



Quarterly Commentary – July 1, 2010

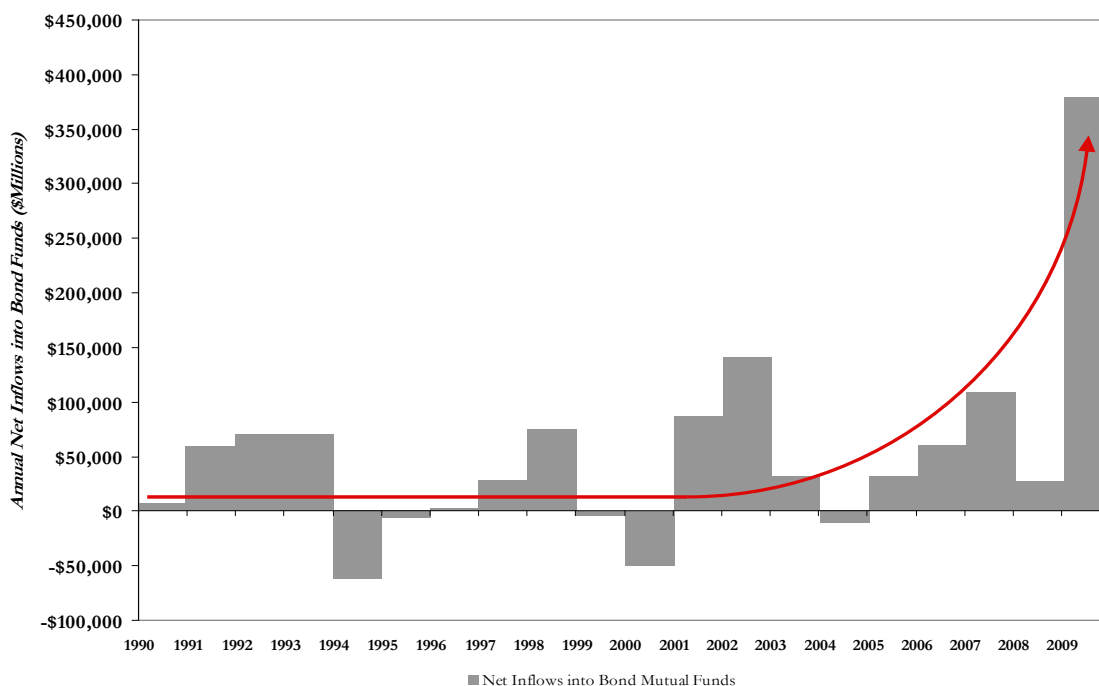
“World Stocks Down as Europe Debt Fears Creep Back”
Associated Press, June 22, 2010

“Double-Dip Recession Fears Putting Scare Back in Market”
CNBC.com, June 24, 2010

Investors are gripped with fear today. This is a natural reaction to a deep recession, and even though we are in a period of economic recovery, the fear persists. The fear is evidenced in several widely-followed statistics. Consumer confidence data released this week reflected a growing pessimism and sent markets downward. Corporations and individuals are hoarding cash, accepting little or no return for their investment. In fact corporate cash levels are at the highest percentage of total assets ever, and total cash sitting in money market funds stands at \$9.4 trillion, also the highest level in history.

Most telling is that investors continue to throw money at the bond markets with little consideration to the risk inherent in choosing an asset class that is grossly overpriced. The yield on the 10-year U.S Treasury bond implies investors are paying a price-to-earnings ratio of 34x for these interest payments. Over the past three years, \$572 billion has flowed into bond mutual funds. Over the same period, nothing has flowed into stock mutual funds.

Bond Mutual Fund Inflows



***THIS LOOKS JUST LIKE THE INFLOWS INTO STOCK MUTUAL FUNDS PRECEDING THE
“INTERNET STOCK MARKET CRASH”***

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Meanwhile, valuations of the strongest, best-managed, most highly capitalized, multinational businesses are priced at a deep discount (roughly 35%) to where they have traded, on average, over the past 10 years.

Investors should keep in mind that consumer confidence bears virtually no correlation with the economy, or even with consumer spending. According to the U.S. Census Bureau, consumer spending on retail and food services is up by 6.8% in the first five months of 2010 versus the prior year, with increases across nearly all categories.

Since consumers spend from wages they earn, more useful statistics than consumer confidence are wages paid and hours worked, which continue to rise. Another indicator that measures immediate and tangible economic progress is freight flows. After all, goods flow *is* the economy. This data is decidedly positive across all modes of transport. According to the U.S. Bureau of Transportation Statistics, truck freight is up +7% year-over-year; intermodal +19%; rail car loadings +16%; domestic air freight +14%; and international air freight +23%. The economy is clearly growing, fueling growth in the revenues and earnings of your companies.

This is good news, indeed, for our clients because as these companies' valuations return to normal over the next few years, not only will clients be catching rising, generous streams of dividend income, but also significant capital gains. The following factors are likely to provide this outcome:

- 1) An over-inflated bond market, which will cause poor returns down the road; investors will then have no other place to go for their income needs except blue-chip stocks that pay high dividends.
- 2) A slow but steady return to an economy which has recovered to normal employment levels.
- 3) Corporations, which today have the most cash on their balance sheets in history, once again will use this cash to grow their businesses and hire new employees.
- 4) Due to cost cutting and improved efficiency, leading corporations will show improved profitability, earnings and cash flow growth.

The best-of-breed blue chip companies in our clients' portfolios today, for instance, have grown their dividends at an average of 14% per year over the last 10 years. Because of their strong cash positions today, they will be able to continue to increase their dividends in the future. Furthermore, we are able to purchase these same companies at an average P/E multiple of 12x, compared to the 21x average multiple these businesses have traded at over the last ten years. It's important to notice that the high quality multinational businesses our clients own have been performing better than the broad market over the past several months; investors are clearly returning to quality holdings.



Today, pricing of our blue chip stocks compared to bonds is the **cheapest since the 1950's!** The opportunity to invest at such attractive relative valuations has occurred only a few times in our lifetimes.

Included with this commentary are your quarterly performance figures, management fee invoices, and a copy of your portfolio allocation as of 6/30/10. If you would like to come in for a visit, please give us a call at (650) 212-2240. We appreciate your continued trust.

Best regards,

The Golub Group

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