Economic Update

Broadleaf Partners, LLC

Happy Halloween

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The following Economic Update is a compilation of recent posts from the New Broadleaf Partners Blog. We hope it will give some unique insights to how we view investing as well as our thoughts on the volatility in the markets throughout the month of October. If you are interested in subscribing, please visit the Broadleaf Blog website and sign up to receive new entries as we post them.

What's Lurking Around that Corner? (Posted 10/30/07)

At about this time last quarter, folks were completely obsessed with what the Fed's next move would be. While folks certainly care this time around, the issue just doesn't seem to engender the same sense of urgency or degree of attention. I'm not sure if this is because most feel that the first cut or change in policy is always the most important one, but it sure seems that way.

We're in the thick of earnings season. And so far, things have been okay, particularly for growth investors. At the margin, the greatest disappointments have come from the financial sector, where complex lending practices and exposure to the housing markets have done the most damage. There have also been pockets of weakness within the consumer discretionary sector. Whether or not this is related to $94 oil, slightly higher unemployment levels, or aftershocks from this summer's credit meltdown is difficult to say. But retail traffic does seem to be a tad lower in most malls around the nation.

There are, of course, always exceptions. Exceptions born of innovation. Consumers still can't seem to get their fill of IPhones and Mac's, Blackberries and GPS devices, or over-sized burritos. Understanding macroeconomic trends is useful, but it may not always be the best resting place for investors.

We think the Fed will cut rates tomorrow. But whether or not it's a trick or treat, there is still good news! Thanksgiving and Christmas are just around the corner!

All kidding aside, this is an environment in which growth prevails. Our job is to find it.

Stress Test (Posted 10/24/2007)

Earlier this week, I had my first stress test. I'm not talking about the work, marriage, or children kind, but the good, old fashioned, "hop on a treadmill and stress your heart" kind. Oh, the joys of turning forty.

Here's what happened. A nurse taped several wires to my chest, put me on a treadmill and then steadily increased both the speed and incline until I failed to keep up. At the same time, a doctor and a few expensive machines monitored my pulse, blood pressure, and heart rhythm. While the test cost me a few bucks, I now know for sure that I have a healthy and fit heart.

Quarterly earnings season is just like a stress test. Each quarter, companies are forced onto the earnings treadmill and subjected to a litany of tests and fast-paced analyst questions. In the end, investors hope to gain a better understanding of whether or not a company's outward

appearance -- its stock -- is justified at a specific moment in time by what's on the inside -- its fundamentals.

The market was moving at a fast pace heading into earnings season and the treadmill was on a steep incline. So it might come as no surprise that some stock prices have collapsed after an unsustainable short-term pace. Lance Armstrong was capable of crashing and burning on any given stage of the Tour De France but over the long haul, he still took home Yellow.

I suspect we will see some backfilling in the markets as the earnings process continues to wind down. And after a period of necessary rest, I think we'll regain our footing and settle into a more comfortable pace, finishing the fourth quarter on a positive note.

Sometimes we need a good stress test just to see how healthy we are.

My Neighbor's Candy (Posted 10/12/2007)

I read another surprising statistic yesterday, which was passed along by our salesman at ISI Group. According to Bloomberg, China has 106 billionaires this year, up from just 15 last year.

A billion dollars is a lot of money. But to have a six fold increase in billionaires in just one year strikes me as borderline crazy.

On the one hand, it strikes me as a sign of extreme speculation. I'm thinking right now of NASDAQ 5000. Easy come, easy go. Forbes 500 one year, off the next. Fake. Can't last. Absurd.

But then the other side of me kicks in, thinking that 91 billionaires didn't become that way overnight. Surely, they've been at their businesses for twenty years, maybe even thirty or one hundred! Maybe these 91 were all at $900 million last year and simply didn't make the cut.

Am I being rational, perhaps too much so? Or am I just jealous of my neighbor's candy?

Planting for a Bigger Harvest (Posted 10/11/2007)

Some interesting data came across my desk this morning, confirming what we've suspected in our blog musings and economic updates over the past few days and weeks.

According to TrimTabs data released this morning, the average U.S. equity fund has slightly outperformed the average global equity fund so far in October. In addition, fund flows to U.S. equity funds outpaced foreign funds for the first time in quite awhile at $6.6 billion versus $5.2 billion. This is quite an amazing turn of events, as foreign fund flows accounted for as much as 80% of all new fund flows in recent years while growth funds often experienced negative outflows.

Of course it's very early and only a short period of time, but I do think this data is insightful and perhaps predictive. I would suspect that a high percentage of the U.S. fund flows so described have also moved into growth funds, but I haven't yet seen that data nor do I know if it is available.

In the short-term, fund flows do affect stock prices, much like any other product in the market place. Higher demand associated with more dollars seeking purchase, pushes up prices in the absence of new supply. Longer-term, of course, higher earnings have to account for some of the higher prices, but not all of it, especially if interest rates are declining. As prices move up, new companies will also come to market, seeking to absorb some of the funds being allocated to high-growth, high-innovation opportunities, or whatever else happens to be in

fashion at the time (private equity recently, housing in the earlier part of this decade, tech and venture capital in the 90's).

For now, the actual data is confirming what we've been suspecting. Strong near-term performance is being caused to some extent by the reality of increasing fund flows, particularly on the growth side. Will it be matched by stronger earnings growth? Over time, I believe the answer is yes, particularly on a relative basis, but likely on an absolute basis as well. While there are no guarantees, investments made today likely raise the prospects for a greater harvest down the road.

Trick or Treat! (Posted 10/10/2007)

By the time Halloween rolls around, we should be pretty well through earnings season. While I suspect we'll have more treats than tricks, this time of the year is always just a little bit spooky.

A few materials and energy related holdings have already reported earnings and they have generally been on the weaker side. Given the slowing economy, these early reports make sense to us. Even though international markets are still generally robust, the slowing United States can't help but have a dampening effect on most industry earnings reports.

The markets and in many cases, the stocks, however, haven't responded too poorly on the downside, which once again suggests a decent amount of support in the marketplace. The rout in the bond markets over the summer, perhaps, may have some folks reconsidering the notion that fixed income is a safer place than equities.

Our portfolio has done extremely well in recent weeks as money has been gravitating towards companies that are capable of demonstrating solid organic growth in a declining economic environment. Certainly, the highest growth names seem to be enjoying the greatest percentage gains, but even slower growers that are capable of demonstrating consistent growth are participating. While volumes are generally still lighter than normal, it doesn't take much to get once long forlorn area like growth moving again.

It's been fun and I suspect the long-term trends favoring growth will continue for quite some time. But I also happen to know that sentiment can change very quickly, often overnight as it did this summer. While earnings reports so far suggest that there is a lot of firepower waiting to buy the dips, and therefore, perhaps less downside than the summer months, I also know better than to believe these data points hook, line and sinker.

Always check your candy. Sometimes it's got worms and on rarer occasions, razor blades. But most of the time, it's just great stuff. Just don't overdo it!

Have a Happy Halloween,

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