COMMENTARY

GLOBAL ALPHA

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Dear clients and colleagues,

We recently had the opportunity to meet with 40 small- and mid-cap (SMID) U.S. companies during a 4-day marathon in New York. This multi-industry event gave us a good picture of what to expect for Q4 and early 2010. Here is an overview of our observations.

Companies involved in the consumer space expect the holiday season to be soft to neutral. In general, they anticipate consumers to spend slightly less than they did last year. Early Black Friday surveys suggest traffic is up, but the dollar amounts spent are actually less.

Shoppers are expected to stay loyal to their preferred brand, but they are likely to continue selecting lower price point items. By scaling down their product offering and reducing the average selling price, retailers have implemented the appropriate merchandizing strategy in this context. Note that discount retailers should continue to benefit from strong traffic going into 2010.

Companies seem to be ready to sacrifice revenues and maintain a comfortable low inventory level. In fact, many suppliers and distributors mentioned that the re-ordering process in preparation for the holidays remains soft. During our retail check, we were very surprised to find little promotional activity in stores. Several managers explained that inventory levels are low and that as a result, the huge discount bargains consumers are accustomed to at this time of year will most likely be kept at a minimum.

On the housing front, homebuilders announced that spring home sales data would be available by the first week of February. In the meantime, they continue to pressure Washington to intensify tax-credit programs for home buyers. Since the construction sector employs more workers than any other industry, they hope to convince authorities to allot a bigger piece of the stimulus pie to home buyers.

When discussing growth strategies, most companies say they will drive their top lines by expanding their business into international markets. Latin America and Asia are generally the most sought-after markets. In their attempt to re-energize the top line and compensate for distant consumers, many companies will consider mergers and acquisitions. As was the case in Q3, a good number of companies may turn to stock issuances to finance acquisitions. We see M&A activity as a positive catalyst for 2010, especially for SMID companies. Very few companies presenting at the conference mentioned that their capital expenditure would increase in 2010. Among priorities, IT spending and efficiency gains are certainly at the top of their list.

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Based on our meetings, we conclude that smaller companies have stronger balance sheets and greater cash levels than their mid and large counterparts. We see a lot of interest from investors toward durable goods and health care. Yet, we find high-beta sectors (Materials, IT, Consumer discretionary) are starting to soften. In our view, 2010 could prove to be a stock-picker environment instead of a low-quality hunting ground like we experienced in 2009.

Regards,
The Global Alpha team

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