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# The Hardest Trade

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March 2010



# Equities are the Hardest Trade

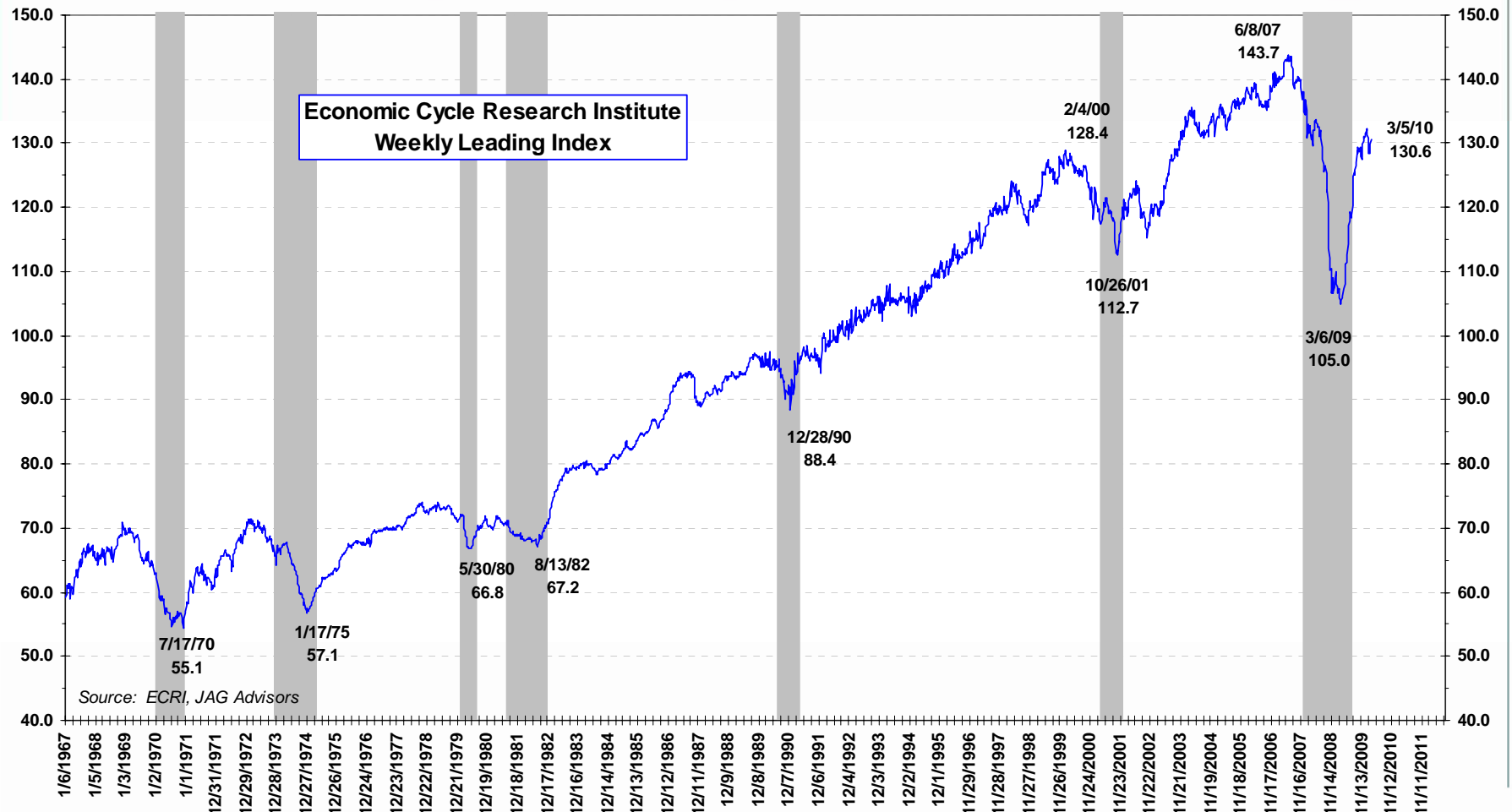
- Disconnect between Main Street and Wall Street has built a Wall of Worry
  - Macroeconomic backdrop is mixed
  - Unemployment/underemployment stats remain uninspiring
  - Retail investors crowded into “safety” side of the asset boat
- But...
  - Equities deserve an allocation in investor portfolios
    - Valuation
    - Mean Reversion
    - BRTRO (Best Relative Total Return Opportunity) versus other financial asset classes
- And...
  - Growth is Cheap relative to Value
  - Large Caps are Cheap relative to Small Caps
- ...Finally
  - JAG Large Cap Growth positioning



# Macro Environment is Mixed

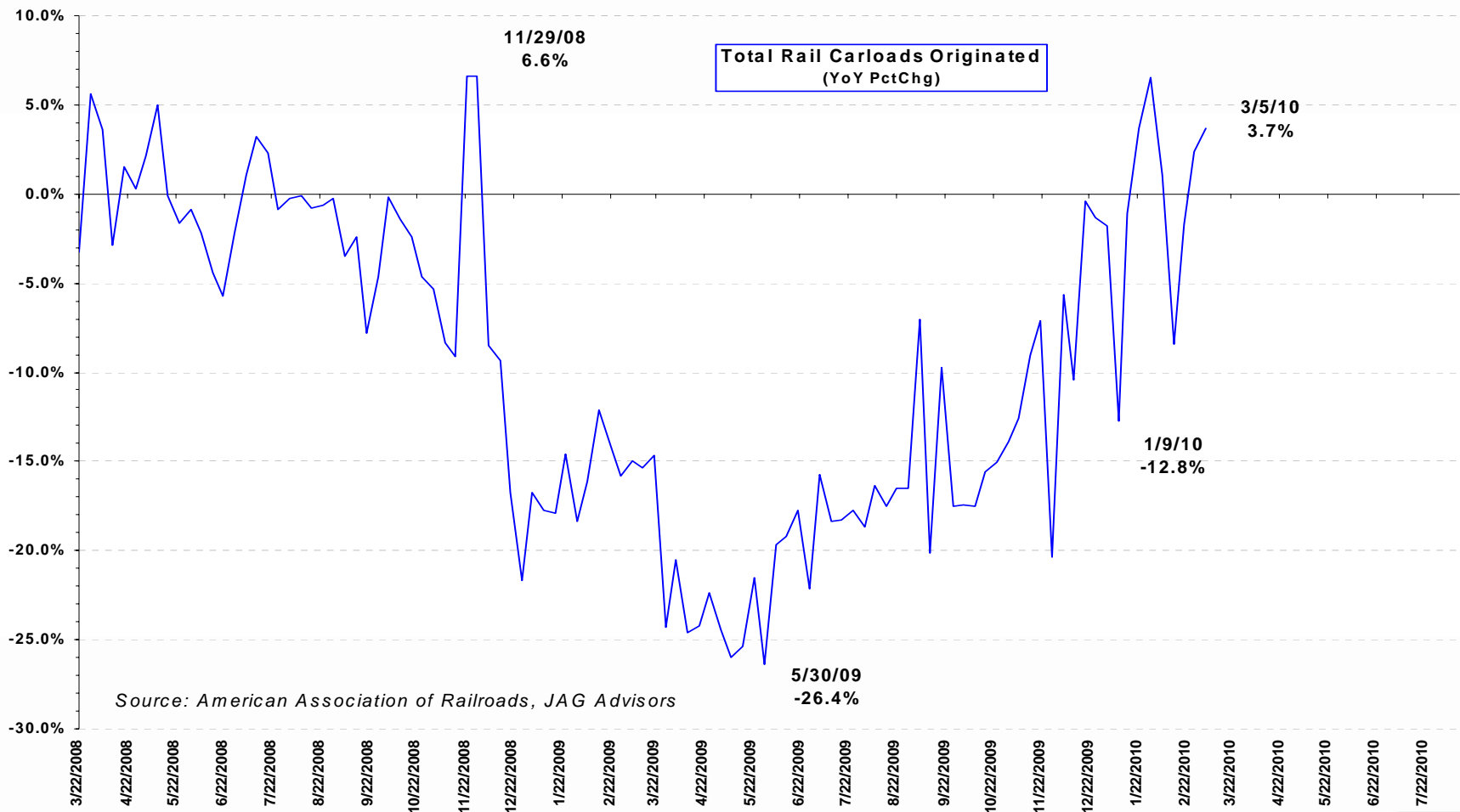


# ECRI Weekly Hovering Near Recovery Highs



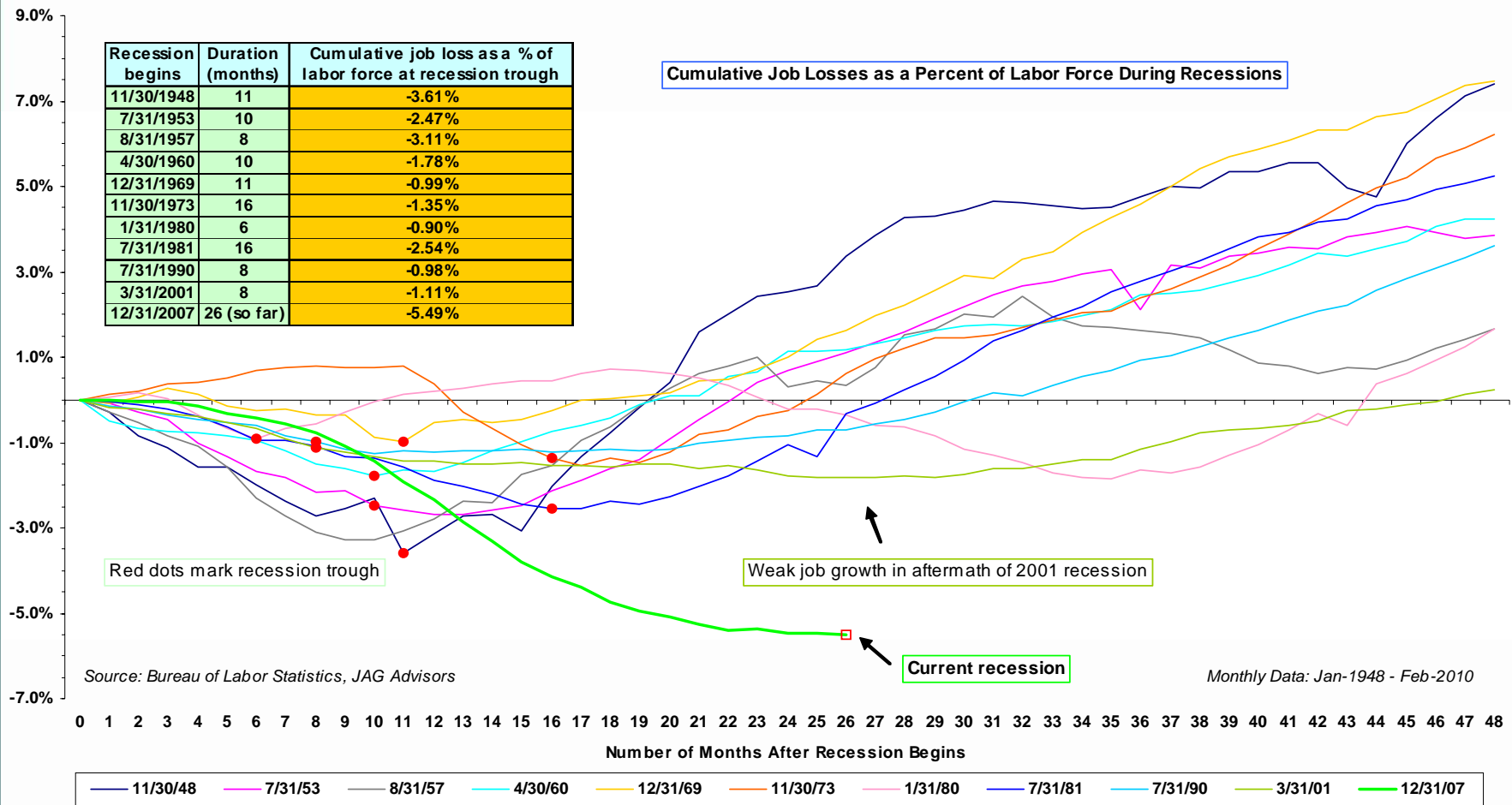
Nothing in this presentation is intended as an offer or a recommendation to purchase or sell securities.

