

US Equity Investment Outlook



Market review

June was another volatile month for US equities. Persistent jitters regarding the ongoing fiscal problems in the Eurozone led the broad-market S&P 500® Index lower early in the period. Stock prices subsequently rallied in the middle of the month amid optimism about Spain's successful debt offering and economic growth in China before tumbling near month-end following the release of disappointing economic data - most notably a significant drop in sales of existing homes in May and a steep decline in consumer confidence in June.

The lack of consumer confidence may be attributable in part to the still-muddled employment picture. While the unemployment rate for June declined marginally to 9.5%, non-farm payrolls fell significantly, reflecting the end of the temporary employment of US Census workers. Although the decrease was partially offset by an overall rise in private-sector employment, there was a double-digit percentage increase in the number of "discouraged workers" - those who are unemployed but not looking for work because they believe that no jobs are available to them. Additionally, nearly one-half of unemployed workers have been jobless for more than six months.

The continuing uncertainty surrounding the possible fallout from the oil spill in the Gulf of Mexico had a negative impact on shares of oil and natural gas exploration and production and integrated oil and gas companies. This offset the short-lived boost the sector received in mid-June following BP's announcement of the establishment of a \$20 billion fund for claims related to the disaster.

Economic and market outlook

We feel that the stubbornly high unemployment rate will likely restrain the expansion of domestic consumption for a while. Ironically, the performance of the US equity market relative to its global counterparts thus far in 2010 has been bolstered as many companies were able to reduce their payrolls dramatically when the economy slowed in late 2008 and have been quite creative in running with leaner workforces since that time. This is perhaps the key reason why many US companies have shown strong cost reduction-led earnings rebounds over the last 12 months, frequently exceeding the market's more conservative expectations, without yet seeing significant increases in revenues. Although we believe that this positive operating leverage will generally persist through early next year, we are well aware of the multiple headwinds remaining in the marketplace.

Since consumer-driven companies led the stock market out of recessionary levels, we still think that many of the stocks now price in significant optimism about the rest of the year and into 2011, despite the sharp decline in consumer stocks during the past month. In our view, however, there are a couple important guidelines to investing in the US: a resilient consumer (thus far) and relentless innovation by businesses to find customers to purchase goods and services from them. Bearing this in mind, our search for companies that can excel in any environment has drawn us to several consumer companies where we believe that growth prospects are better than those of the broad economy as a whole, and for which we are confident those expectations will be met or exceeded. These companies tend to be a bit smaller than average, have self-financed store expansion plans and carry differentiated product offerings. In fact, they are generally exposed to just a few major regions of the country, giving them ample expansion room for years to come.

The improvement in the consumer-related sectors may ultimately prove to be a boon to other industries. As the economy continues to expand, more goods need to be transported. While the US rail system is not as good at hauling people as other developed countries, it is actually quite efficient at hauling goods, including coal, industrial parts and consumer products. Most of the larger rail companies in the US are well-run, efficient organizations that compete in markets with significant barriers to entry. And considering transportation costs are such a small component of the total cost of most goods, we believe rail companies in general will maintain pricing power, especially as utilization continues to improve. We have exposure to the industry in all of our major US investment portfolios and anticipate continued solid returns from the stocks through the rest of the economic recovery.

While the US certainly is not insulated against the current instability in the global stock markets, positive sentiment in the region has helped to cushion the declines in the share prices of American companies during the recent downturn. As always, Aberdeen's experienced US Equity team will continue to seek to uncover opportunities in the market from the "bottom up."

Concerns over the Eurozone debt crisis, along with the release of weak economic data, led the US equity market to its second consecutive monthly loss in June.

While the unemployment rate was slightly lower in June, there was a sharp rise in the number of "discouraged workers."

Many US companies have increased profitability without higher revenues by reducing payrolls.

We are focused on some consumer-driven companies which we feel have relatively better growth prospects than those of the broad economy.

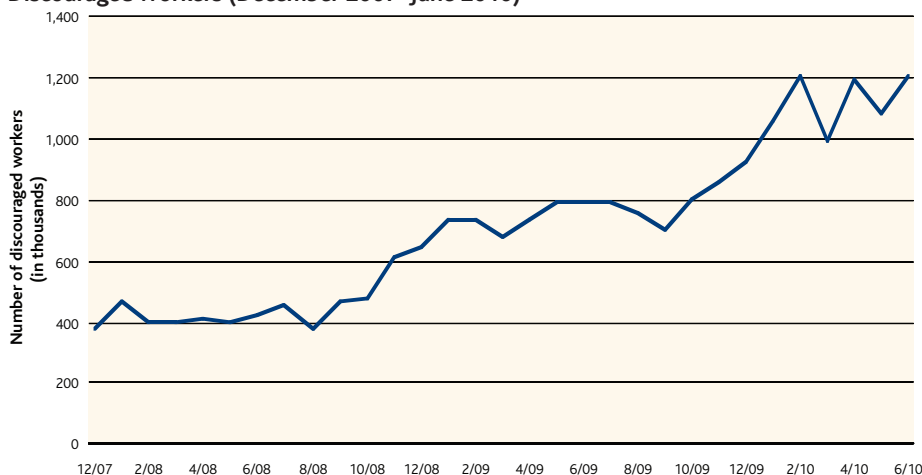
Transportation companies may benefit from improvement in the consumer-related sectors.

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A discouraging word

A contributing factor to the modest decrease in the unemployment rate in June was the significant exodus of jobseekers from the market. The US Department of Labor classifies this segment of the population as "discouraged workers"; that is, they are unemployed but are not looking for work because they believe that they have no job prospects. The Bureau of Labor Statistics subtracts these individuals from its total unemployment count, thereby increasing the percentage of people who are employed. As the chart below illustrates, the number of discouraged workers has risen at an alarming rate since the onset of the current recession, which began in December 2007. Adding the 1.2 million discouraged workers noted in the June report to the total number of jobless would result in an increase in the unemployment rate to more than 10%. In our view, the US economy cannot sustain its current momentum without a strong rebound in employment.

Discouraged Workers (December 2007–June 2010)



Source: US Department of Labor, Bureau of Labor Statistics, July 2010

For more information

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