Trader's Notes
RIVERFRONT
INVESTMENT GROUP

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Umbrellas Still on Sale

In our May 12, 2008, *Equity View* publication, we highlighted the attractiveness of the Consumer Staples sectoré particularly if recession fears were to return to the market. We believe the S&P 500ôs violation of key support at 1390 yesterday was a ñshot across the bow,ò signaling that recession fears may be returning and that the economy could be far from out of the woods. Given this event we wanted to reiterate the opportunity being offered by Consumer Staples stocks, especially given the fact that their valuations remain reasonable and the stocks have yet to incorporate a recession premium in their multiples. As a group, Consumer Staples stocks currently trade at only a one multiple point premium to the S&P 500, offer a dividend yield nearly 30% higher and have historically enjoyed far more predictable growth. Below are our May12 comments updated for todayôs market environment.

Consumer Staples…. Emerging Market Participation with Recession Protection

There are few things more attractive in investing than finding companies priced reasonably that stand to benefit from major potential catalysts. In our opinion, this is the equivalent of getting a ñcall optionò for free. These opportunities are typically difficult to find, because while catalysts are not rare, stocks that have not incorporated a catalyst premium in their valuations are. Today, we believe companies in the Consumer Staples group stand at the intersection of two potential catalysts that, if realized, should represent significant upside to their current valuations.

1. **Call Option on a Recession:** Staple stocks have historically outperformed the market during recessions because consumers will continue to eat, clean their homes and groom themselves in all economic environments. Historically, the degree of the groupôs outperformance during such periods of economic weakness has been significant. After a five-year bear market, the valuations of Staples stocks are in line with their 20-year historical averages. The ability to purchase Staples stocks at average valuations with the prospect of a recession imminent is surprising. It would be analogous to an insurance company writing policies on beachfront property at normal rates as a hurricane brews offshore.

2. **Call Option on the Strength of the Developing World:** Much has been written about the maturing of the developing world and the insatiable demand its populations are likely to create. While commodity prices for energy, food, and metals have been rising in response to and anticipation of this demand, the prices of the branded Consumer Staples companies with significant emerging markets presences have not. We believe it is only a matter of time before the valuations of Staples companies appreciate to more accurately reflect the significant opportunities in these markets. One of the first aspirations for many in the developing world is to purchase the same branded Consumer Staples products ubiquitous in the developed world. Because of their affordability and luxury allure, personal care products, carbonated beverages, candy and cigarettes are often the first items on the shopping lists of consumers in developing economies as they begin to mature.

Chart 1 shows the price performance of the S&P Consumer Staples group relative to the equally weighted S&P 500. During and in the years preceding the last two recessions, Staples stocks outperformed the broad market by 30-60%. Since mid-2007 when the rally began in Consumer Staples stocks, the group has only slightly outperformed the broader market, suggesting additional upside may exist. We shaded the recessions of 1990-91 and 2000-01 to aid in the comparison.

Chart 1

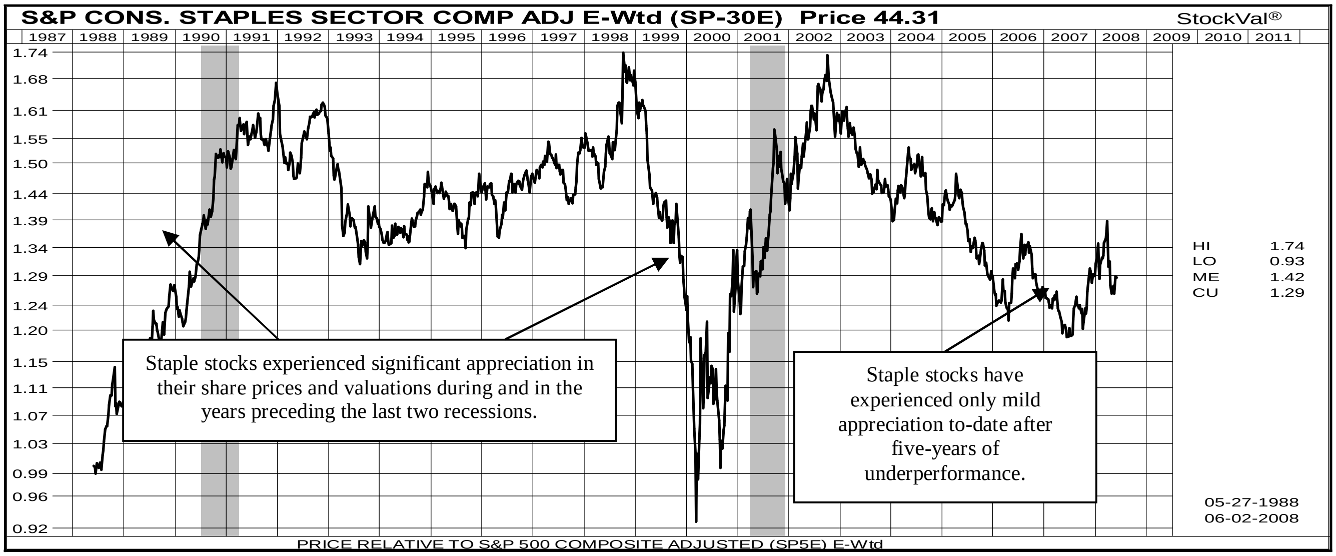

Chart Courtesy StockVal

Bottom Line: We believe that Staples stocks will benefit from the ñthree Wôsò: Worry, World and Warren. When it comes to ñworry,ò Staples stocks have historically offered predictable growth that is valued more highly during difficult economic times. From a ñworldò perspective, the products and services offered by the companies in this category meet the most basic needs of individuals and should benefit as the developing world comes on line. The final ñWò references Warren Buffet and his financial involvement in the Mars Corporationsôrecent offer to purchase one of the industryôs bellwethers: Wm. Wrigley Company (WWY-N-$77.00). Investing in the sector that is attracting the attention of one of the most-revered investment minds of our day, gives us greater confidence that we are on the right track with our outlook. We currently recommend a 200-400 basis point overweight to the Consumer Staples sector, which represents roughly 10% of the S&P 500. For the average investor, this equates to holding two to three positions within a 20-25 stock portfolio.

A few of our favorite Consumer Staples stocks include the following: CVS Caremark Corp. (CVS-N-$42.68), JM Smuckers (SJM-N-$53.04), H.J. Heinz Co. (HNZ-N-$49.70) and Colgate-Palmolive Corp. (CL-N-$73.16). For those looking to implement a Consumer Staples position via an ETF, we would recommend the Vanguard Consumer Staples ETF (VDC-A-$69.42).

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