# Year-over-Year Rail Carloads Recovering (Finally)



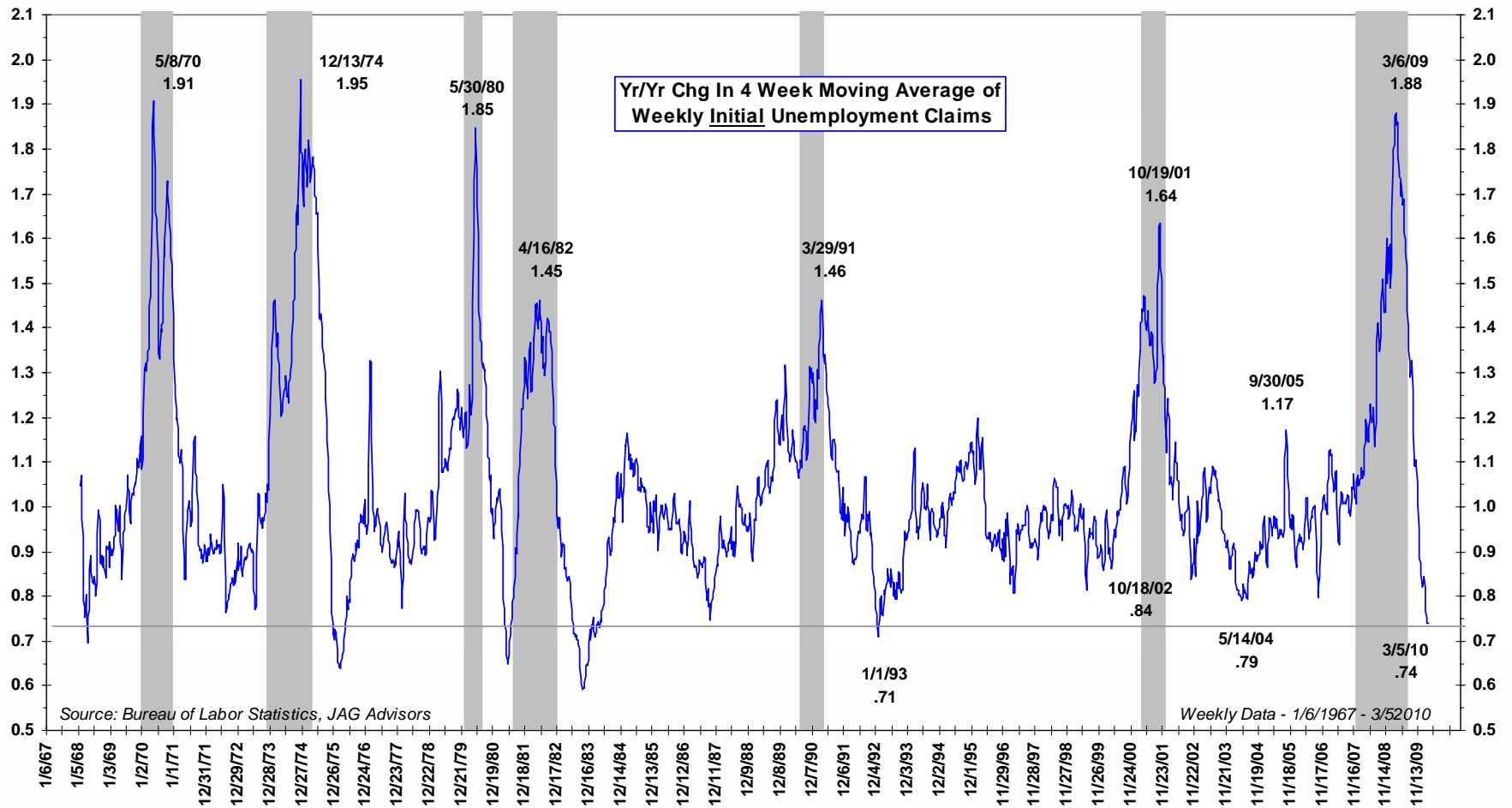
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# Job Losses are Worst in Post-War Era



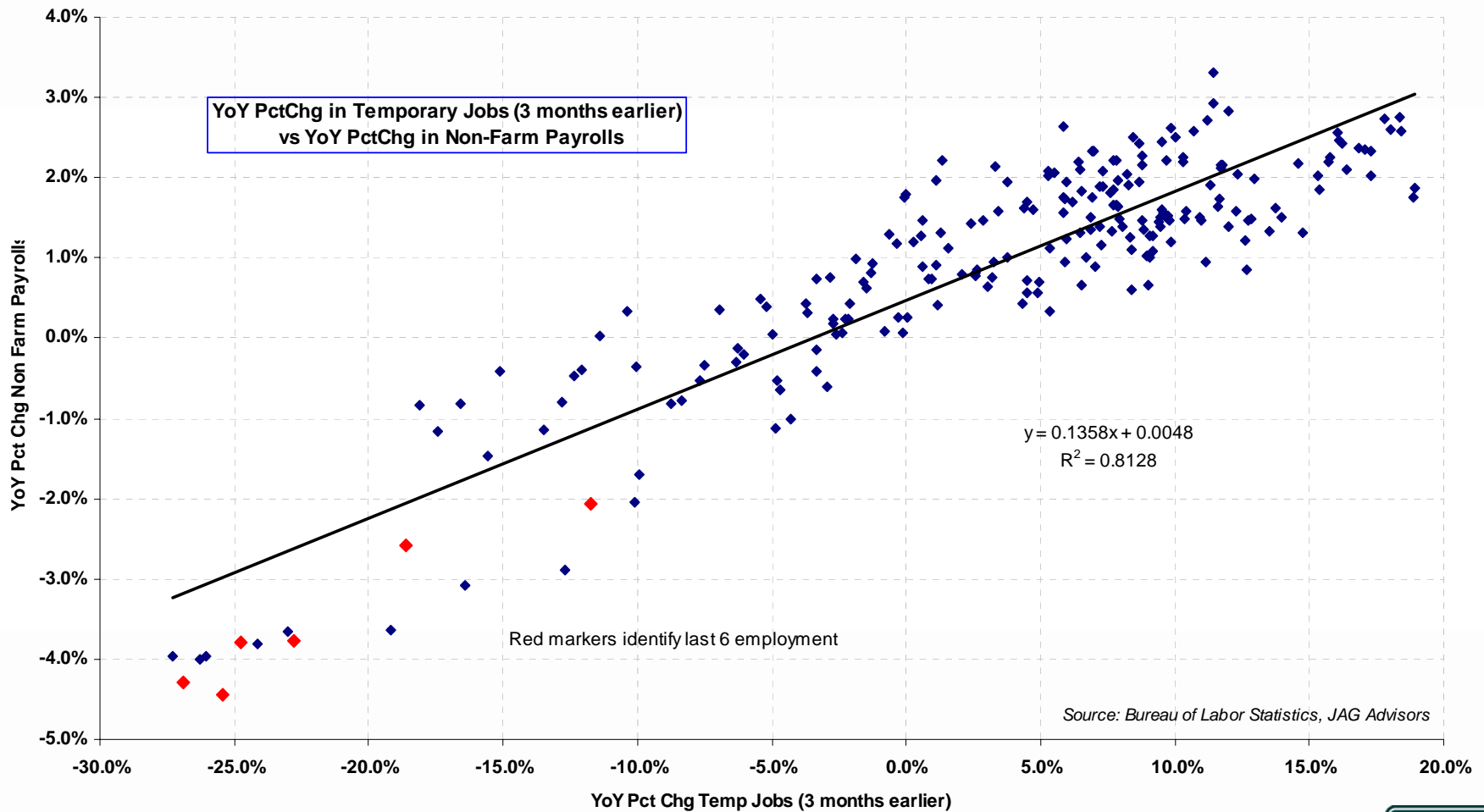
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# ...But YOY Change In Initial Unemployment is “Less Bad”

