***General Market Comment*:** **July 19, 2010**

We have had quite a roller coaster in the equity market. No one would have guessed the market volatility or the extremity of sentiment we have seen if the only information they had to go by was that 1) S&P 500 earnings grew 92% in Q1 over 2009, 2) earnings look to grow 43% in Q2, 3) inflation is trending down, 4) interest rates are down and 5) employment and personal consumption are up. These facts are all true.

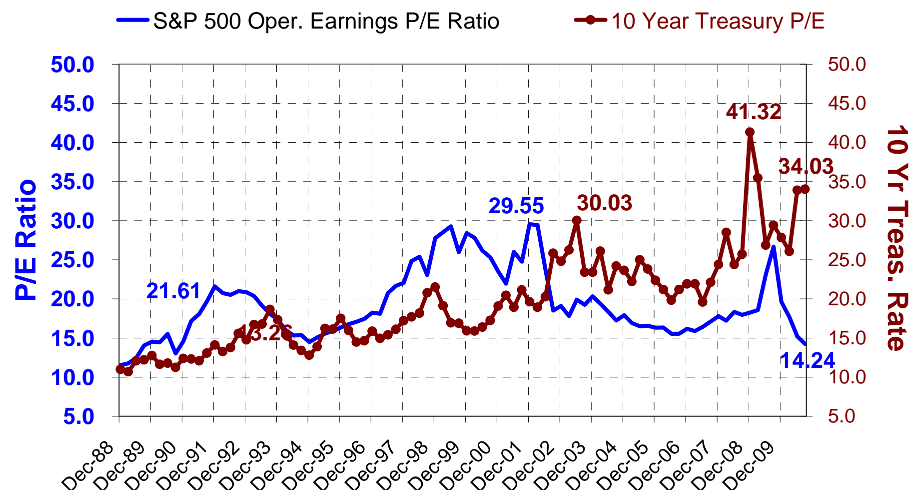
I have written in recent weeks that market conditions were remarkably oversold and that stocks are testing historic low valuations. I was discussing all this with another money manager friend – Shad Rowe of Greenbriar Partners – who made a very interesting point. He noticed that if one looked at the "p/e ratio" of 10 year Treasury bonds (i.e. divide 100 by the yield) no one would believe that bonds were anything but grossly overvalued. I decided to have a look at this and generated the following chart contrasting the p/e ratio of the S&P 500 compared to the implied "p/e ratio" of the 10 year Treasury. The 10 year Treasury is yielding 2.9%. The earnings yield on the S&P 500 is 6.7%. Have a look.

The P/E ratio of the S&P 500 is the lowest since the mid 80's. The "P/E ratio" of the 10 year Treasury hasn't been higher in at least 4 decades other than the spike of late 2008.

One of these two metrics is way overvalued.

Which one do you guess it is? . . . Any 10 year old kid can tell you "It's the brown line Daddy".

This comparison supports buying stock and selling Treasuries.



Treasuries are trading at an implied p/e ratio of 34X. This is extreme to say the least. With stocks, earnings can improve and drive up the value of the shares. With bonds – well the amount of income is "fixed" – that's why they call it "fixed income" – eh? So if the "p/e ratio" of bonds is at an extreme high and income is fixed the only thing that can adjust if the "p/e ratio" should decline is price . . . and the "adjustment" would be down.

The markets don't like bubbles and that's what we have in Treasury bonds. They don't like high p/e ratios. The reason bond prices are so high and rates are so low is there is broad consensus that the economy and more specifically, corporate America, is at the precipice of a material slow down – mind you most don't say "decline" – just "slow down". Given that the broad consensus is usually wrong, the easy contrarian bet is that the "slow down" won't be so bad.

So, Snap Out It! . . . Go Buy some stocks!

I have stated all year I would not be too concerned if we had some pullback in prices. I doubted we would see appreciable downside "failing some exogenous shock to our collective psyche". Well – we had the "exogenous shock" – the European debt crisis and the Gulf of Mexico oil spill – and we had a correction in stock prices. **Now we have entered what should be a very respectable Q2 earnings season with prices lower and interest rates also lower**. **The combination of the those factors – rising earnings, low interest rates and lower prices should result in a resumption in rising equity prices.**

Please do not hesitate to call if there are any questions.

Regards:

Jeb Terry

Wk: 214-347-9114
Cel: 214-552-6708

Caution: It's a risky world we live in. My opinions are based on information believed to be reliable but hey, I could be wrong. When investing, try to use good judgment and don't hesitate to seek professional assistance. Remember to set limits and have a plan. . . Good Luck!