TRITON

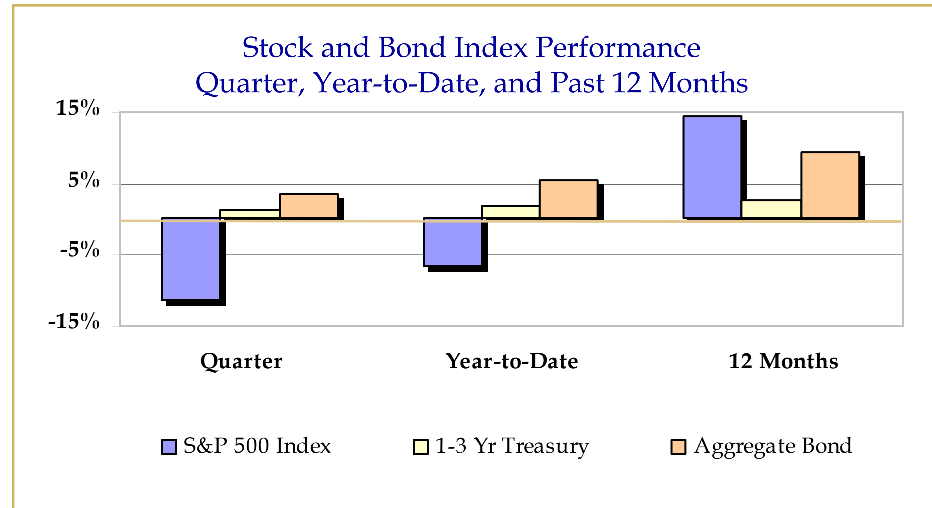
INVESTMENT ADVISORS, LLC

I'm not concerned with all hell breaking loose, but that a PART of hell will break loose…it'll be much harder to detect. ~ George Carlin

Stocks retreat in the wake of disappointing economic reports and talk of a double dip.

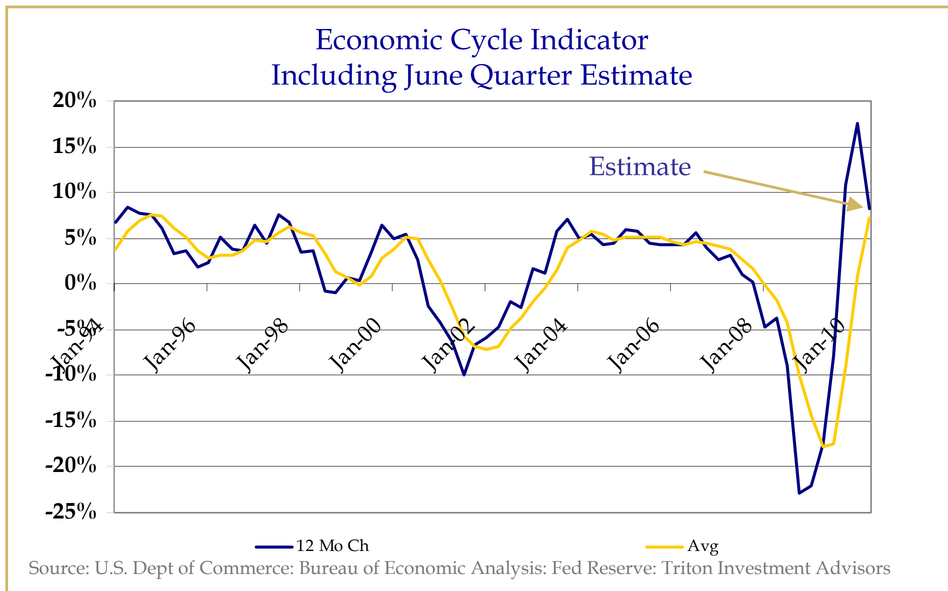
BP, European austerity and sovereign debt risk, slow U.S. employment growth, large fiscal deficits, and a double-dip recession. What caused that "flash crash," and is that new neighbor just an attractive women with an accent, or is she a Russian spy? The depth and diffusion of these global events destroyed all remnants of optimism, driving the somewhat extended bull market down nearly 12%. When faced with an abundance of variables – some knowable, some not – investors tend to find it so difficult to make a decision that they simply do nothing. Or, as was the case this past quarter, they seek the solace of the "risk free" Treasury market, while shunning the opportunity for growth of principal and income provided by equities. This, the rational investor does, when the yield on equities rivals that of the 10-year Treasury Note.