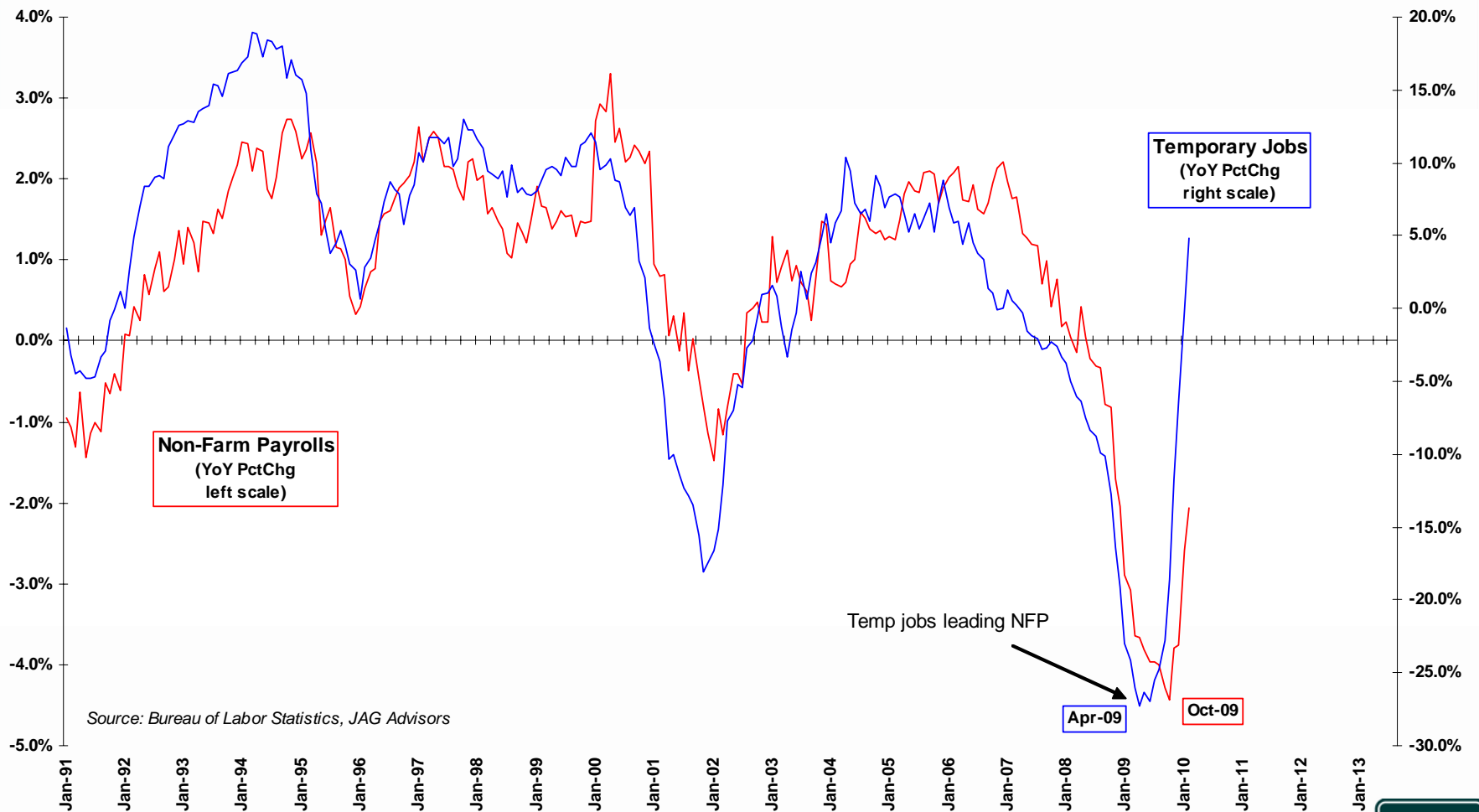


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# Note That Temporary Hiring Leads Non-Farm Payrolls



