

## Euro-zone News & Emerson Thoughts

**Dear Client,**

This week it seems the whole world is focused on the euro and euro-zone rescue package. It all started with Greece, and its troublesome ability to finance its sovereign debt. The Greek crises quickly led to a broader concern that other euro-zone countries (notably Portugal, Ireland, Italy and Spain) could face similar problems - thus potentially impairing the health of the European economy and the value of the euro. Some now fear that a weak Europe could impede the global economic recovery, and perhaps even create another bear market in U.S. stocks.

At Emerson, we do not believe the euro-zone financial problems will create a new bear market for stocks. While the major stock markets of the world have been shaken (S&P 500 down 12%, London's FTSE down 17%, Germany's DAX down 13%, MSCI Emerging Markets down 13% (all in U.S. dollars since April)), we think the impact is overdone. Yes, we worry about the value of the euro, and the high levels of sovereign debt in many of the developed countries, including our own. And yes, we are concerned about the recent weakness in stock prices. However, we have not had a meaningful "correction" in stock prices for the past thirteen months. We know that stock prices never rise in a straight line, so this correction was overdue. To see stock prices decline 10% or more (from April's high) can be expected - especially after the major global indices advanced 60% or more from their March 2009 lows. Market corrections normally start with a news catalyst to provoke the necessary selling pressure on stocks. We believe the euro-zone problems were the catalyst this time.

For now it appears the European crisis is manageable. The €750 billion euro rescue fund should contain the debt problems for the next 24 to 36 months. During this time we would expect most of the troubled European countries to install new fiscal policies designed to constrain debt. There will likely be fiscal pain, and the policies will be unpopular due to lower wages and higher taxes. However, we believe the European community will come through the mess, and ultimately the Greek problem will serve as a constructive "wake up call" to other countries living beyond their means.

Looking at the U.S., we continue to see positive signs of a recovery in 2010 as we pointed out in our April newsletter. Consumers are spending again, factories are producing and businesses are investing. We suggested stocks were attractive in April, and after the May correction they now offer even more value. The combined earnings of the 500 companies in the S&P index should rise to about \$80 (Wall Street consensus earnings), up from \$58 in 2009. This means the price to earnings ratio (P/E) of the 500 companies stands at a reasonable 13. The reciprocal of the P/E ratio is the "earnings yield" which is now 7.6%. If we add a dividend yield of 2.0% to the earnings yield, the resulting 9.6% is very competitive with a 10-year U.S. Treasury yield of 3.4%, corporate bond yield of 4.5% or a money market yield of zero!

In times of economic uncertainty the good news in stock values and company profits is overshadowed by the headlines. We believe this is now happening. Emerson clients are diversified, their portfolios are balanced and we continue to produce dependable income from stock dividends and bond interest.

We hope this short commentary is helpful, and as always, we welcome further discussion or inquiries on our current investment strategy.

Sincerely,

A handwritten signature in cursive script that reads "Brad".

Bradford A. Gardner  
President & Managing Director

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