Many years ago I had a client who would ask me what I knew for certain. My reply would always be "for certain – nothing." Having acknowledged this truth long ago, the focus has been on the analysis of the variables we can know, that are driving market returns today.



Economic Growth and The Double Dip Recession

Based on a four phase economic cycle -- recession, recovery, expansion, and crisis -- our Economic Cycle Indicator (ECI) suggests that we have transitioned from the recovery phase to the expansionary phase. Having said that, we note that our ECI shows signs of moderating. This is not unusual following the recovery phase, as the economy often displays fits and starts as it transitions to self-sustainability. Our best tool for distinguishing a recession from a slowdown, the Recession/Recovery Indicator, shows no sign of a double dip. These indicators bear watching, given the lack of monetary and fiscal options available to policy-



Source: U.S. Dept of Commerce: Bureau of Economic Analysis: Fed Reserve: Triton Investment Advisors

makers to prop up the economy should it roll over.

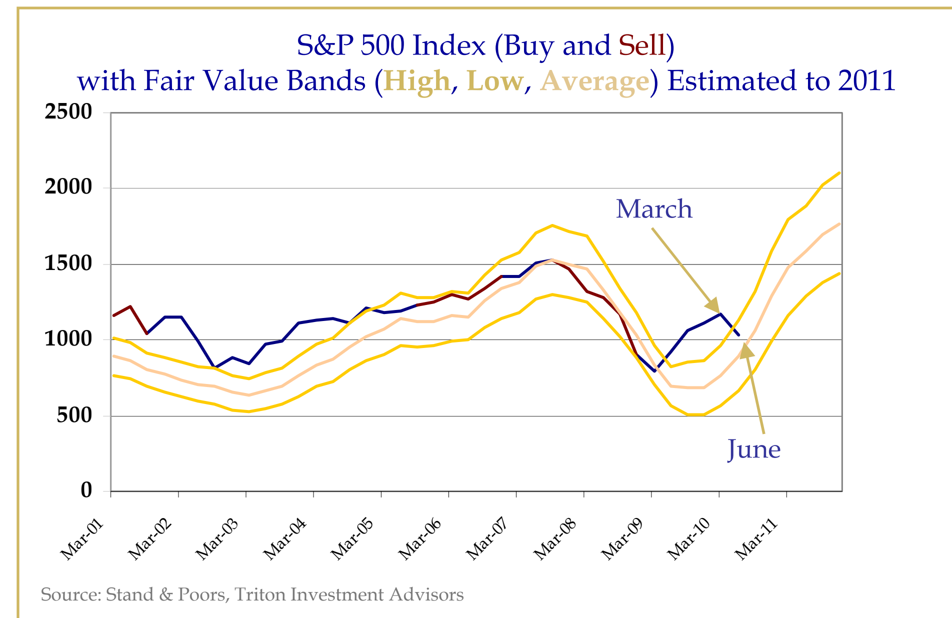
Double dip recessions are very rare, occurring only once in the last 50 years, and that was at the hands of an inflation fighting Fed chairman by the name of Paul Volker. Mr. Volker so tightened monetary policy that both the 3-month and 10-year Treasuries traded at interest rates in the mid-teens. (Some of you may even remember 20% interest rates.) The likelihood that the Federal Reserve would purposefully induce a recession at this point in the economic recovery is preposterous.

Corporate Earnings and the Stock Market

The greatest stock market gains have historically occurred in the late recessionary and early recovery phases of the economic cycle. Corporate earnings benefit from easy comparisons and improved productivity, as profits grow unimpeded by wage and input price pressures. Gains in the expansionary phase, while still positive, moderate as the expansion moves forward, drawing down the inventory of labor and resources, and driving up costs. Stock price appreciation in the expansionary phase is therefore dependent on the initial slack in the economy, as well as the strength and duration of the expansion.