# Rise In Temp Jobs Point To Continued NFP Gains

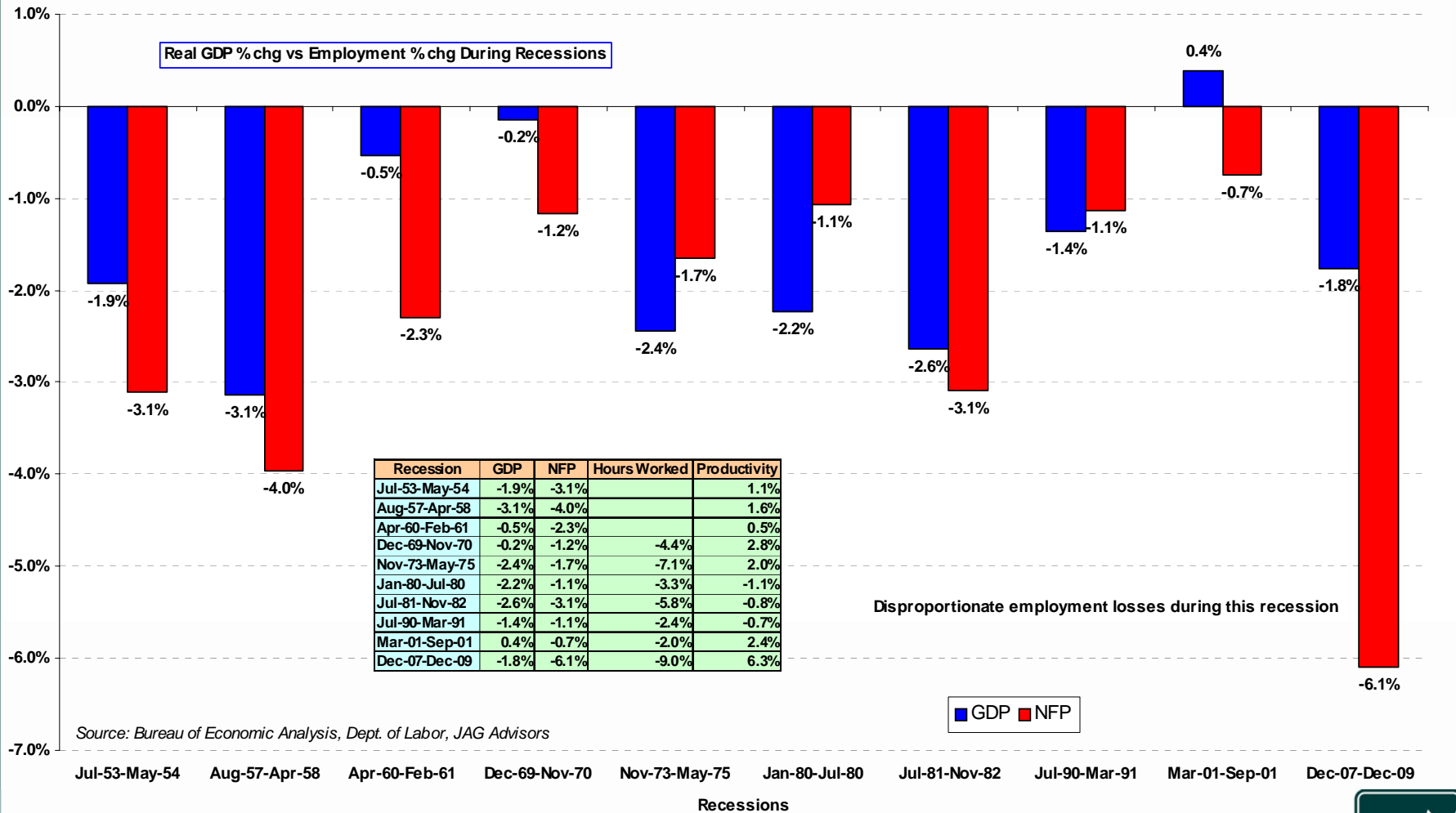


Source: Bureau of Labor Statistics, JAG Advisors

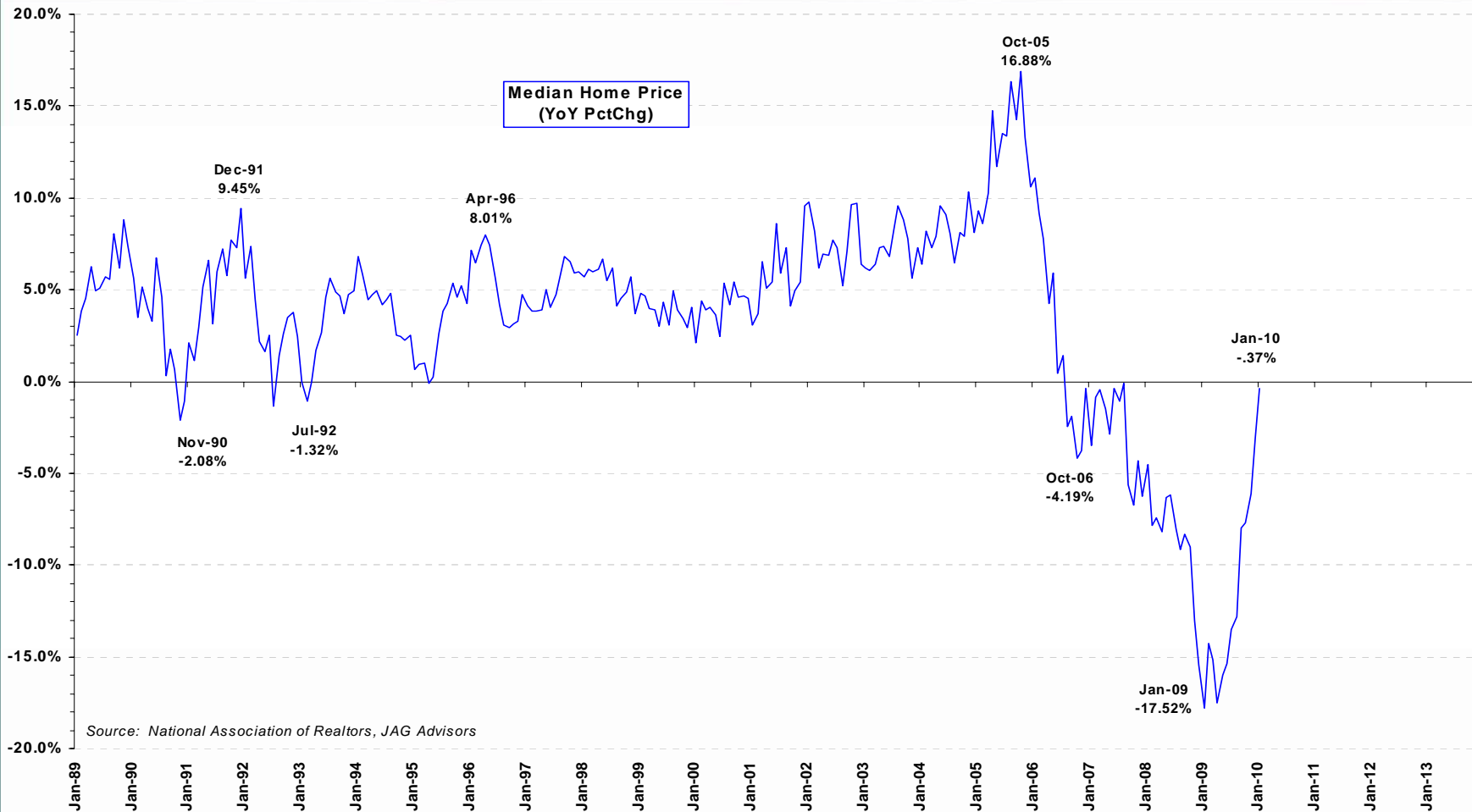


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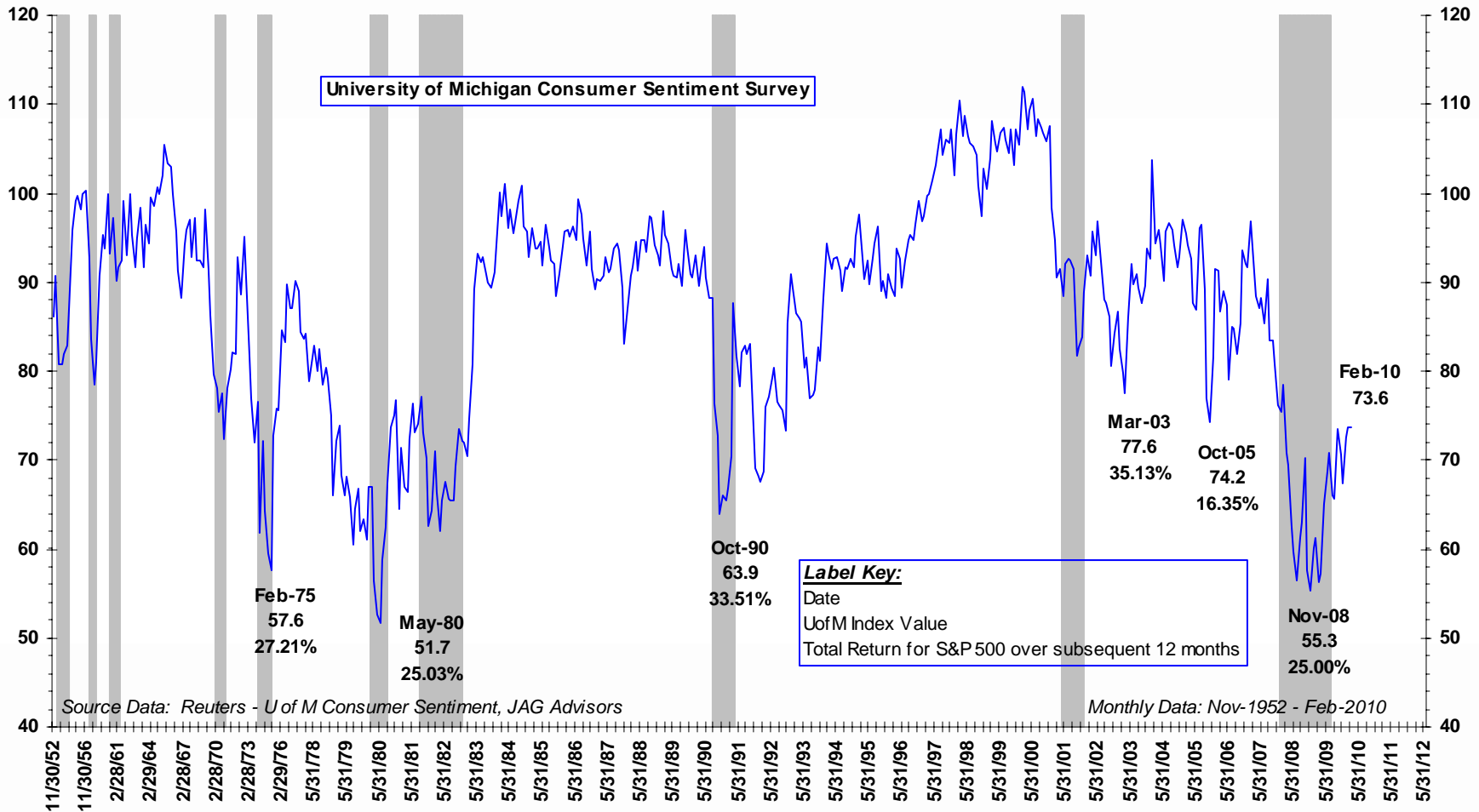
# ...Probably Because Employers Panicked in '08-'09!



# Glimmers of Good News in Residential Real Estate



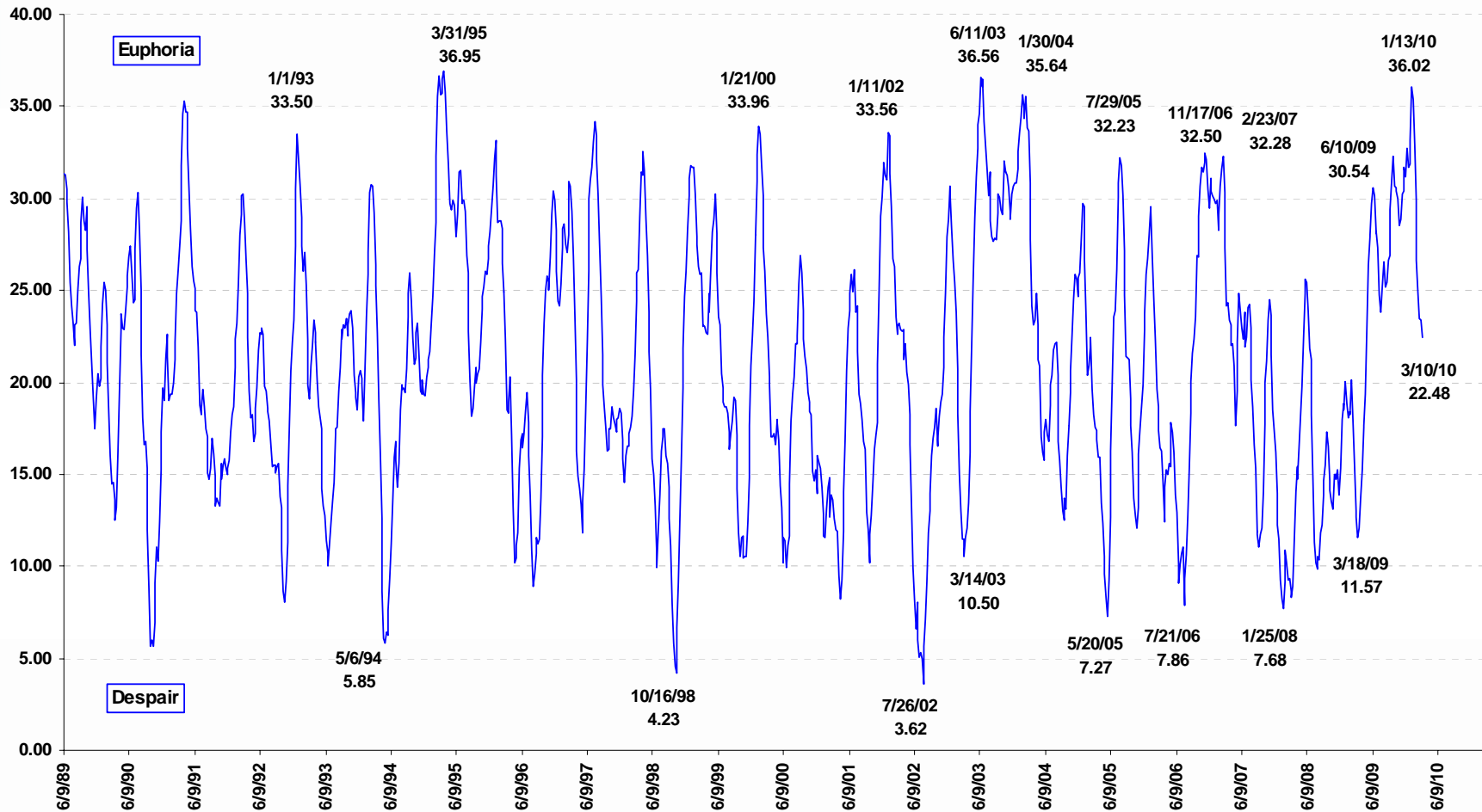
# Consumer Sentiment Trough Bodes Well for Equities



