

TRANSCRIPT

Merrill Lynch Global Wealth Management Webcast

Equities: Finding Growth in 2010 and Beyond

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AQ: David, the last decade has proved a pretty rough one for stocks, I think, in fact, the I—the worst decade since the, since the 30s. So, looking back over that difficult period, was there any good news for stocks?

DB: Well for investors that owned stocks and held them without any trading since the end of 1999, no, the returns are really poor and I think a lot of the poor returns comes from very exuberant expectations for performance over, back, back at that point in time.

But one thing that the companies, the S&P companies accomplished on an operational basis of success, they expanded their businesses internationally. They increased the proportion of their profits coming from abroad from 20% to 40% and their margins internationally are now as strong or even stronger on an after tax basis than the domestic margins.

So that's a big accomplishment and it shows the S&P can replicate its business models abroad and I think that's going to be its biggest source of growth in the years to come.

AQ: You bring it to the very recent past. We've had this gut wrenching turnaround in stocks

where there's been a very strong rally, I think actually one of the strongest rallies on record through 2009. So for those people who've lived through that, should we be comfortable that there's more to go?

DB: Well, I think there is more to go. I think whenever you have these strong rallies people wonder when there's going to be a pullback. I think there is a risk of a pullback from volatility and interest rates over the coming months but I think that pullback will occur only from a level even higher than where we are today.

I think the market's going to make it to about 1200 in the very near term. We're still trading the low 1100s. And once we get to about 1200 I think all eyes will turn to what the new interest rate environment will be as I think confidence in the recovery continues to increase.

AQ: So I guess if the market's still moving ahead but at a more moderate pace it becomes more important to be selective within the markets. So sector-wise where are the best places to be to benefit from that further market appreciation?

DB: You know for the sectors that we think are going to perform the best in the near term and over the full course of 2010 are energy, financials and industrials. Energy and financials are probably going to be the best in the very near term.

I think financials are doing nicely in the start of the year. I think energy has a lot of upside being that we've seen oil prices break out to above 80 and that's not because of a weak dollar. It's more because of in cur—in continuing confidence in Asian growth. So I think oil and energy stocks have some good upside in the very near term.

And the, the sectors that I think are going to be of, of not such strong returns but still healthy returns and not as much downside risk, things like technology, I still like. I've gone from overweight to equal weight technology but I still like it. And these are basically the sectors that are most exposed to the world economy, international economies that I think investors should overweight.

AQ: And what about the, the size of stock? Do you think it's, it's particularly the big or the large cap names that are going to do well through the course of this year?

DB: I think the big cap stocks are where you won't want to position yourself for the best returns on a risk adjusted basis. I think the big cap stocks will have much to strong 2010 but strong 2011 as well.

I wouldn't go so far as to say that small cap stocks underperform big cap stocks where they have high beta and in a recovering economy, domestic economy, as we expect. They often perform better than big cap stocks. I just don't think they, I don't think they outperform as much as they usually do versus big cap stocks.

AQ: Let's talk a bit about the currency and the dollar has been moving around a lot and that's clearly a concern for equity investors. So say if the dollar continues to strengthen, is that a good thing from an equity point of view?

DB: Well, the strengthening dollar is good in the sense that it suggest there's more confidence

in the US economy and a strengthening dollar is good in the sense that it relieves some of the interest rate risk from a dollar crisis and I think a surge in interest rates is one of the biggest risks facing the US recovery and the stock market. Moderately higher interest rates are OK but we don't want a surge in interest rates.

But the stronger dollar is a negative in the sense it's a headwind to S&P earnings growth. But we have that factored into our earnings estimates and if you were to use current exchange rates you would have to add at least a couple of dollars to my low 70s earnings estimate and low 80s earnings estimates for 2010 and 11.

AQ: So a strong dollar sort of OK but what a, what about a weak dollar? It's, how do you see a weak dollar should that transpire?

DB: Weak dollar when you have that, a moderately weaker dollar tends to suggest that people just very excited about Asia versus the United States. But an extremely weak dollar, if we went back to what we saw in late 2008, it suggests that investors are scared of the entire world and are fleeing for safety.

So I'm comfortable with a, a moderately weaker dollar from these levels. I don't think the recent strength of the dollar is a problem either. But I don't want to see any further extreme volatility in the dollar.

AQ: You mentioned Asia there Dave and I think a lot of people are looking for superior growth, stronger growth in a lot of emerging market economies next year and in fact for the

next several years. But if I'm that, if I'm a US investor and I'm primarily interested in US stocks is there some way I can benefit from that external growth?

DB: Absolutely. Absolutely. I mean, where I have, personally, my most confidence in, in Asia is in the real economy, that there will be strong economic growth out of Asia.

How to play that, as always in investing, you have to weigh it against the valuations. And I think that the valuations are really reasonable on, on many of the US companies that are exposed to Asia, not just the ones that have direct exposure like technology, certain consumer staple companies. But remember that there's a lot of indirect exposure for the S&P to Asia through commodity prices, particularly oil.

So energy and industrials, industrials being a supplier to the energy complex, energy and industrials, my two overweight sectors in addition to financials, are ways I would play; strong, Asian, real economy growth.

AQ: And that's gone up over the last decade, to our previous discussion. That exposure has increased to the benefit of corporate America effectively.

DB: That's right. The S&P's exposure to foreign economies has increased but the growth in emerging economies in general, particularly out of Asia, what it's done is it strengthened commodity prices and stronger commodity prices and big benefit to the S&P 500's earnings power.

AQ: So changing tack a little bit, what about interest rates, general expectation that they rise through the course of this year? Again, I'm an investor. Should I be worrying about that?

DB: Well, that's, our, our view is—for the bank our house view is that the interest rates, long term treasury yields will rise over the course of 2010 as the economy strengthens.

So, higher interest rates is a sign of, of economic growth and, and a re-normalization in the economy, but I don't want interest rates to surge. Any yield on the 10 year treasury in the 4s I'm very comfortable with and excited about but if we were to exceed 5% by a significant amount that would jeopardize my 1275 price target on the S&P for 2010 year end.

AQ: Now, difficult question to end with. Looking forward we've just been through a difficult decade, looking forward to the next decade, you get your crystal ball out, what are the two or three key themes that you think are going to be the most prominent ones for investors through the next 10 years?

DB: Right. I think a key theme for investors always and so it should be for the next 10 years is which companies have the ability to grow, which companies have the ability to earn returns better than, than you and I can get on, on our saving money in the bank, you know, who can grow their economic profits?

And so finding growth companies is I think a key issue for investors for many years to come and I think the way to find growth is to find companies with that direct and indirect exposure to emerging economies.

So right now I'm bullish on certain things like financials just because I think it's a good cyclical play, I think they're a normalized earnings power, is underappreciated, but once we get a, a reevaluation of those stocks at the higher levels that reflects their normalized earnings power I think it's other sectors with growth prospects like tech, like industrials, and also the right consumer staples and even helps their stocks which right now I'm underweight that sector, but if you look to the right companies with foreign exposure, that's the way I think you'll make good returns and outperform the market for the long term.

AQ: OK, David, well thanks very much for your time.

DB: Thank you.

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