We've been tracking Standard & Poors earnings estimates for the S&P 500 with considerable optimism. At the depths of the downturn, S&P estimated that 2010 reported earnings would hit $34.61; today that estimate stands at $67.38. Additionally, earnings for 2011 are expected to grow 15% to $77.64.

One could argue that stock valuations were a bit ahead of themselves at March end (see chart below), and that the 11.8% decline was simply a correction back to more normal levels. That may very well have been the case. Perhaps more relevant, for those with a longer-term outlook, is that history suggests earnings should push stocks higher in the coming years.



Source: Stand & Poors, Triton Investment Advisors

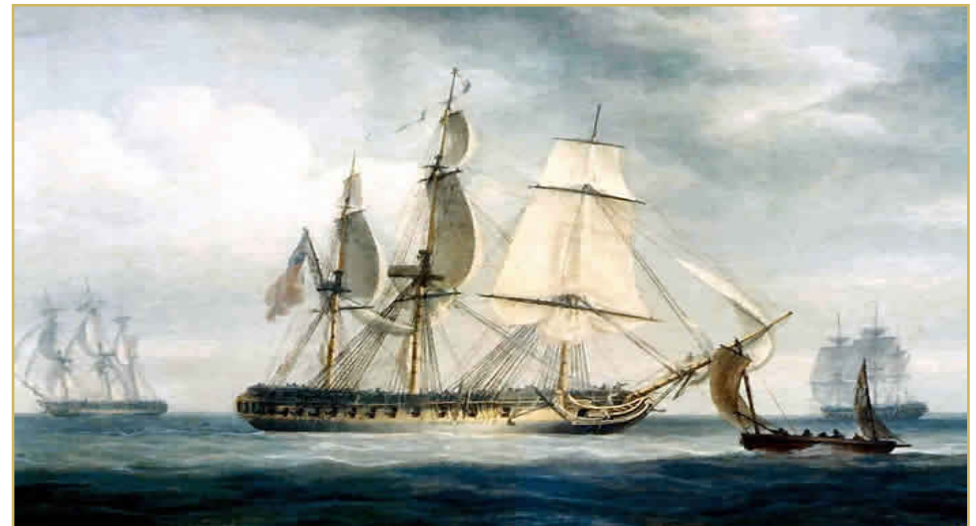
Investing in an Uncertain and Volatile Environment

Given the run-up of stock values at the end of the first quarter, markets were justifiably skittish about the economic prospects heading into quarter two. Our Recession/Recovery Indicator shows no risk of a recurring, or double dip recession, and this indicator has confirmed every downturn (and even some that haven't materialized) since 1960.

But, could a PART of hell, as George Carlin puts it, have broken loose that we can't detect? And, if it has, do we – meaning the global community – have the character and resources to press forward? The answer is we don't know, and neither does anyone else. If we knew these answers, our guess is that stock prices would be considerably higher. So we concentrate on what we do know.

We know that the Fed won't induce a recession at this time. We know there is a lot of slack in the economy, so even moderate growth should translate nicely into profits. We know there is a ton of cash on the balance sheets of corporate America, and eventually that will be put to work. And we know, that despite all the negatives, there is a lot of work that needs to be done.

At Triton, we keep reaching the same conclusion regarding the proper fiduciary course of action to take for our clients. We can only control that which is in our sphere of influence. Therefore, we continue to invest in quality companies, pay only a reasonable price, closely monitor the investment landscape, look for signs that our assumptions are wrong, and remain open to change when change is necessary.



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Glossary of Terms Mentioned

Economic Cycle Indicator – A compilation of economic and monetary series that include: Industrial Production, New Orders x Aircraft, PPI, Total Nonfarm Payrolls, Credit Spreads, and Monetary Velocity.

Recession/Recovery Indicator – A credit based tool that monitors interest rates and credit spreads for signs of an economic slowdown.

S&P 500 Index (Buy and Sell) with Fair Value Bands (High, Low, Average) – An assessment of the likelihood that real stock returns will outpace inflation (Buy, Sell), within the context of historical valuation metrics (High, Low, Average), based on 63 years of data.