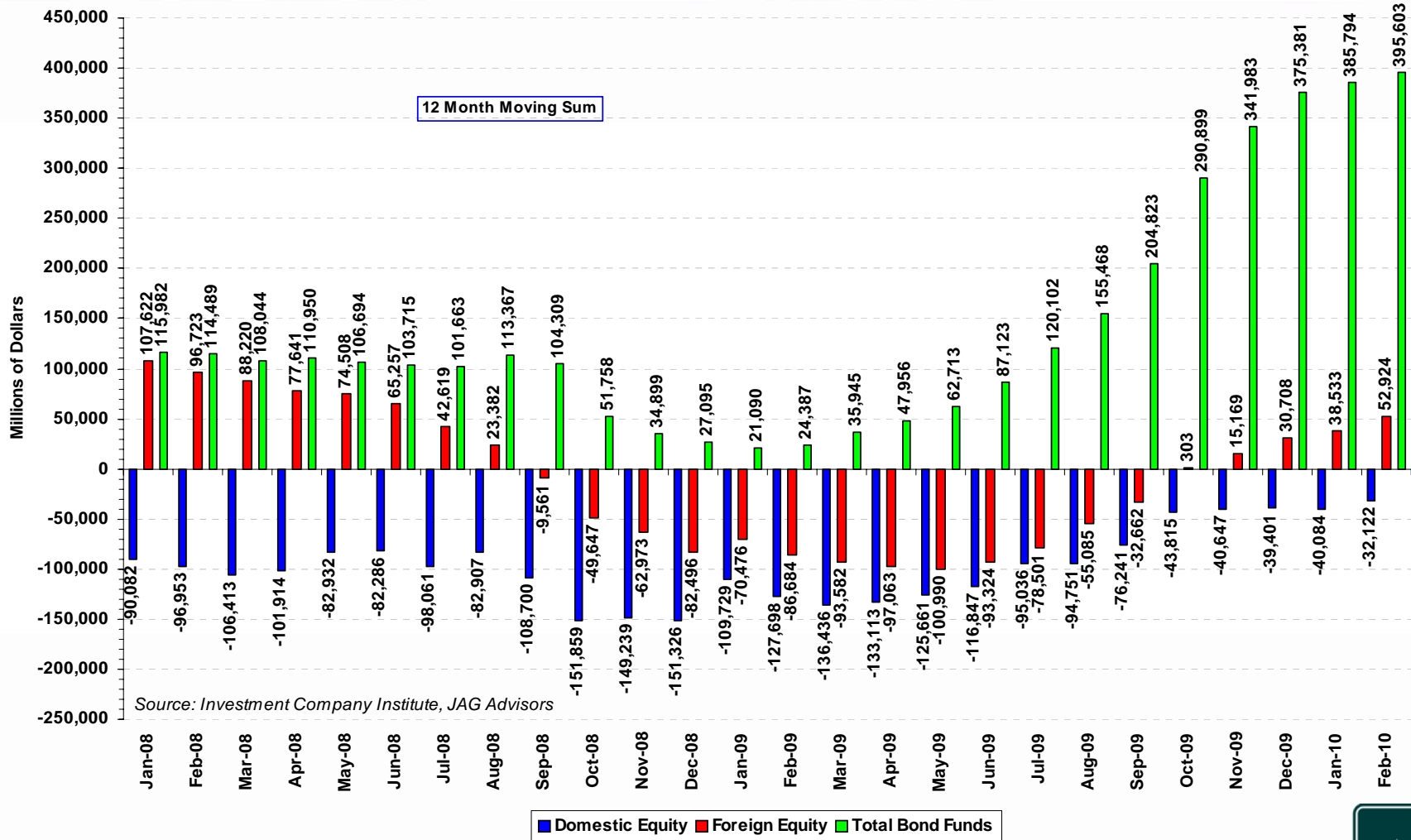
# Sentiment



# 10 Week Sum Sentiment Index



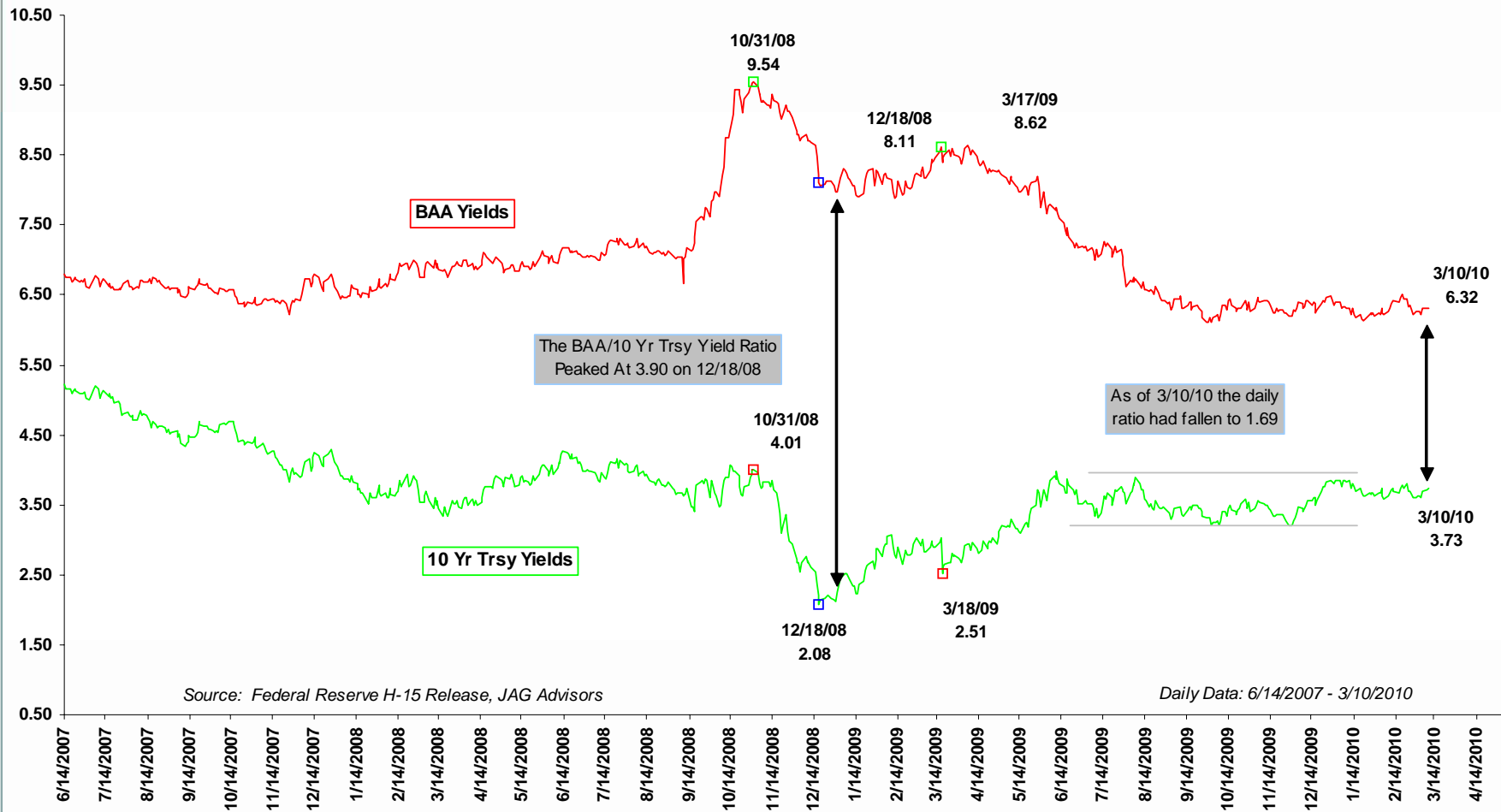
# This is What a “Flight to Safety” Looks Like



# Credit Markets Continue Recovery

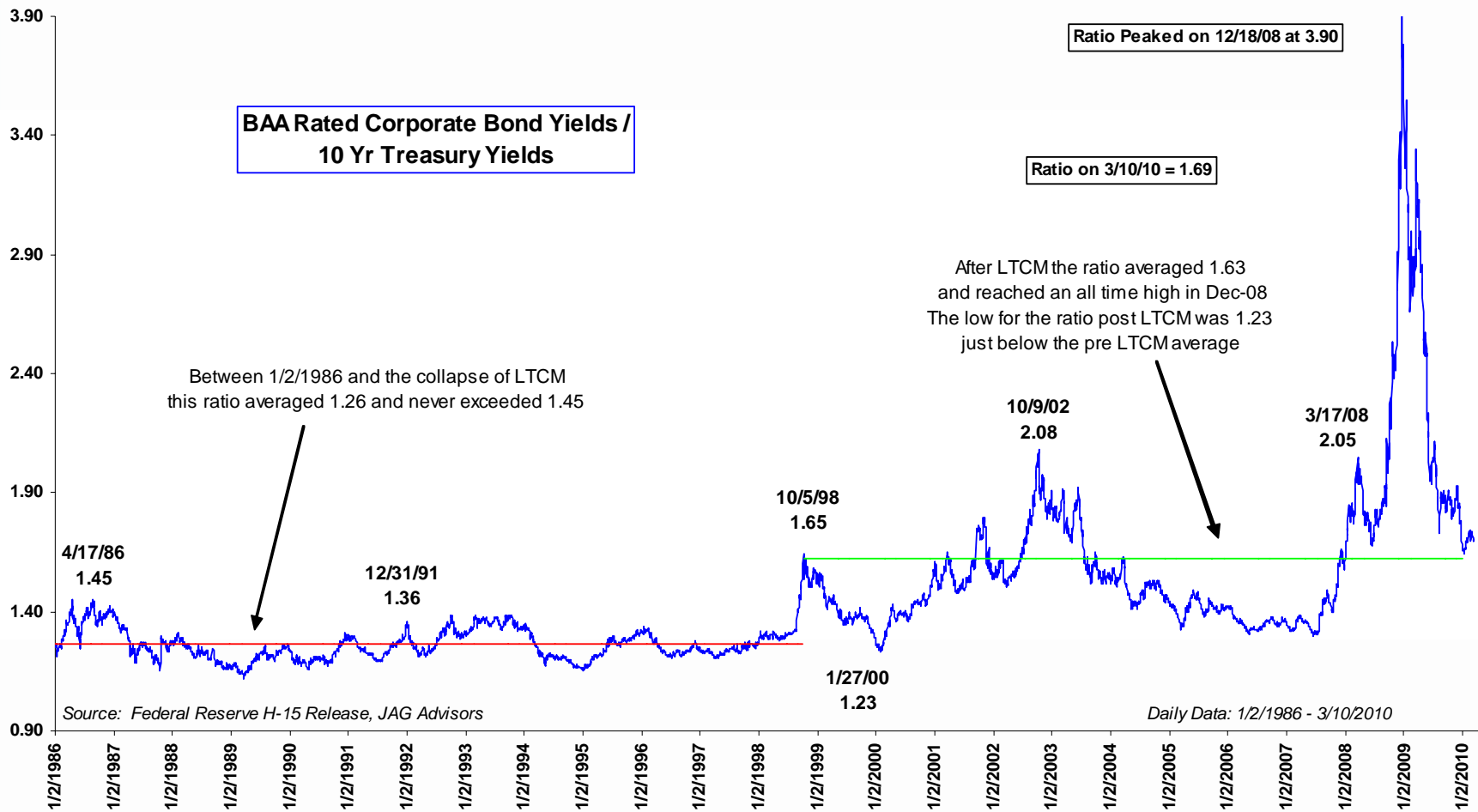


# Baa vs. 10 Yr Treasury Yields

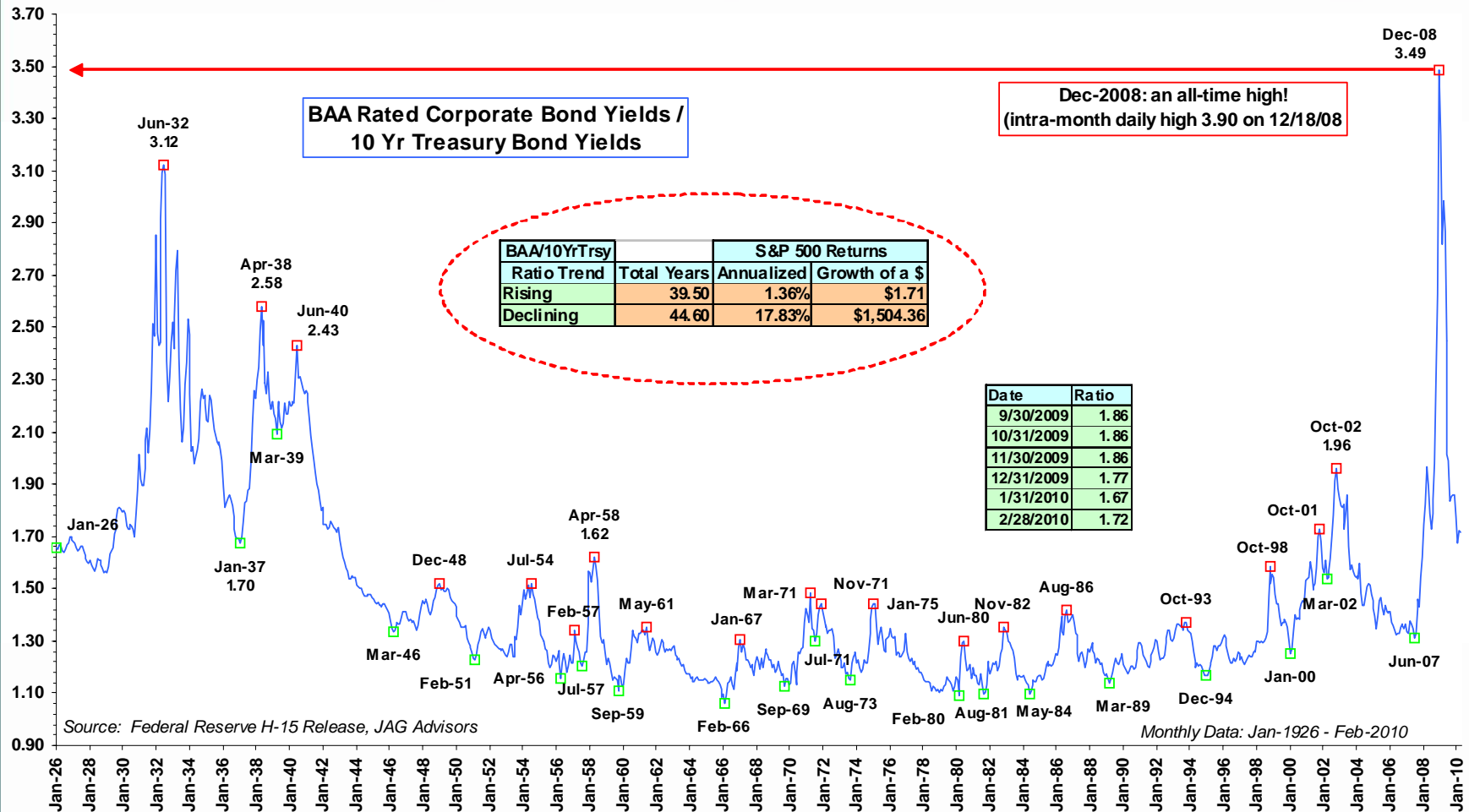


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# Baa/10 Yr Treasury Yield Ratio - Daily



