

Viewpoint

US Equities
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The US equity market has recently benefited from the perception of being a relatively safe haven for increasingly risk averse investors. This comes as equity markets around the world have faced renewed uncertainty stemming from investor concerns over government deficits, an end to central bank stimulus measures and speculation of a double dip recession.

So why is the US being seen by investors as an attractive destination for their money amid the increased uncertainty? The most overriding advantage that America offers is the sheer depth and breadth of its market. Its immense scale still sets it apart from any other country. This means that one looking to invest in the US is not dependent on playing a particular theme, whether that be looking for beneficiaries of infrastructure growth, rising commodity prices or expanding exports. Any of these strategies and more will be available in some area of the American market.

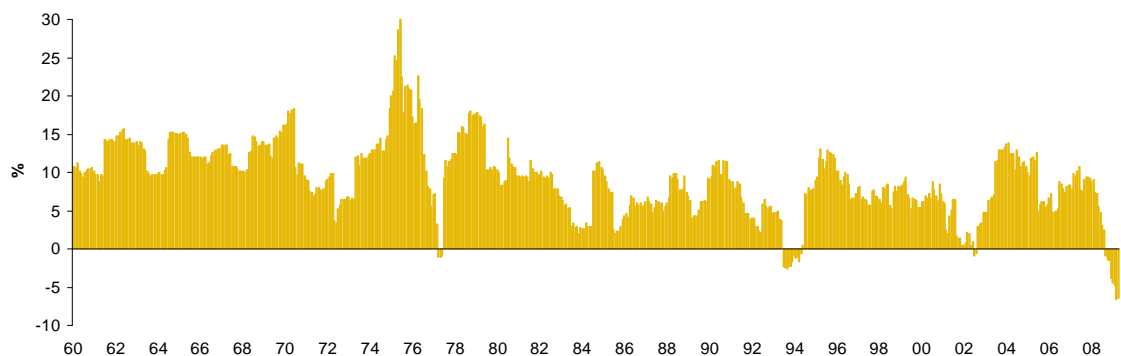
However, the size of their market is far from being the only relative advantage that US companies enjoy. Another factor favouring firms operating in America is the enduring advantage of a relatively light regulatory regime, coupled with a transparent, predictable and evenly applied legal framework. For example, American companies have greater flexibility in hiring and firing in response to changing business conditions compared with companies in much of Europe or Japan. There is no doubt that this has been an important factor in their ability to not only cut costs, but boost profits during a period of extremely difficult trading conditions. As a result, many American companies have reported earnings since the beginning of the year significantly better than we would have predicted a year earlier.

The economic recovery seems to be well under way, but our GDP growth estimate is lower than the consensus view. Historic data shows that after a financial crisis, as opposed to just an ordinary recession, private consumption typically remains subdued for at least three years. We are now two years past the peak in output for the preceding cycle, suggesting that consumption will remain muted for at least another year.

Despite our cautious view on the economy, we are optimistic about the outlook for corporate profits. US companies have shown themselves capable of rapidly adjusting their cost bases. Among the top 1500 US stocks, selling, general and administrative expenses (which cover salaries, commissions and travel) have been cut at a faster rate than at any time since data first became available in the early 1960s.

Expense Control Has Been Impressive

Large-capitalisation stocks, year-over-year change in S, G&A expense 1960 to mid December 2009



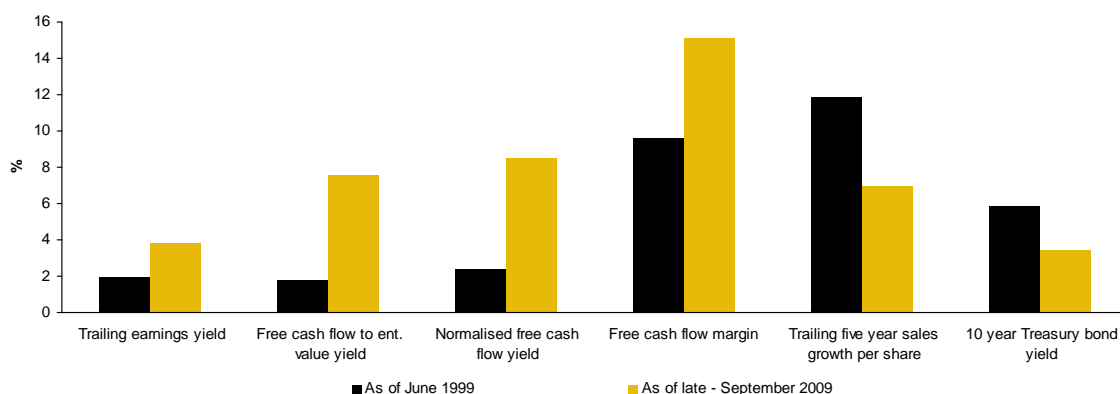
Many American companies have restructured their businesses to benefit from globalisation. US companies have shown themselves especially adept at hiving off non-core activities to firms abroad in order to lower labour and other costs while they focus on core competencies.

And it is probably no coincidence that US companies remain global leaders in innovation in a number of fields, such as IT. A cultural tradition of entrepreneurship and buoyant new company creation are additional factors behind these advantages.

It is no coincidence either that the US has developed a disproportionate share of global market leaders that grew and honed their trading models within America's vast economic hinterland. This has left many well placed to survive in harsher trading conditions, while providing their investors with strong dependable earnings streams.

Technology Sector Has Undergone a Metamorphosis This Decade

Technology sector financial characteristics as of June 1999 and late September 2009



While we are finding a number of companies with the appropriate attributes across most sectors in the market, one sector where we see a particularly high number of opportunities is technology. This is a diverse industry featuring a mix of cyclical businesses, high growth/high valuation situations and stable, annuity-like revenues. We believe management in the IT firms have learned from the crisis in the sector at the turn of the millennium, and know how to run their businesses through difficult times. Cash flows are particularly strong and many of the firms are world leaders in their chosen field.

Conclusion

Looking ahead, we remain optimistic about the prospects for US equities. The average equity today represents much better quality than at any time in the past 20 years, while valuations are the most attractive they have been since the early 1990s. Meanwhile, cash flow, debt to equity and capital allocation are all better than they were at that time. Furthermore, we believe many US companies are well positioned to benefit from rising economic activity.

Important information

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