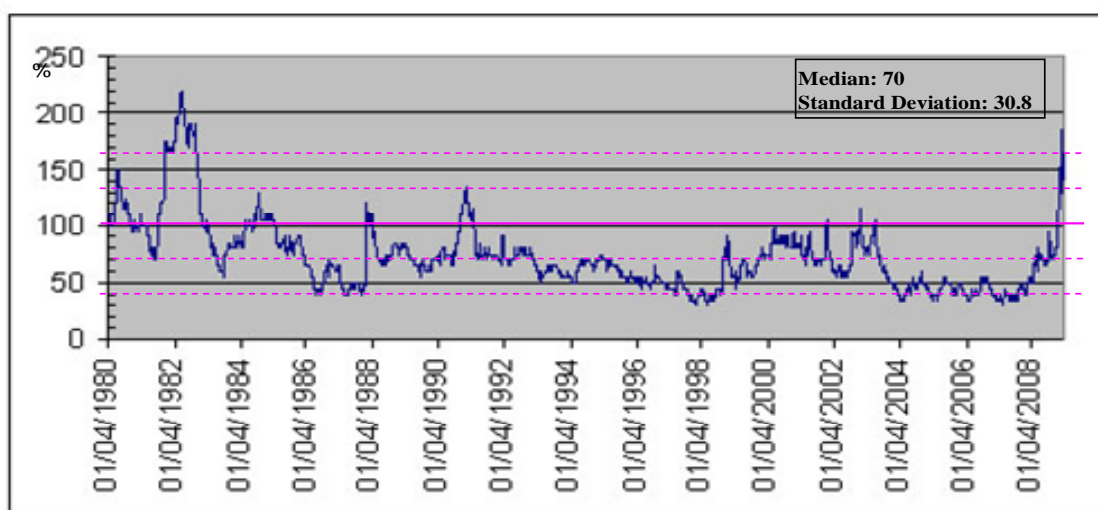
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The Line on Value in *Value Line*

January 5, 2009

Each week, the *Value Line* service provides an estimate of the 3-5 year upside potential for the average company in its 1700 stock universe. Generally speaking, a stock market that has been in a bull market phase for 3-4 years may generate numbers in the 30-40% range. These are consistent with a market where the average stock has more limited upside potential. Readings in this range may last for several years, so they are not very helpful as a timing tool for market peaks.



Note: The data reflects the median potential by which Value Line's analysts expect the 1,700 stocks they analyze to rise over the next three to five years. Solid line represents the median value, the dotted lines represent standard deviation. This is not a projection of any specific stock. Stock investments involve risk of loss.

Source: Value Line. Used with permission. Data as of December 2008.

As the chart above shows, there have been several occasions when the *Value Line* projections have reached very high levels. In 1982, according to *Value Line*, the average stock had the ability to triple (200%) in the next 3-5 years. In December 2008, the *Value Line* estimate reached 185%, one of the highest figures on record.

There are major contrasts between the early 1980's and now. In 1982, interest rates were sky-high and Fed Chairman Paul Volcker was on a mission to rein in inflation. With high interest rates, P/E ratios were correspondingly low. The *Value Line* estimates back then correctly predicted that when interest rates came down, P/E ratios would begin to expand. When this was coupled with improving corporate profits, stock market appreciation was outstanding. The combination of expanding P/E ratios and rising corporate profits presents a dynamic environment for common stocks.

Currently, interest rates are at historically low levels and unlike the early 1980's, we may see negative CPI (Consumer Price Index) numbers in the months ahead. If this happens, this will be the first time since the early 1950's when

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inflation, as measured by the CPI, registers negative numbers. A recent headline in the Wall Street Journal heralded a successful auction of 3-month U.S. Treasury Bills at a 0% rate! This reflects investors' fears as well as the fact that, for the next few quarters, inflation is not likely to be a problem.

Because of these factors, stocks are not as statistically cheap as in 1982 but they have come down a long way from their highs in 2007-2008. The *Value Line* estimate, in December, is the second highest on record and only the second time an estimate has exceeded the mean of "70" by more than 2 standard deviations. In laymen's terms, this is a rare event.

We believe the *Value Line* estimate is another in the "weight of evidence" factors we have discussed in recent pieces suggesting the stock market is in a bottoming process. This bottoming process has taken as little as 2 months (1974 and 1987) and as long as 7½ months (July 2002-mid-March, 2003). Once a major market bottom is in place, the stock market has been substantially higher six-months and one-year later.

It is important to remember that the stock market, in early January 2009, will be discounting the news that eventually will be reported in the Wall Street Journal and other leading publications between June and September of this year. The *Value Line* estimates are another reason why many investors should be looking with renewed interest at high grade common stocks early in the year.

Our own belief is that large-cap common stocks will outperform real estate, bonds, gold, and collectibles over the next 3-5 years. Although 2009 may be a year where deflationary influences predominate, the unprecedented growth in the Federal Reserve balance sheet and the world's money supply suggests that there will be a distinct inflationary bias between 2010 and 2015. Many stocks should do well in this environment including natural resources companies, whose shares have fallen more than 50% from highs reached, in many cases, at mid-year 2008!

John G. Goode

January 5, 2009

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