# Cannot Look at Credit in a Vacuum!

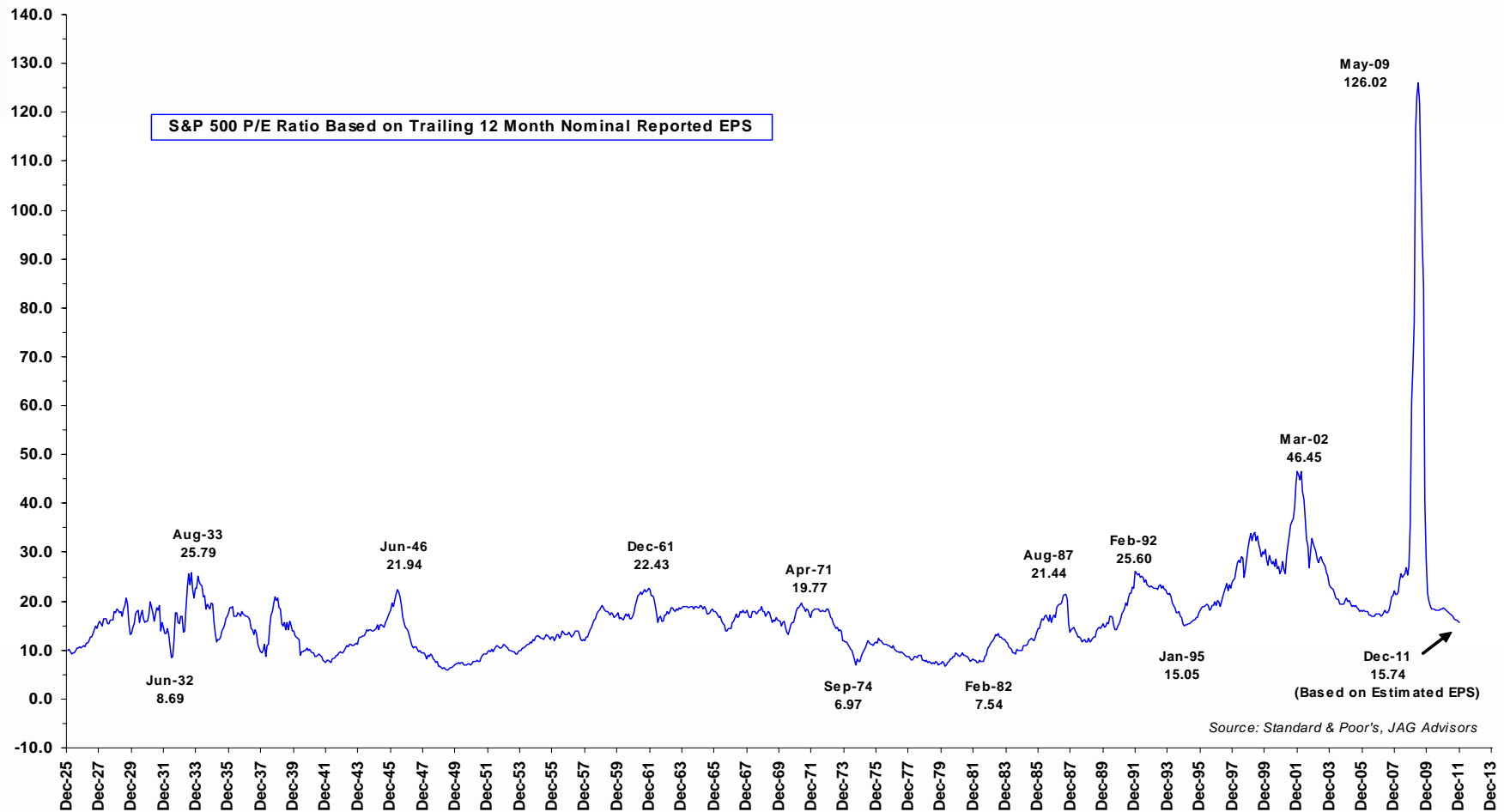


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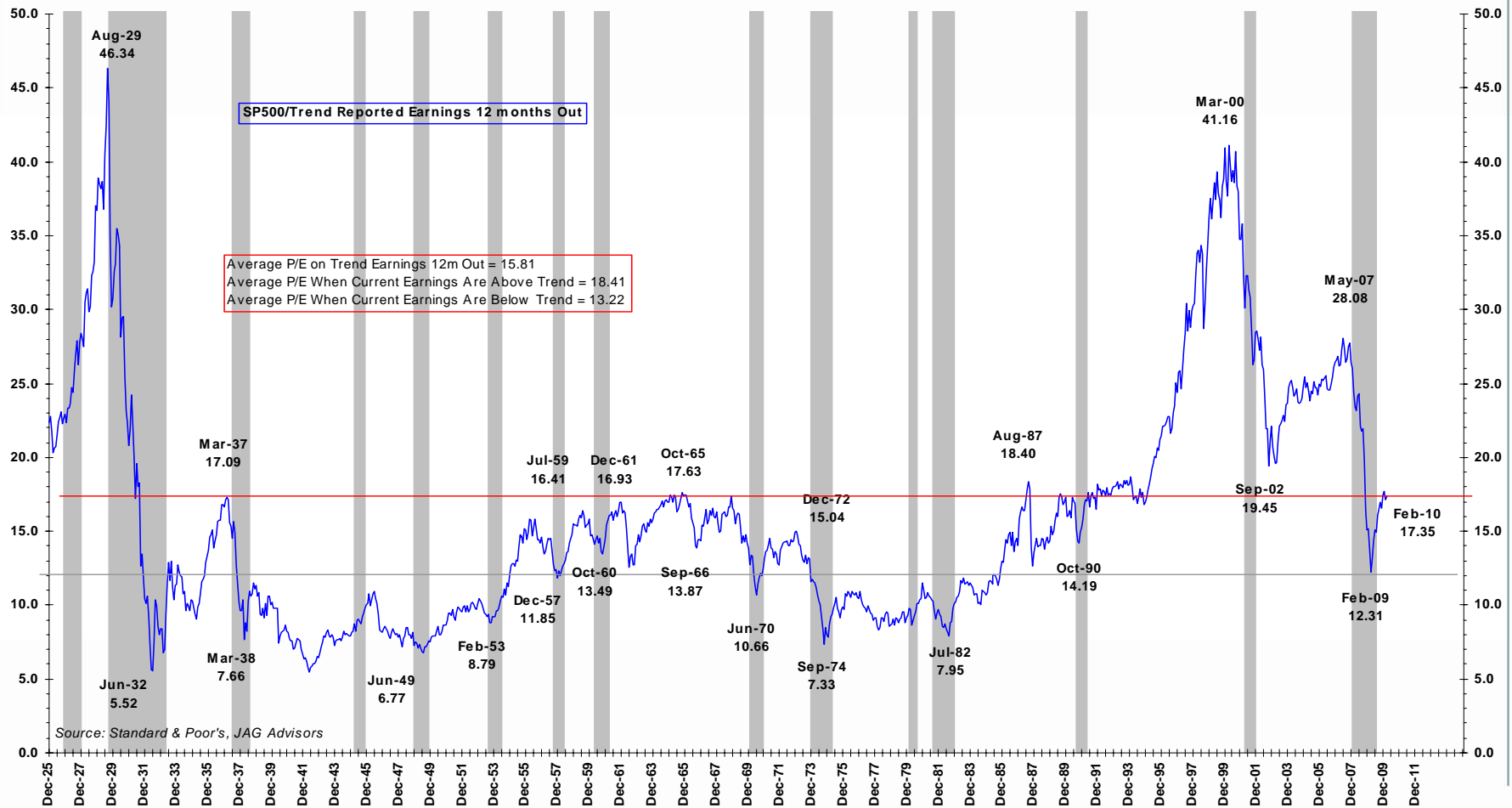
# Equity Valuation



