



2010 Forecast

The economic recovery continues to accelerate. The private sector finally stopped cutting jobs and started adding to payrolls. We are in the very early stages of an economic upswing. 2010 should see above average economic growth and above average performance for stocks.

Performance

For the three months ending March 31st, the growth accounts under the management of Barden Capital were up about five and a half percent, almost matching the performance of the S&P 500, which was up about 6 percent. During periods of fast-rising markets we will tend to lag somewhat due to the multi-asset class composition of the portfolios. In quickly appreciating markets, less risky assets like treasury bills and corporate bonds act as a drag on performance.

For the last twelve months, the growth accounts are up more than 45%. Since Barden Capital's inception in November, 2006, the growth accounts have outperformed the S&P 500 by 3% a year on average with lower volatility.

Corporate Profits

The market looks as far out as it can see. It's not the change in expectation on near term earnings that drives stock prices, but it's the change in expectations on earnings 12 and 24 months out that has the most impact on stock prices. Over the last 22 years, investors have valued the market at 17.6 times forward earnings, on average. Valuation has ranged as high as 28 times forward earnings during the dot-com boom, and as low as 10.8 times during the credit crisis of 2008-9.

Today, investors value the market at 15.2 times earnings, a little low by historic standards, but these are obviously not ordinary times. Multiple expansions tend to coincide with increased investor confidence. As the market recovery matures, it's likely that the multiple will increase to at least 17 times earnings, likely peaking somewhere around 20 times earnings.

Regardless of how confidence plays out, the earnings component of the valuation equation continues to improve. At the end of 2009, analysts anticipated \$84 in 2011 earnings for the S&P 500. Now, just three months later, analysts are projecting S&P 500 earnings of \$91, an all time high. At the conservative 15.2 times earnings, the current estimate implies a year-end price target for the S&P 500 of 1383, or an additional 17% appreciation from today's levels.

The high water mark for S&P 500 earnings was \$88 in 2006. If the S&P 500 sets a new high for earnings, stocks will likely set a new high as well. My guess is that the S&P 500 will exceed 1500 sometime within the next 18 months.

Market Strategy

Large, high-quality growth stocks continue to lag small low-quality stocks. This is typical coming out of a bear market, but what is unusual is the size of the performance disparity. Eventually, this disparity will reverse, and high quality stocks will outperform, but the timing of this shift is unknowable. It appeared that the Greek debt crisis might start a run to quality, but now European debt problems are only simmering rather than boiling over.

I'm reluctant to chase low quality stocks that are outperforming. We have a portfolio of undervalued companies with strong quality characteristics like low debt and strong cash flows. This prevents us from matching the gains of the most aggressive strategies. But, we are pursuing a course that will yield stout gains through strong earnings growth while limiting our risk by owning high quality companies.

Economic Outlook

The stock market is a leading indicator of the overall economy. Now that the first year of the new bull market is behind us, we can get a sense of the potential of the impending economic recovery. From the low on March 9th, the S&P 500 was up 68% over the next year. That makes this the best first year of a bull market performance since the 1930s. Given the severity of the economic downturn, it's quite likely, that we are setting up for the strongest economic expansion since the end of the Depression.

Inflation

Core inflation continues to gradually decline in spite of higher energy costs. High unemployment precludes any significant wage increases, which is a requirement for runaway inflation. A strengthening dollar also mitigates the risk of inflation. Even though many observers stress the risk of deficit spending, the nearly unprecedented increase in private savings has so far more than offset the increase in government spending.

Unemployment

The private sector finally stopped cutting jobs and started adding to payrolls. The most optimistic economists are forecasting as many as 300,000 new jobs a month for the rest of the year. But, the economy needs to add approximately 3,000,000 jobs just to reduce the rate of unemployment by 1%. To reach what economists consider full employment (5% unemployment) the economy needs to create about 15 million jobs. Assuming the optimists are right, it will still take the economy more than four years to get back to full employment levels. This is a simple estimate for the expected duration of the current economic recovery.

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The Standard & Poor's 500 Index (S&P 500) is an unmanaged capitalization-weighted index based on the average weighted performance of 500 widely held common stocks. BCM Returns are based on a size-weighted composite of all BCM accounts under management at the end of the period.