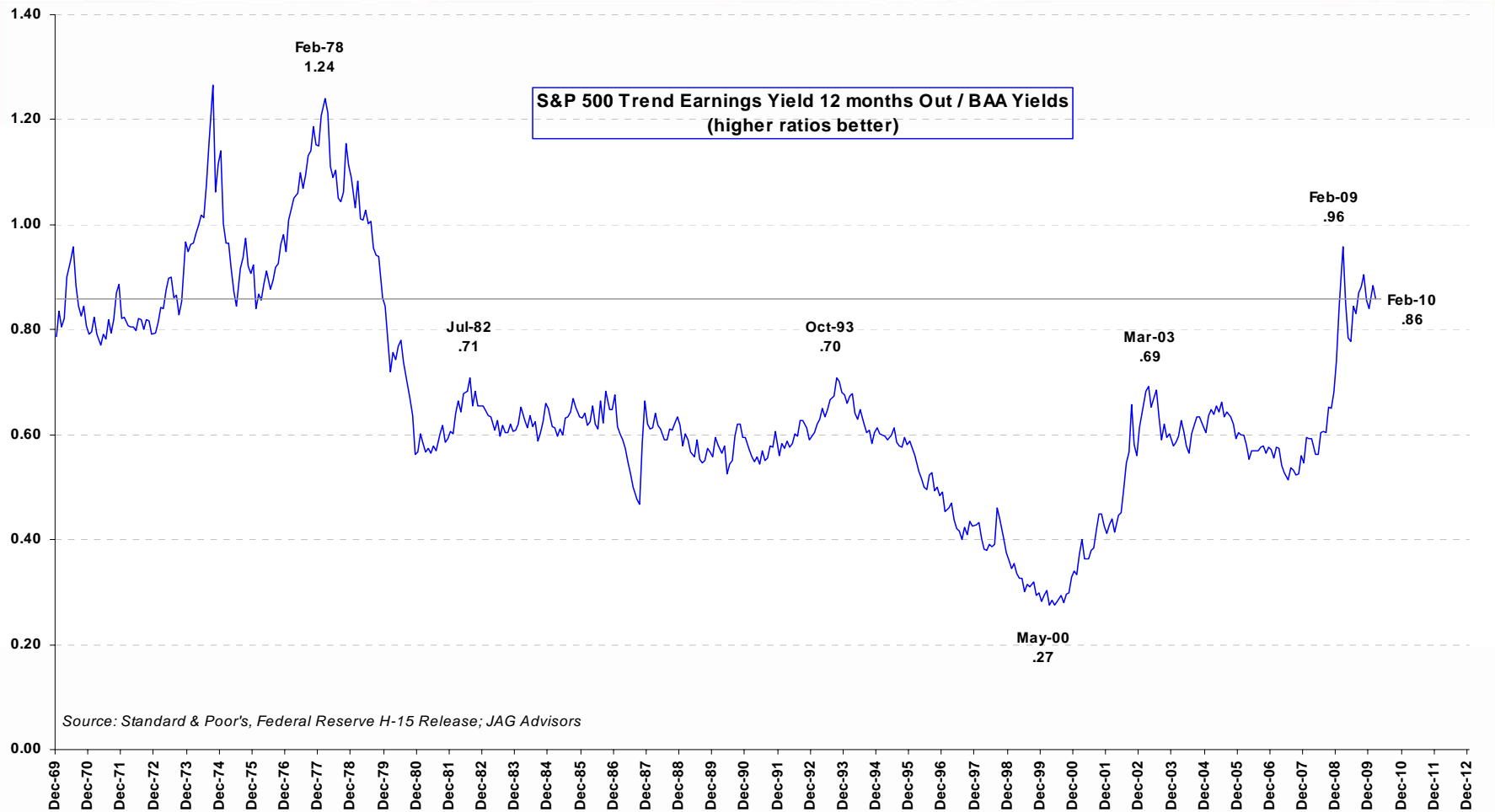
# S&P 500 Trailing 12 Month P/E Ratio



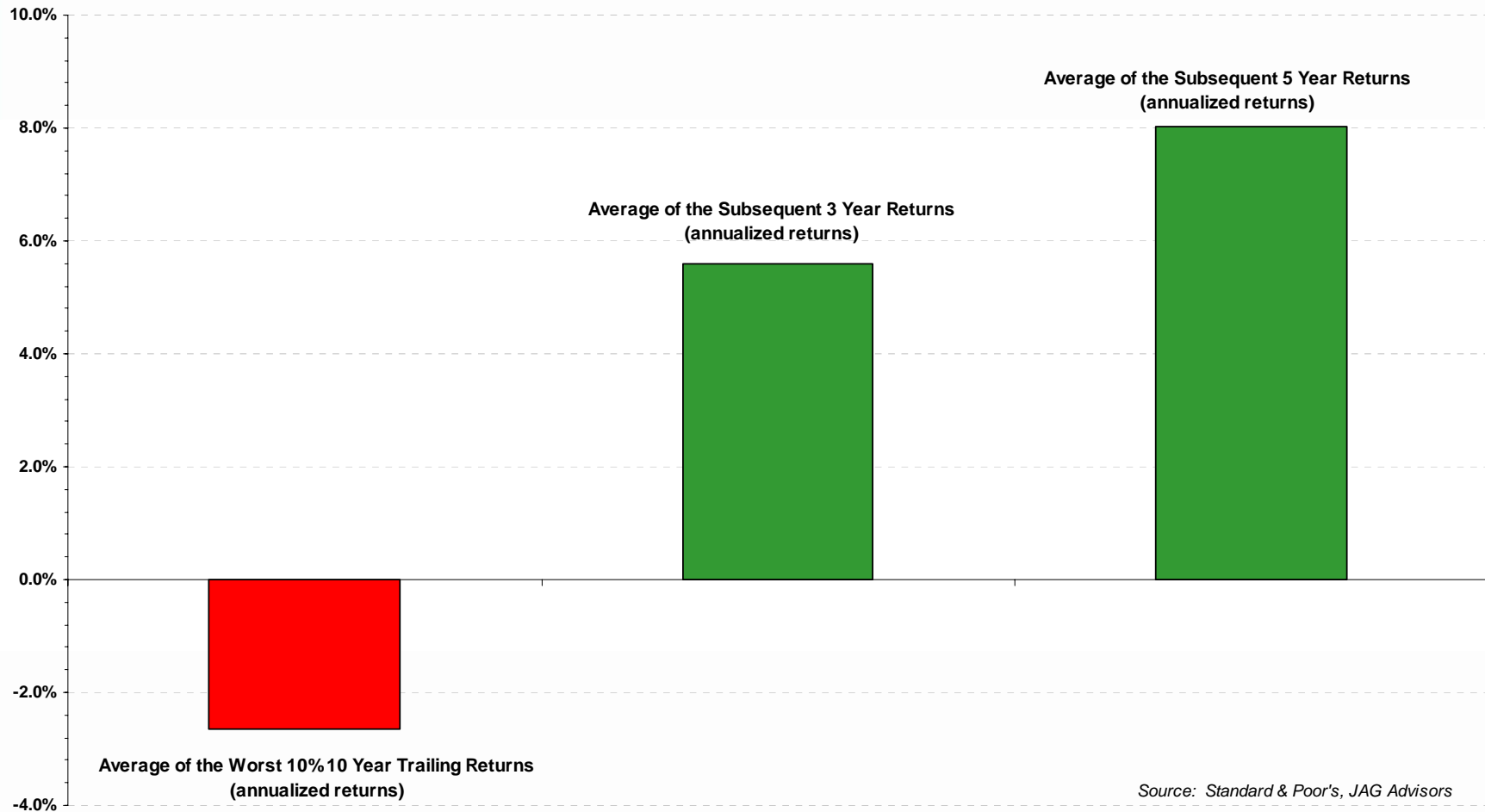
# S&P 500 P/E Ratio Based on Trend EPS 12 Months Out



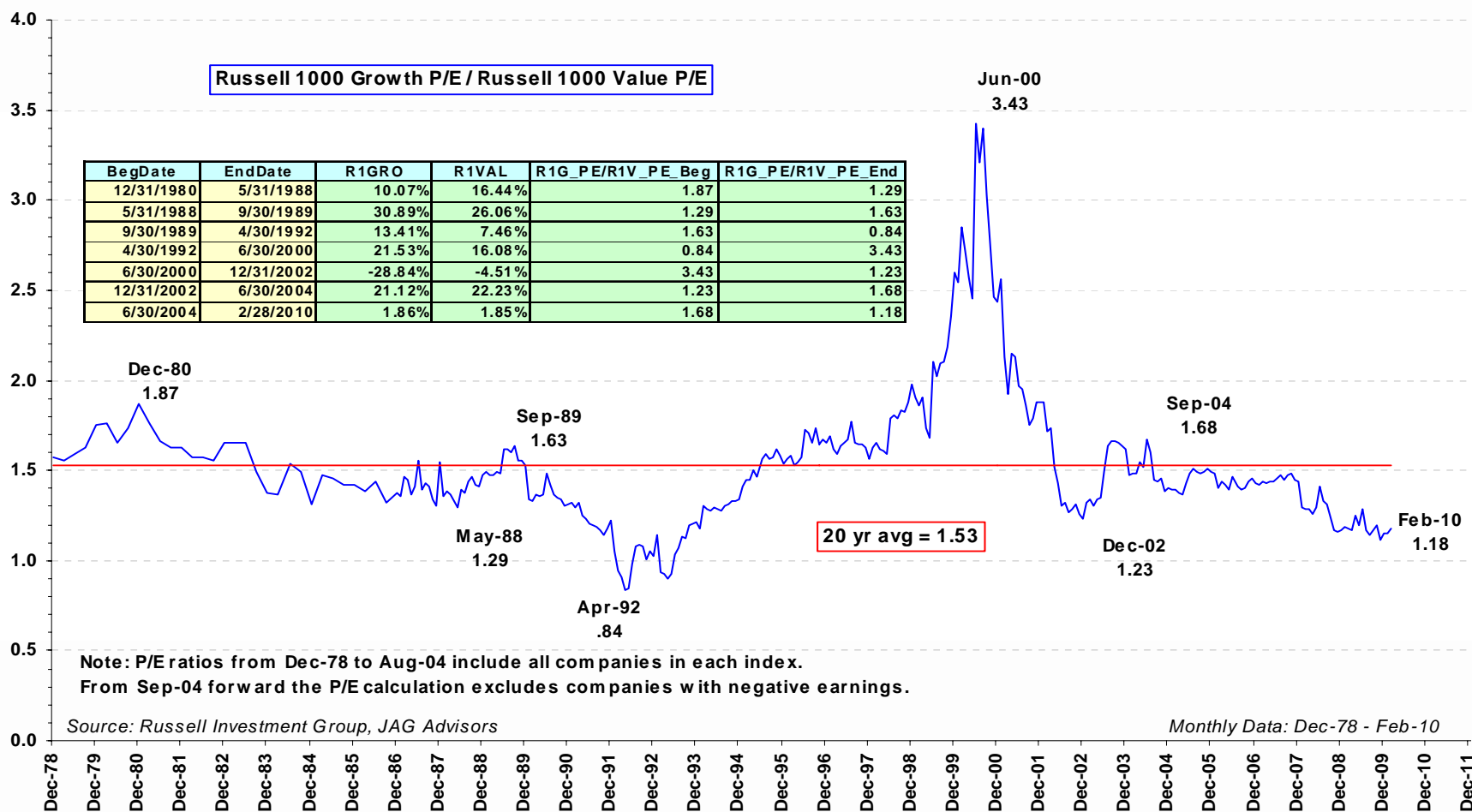
# Equities Quite Inexpensive on Forward Earnings Yields



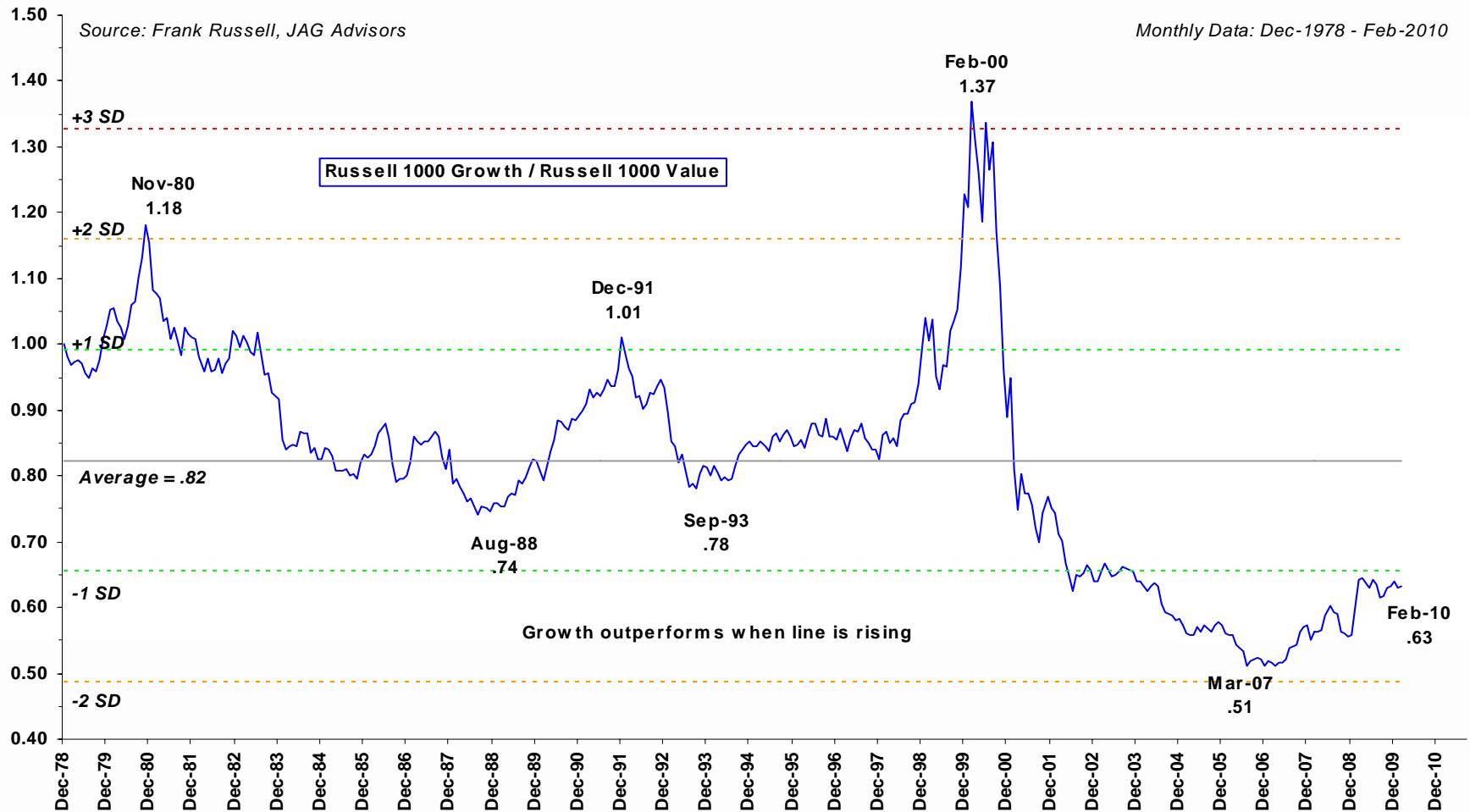
# What Happens *After* 10-Year Equity Bear Markets?



# Large Cap Growth Cheap Relative to Large Cap Value



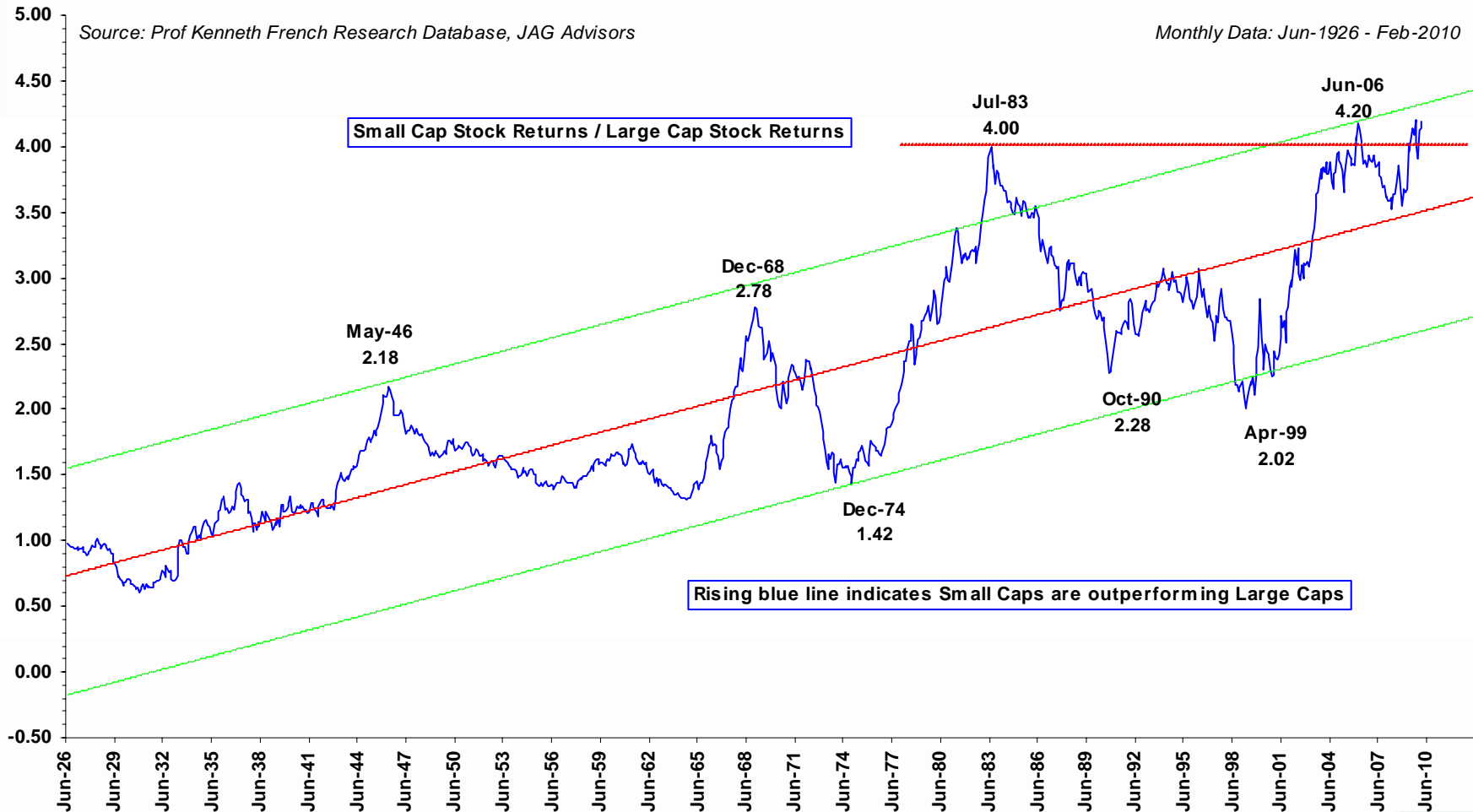
## ... And Growth Has "Room To Run" vs. Value



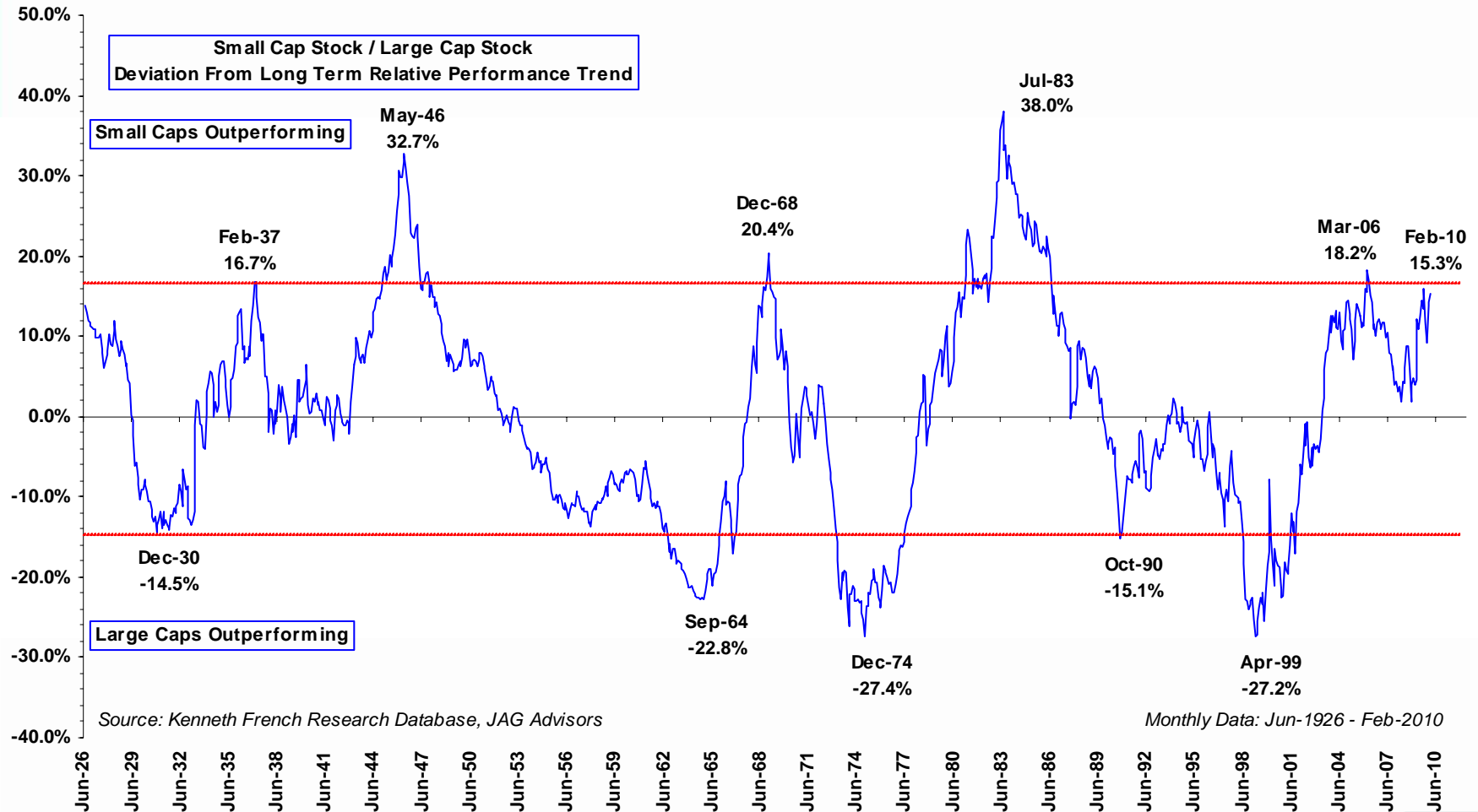
# Small Caps Unable To Make New Relative Highs vs. S&P 500



# Is This Cycle of Small Cap Out Performance Ending?



# 11 Year Run of Small Cap Out Performance May Be Ending



# JAG Large Cap Growth Notes



## JAG Large Cap Growth Philosophy & Process Summary

**Mission/Goal** Our mission is to build long-term wealth for our clients by proactively managing a portfolio of growth equities. We seek to consistently generate annualized excess returns versus the Russell 1000 Growth Index over rolling three to five year periods.

**Philosophy** JAG believes that stock prices are driven by earnings growth and earnings expectations. We employ a bottom-up, quantitatively-derived buy discipline to identify and acquire stocks with superior earnings and revenue growth characteristics. Our rigorous sell discipline is designed to eliminate holdings with deteriorating growth metrics.

**Construction** The Large Cap Growth strategy invests primarily in common stocks of U.S. companies with large market capitalizations (i.e. over \$5 billion) that JAG believes possess strong earnings and revenue growth potential. The portfolio typically consists of 30-40 securities.



# JAG Large Cap Growth Current Positioning

- **Overweight Sectors**
  - Information Technology
    - Web 2.0... components, software, infrastructure, applications
  - Consumer Discretionary
    - Consumer “Not Dead Yet”
    - Sector made relative strength bottom in July 2008
  - Industrials
    - Early-cycle beneficiary, “bull whip” effect on YOY sales possible
- **Underweight Sectors**
  - Consumer Staples
    - Low growth, high multiples = unattractive (unless you are willing to bet on double-dip recession)
  - Energy
    - Troubled by revenue/earnings results & guidance
    - Would rather overweight in Materials (specifically agricultural)



## JAG Large Cap Growth: 2010 Themes

- Sales Growth More Important than Earnings Growth
  - Last 3 quarters: EPS growth was driven by cost cuts
    - 2010: Bottom-line growth will not be enough to ward off multiple compression
  - 2010: Companies with strong sales growth will be rewarded
    - YOY Top-line growth is key now that we are “lapping” Fall 2008 collapse
    - Revenue guidance also extremely important
- Web 2.0 Is For Real
  - Mobile Internet + The Cloud
    - Secular, not cyclical theme
    - Similar in scale to PC revolution ('80's – mid 90's) and Internet revolution (mid 90's through 2000)... But timeframe is compressed
    - Amazing uptake rates (i.e. Facebook, iPhone)
    - New Products (i.e. iPad)
    - New Applications (i.e. Apple's App Store)
    - No IPO's yet... But watch out for some in late 2010 and 2011



## Conclusion

- Equities are the hardest trade, but deserve a portfolio allocation
  - Valuation not stretched
  - Economy is recovering
  - Mutual fund flows are contrary indicators at extremes
  - Bias should be “buy the dips” in 2010 (and there will be dips)
    - Through at least 2012, investors will view every correction as “the big one”
    - This dynamic will create opportunities
- Big Cap Growth Stocks
  - Cheap to Small Caps, Cheap to Value
  - *Already* “de-leveraged”
  - Healthy Tech weighting can provide a longer-term “call” on Web 2.0



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