

PG PERSPECTIVES

A New Season of Growth. *Recognizing Opportunities in the Equity Market*

DESPITE SOLID MARKET GAINS over the past two years, select companies continue to offer significant investment opportunities.

Many companies are only now beginning to shift from preservation and recovery measures to growth initiatives. This environment will provide excellent opportunities to invest in strong companies with attractive growth prospects. We believe that now, as the equity market enters a new season in the market cycle, is a good time to revisit your equity strategy. Participating in future growth requires a disciplined, long-term equity strategy focused on investing in high quality, well-positioned companies.

Strong companies are getting stronger.

Economies in the U.S., Asia and South America are once again growing. The pace is moderate, but economists expect a period of continued, sustainable growth. In this environment, financially sound companies are beginning to implement strategies to grow. The upside of this moderately-paced recovery is its potential to persist and provide a climate for these strategies to take hold.

The moderate pace of recovery has magnified the disparity between strong and weak companies. Weaker companies have struggled to keep pace with stronger competitors; as a result, many industries have contracted. Struggling companies cannot, in the absence of a robust economic recovery, generate the revenue needed to grow their businesses. Also, they have limited access to bank borrowing. As a result, the strongest companies have become more dominant and will continue to prosper even in a slower growing economy. Thus, even as the overall economy grows moderately, well-positioned companies may experience substantial growth that exceeds the performance of broad market indices.

Companies have many ways of growing.

Until recently, many companies remained focused on preserving their businesses. **The strongest companies are only just beginning to re-focus on growing their businesses.** These companies, having carefully managed through the downturn and accumulated cash, are now well positioned



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to capitalize on opportunities created by increasing economic activity and industry contraction.

Well-managed companies are positioned to grow as a result of:

- **Economic growth.** Domestic and international economic expansion, particularly in emerging economies, is generally increasing demand for a wide variety of goods and services.
- **Industry growth.** Many companies are further benefiting from industry growth that is significantly stronger than broad economic growth. For example, the *Energy* industry is rapidly expanding due to rising demand from emerging economies, and the *Technology* industry continues to thrive with new business and consumer products.
- **Company-specific initiatives.** Individually, companies can grow their businesses by becoming more efficient, developing new products and services, and expanding into new regions or countries. This expansion has already started as stronger companies are investing in new facilities, equipment and technology, and hiring employees.

In addition, industry consolidation through mergers and acquisitions provides yet another avenue for growth. This is enabling stronger companies to become more dominant players in their industries. A number of companies have already made acquisitions that will take their businesses to the next level. Small, well-established companies that are leaders in their industries have become attractive acquisition candidates. Investors can benefit from both sides of this activity.

How 2% turns into 25%.

Companies may be able to grow faster than the economy as a whole or their industries. To appreciate the growth potential of these select companies, consider, as an example, the five-year outlook for a small energy services company that is a leader in this specialized market.

▬ 2%

Based just on the prospect for **economic growth**, the company might anticipate an annual growth rate of 2%.

▬ 10%

As a result of rising demand in emerging economies, including India, Brazil and China, energy companies are growing faster than the overall economy. Layering **industry growth** trends on top of economic growth, the company might anticipate an annual growth rate of 10%.

▬ 25%

Company-specific opportunities may further expand the company's prospects. For example, the company may develop new technologies to take advantage of rising demand. The company then might anticipate an annual growth rate of 25%.

WHAT PG PORTFOLIO MANAGERS HAVE TO SAY ABOUT...

Investment Opportunities

"We continue to think there are a lot of opportunities in **large cap** and **mid-cap** stocks. Many large, multi-national companies remain undervalued while offering stable growth and attractive dividends. Mid-cap companies, meanwhile, operate in a "sweet spot" of the economy; they are large enough to weather market and economic storms, yet they can grow rapidly like a small company. Importantly, leading companies are now beginning to press more firmly on the growth accelerator. We see international growth and acquisitions as significant opportunities for both large and mid-cap stocks."

~ *Charles Suh*

"Over the past few months, many **small cap** companies have shifted their focus to increase earnings through growth initiatives rather than by reducing expenses. As these companies become more profitable and have increased access to financing, they have greater flexibility. They are then able to expand through investments, mergers and acquisitions. Also, these companies have greater pricing power as consumer demand continues to improve in the U.S. and global markets."

~ *George Henning*

Why a focused approach makes sense.

In contrast to an index approach, a focused approach concentrates in the most favorable sectors and companies. The stock prices of many companies have recovered strongly from the worst of the market sell-off. Even so, the current prices for many companies with strong growth initiatives do not yet reflect their earnings potential. They remain undervalued and, therefore, offer attractive investment opportunities. Taking advantage of these select opportunities requires a focused investment approach.

We employ focused investment strategies to take advantage of the best opportunities. Each portfolio typically invests in 30 to 50 companies that are undervalued but that have excellent prospects for growth. Each company is well-established and has strong management and a proven track record.

Will your equity strategy take full advantage of the growth opportunities in today's market?

Many investors, understandably, remain cautious; with the experience of the market downturn still fresh, they may be inclined to take profits to protect their investment returns. **A suitable equity strategy, though, can position investors to continue to benefit from new growth while managing risk.** That means maintaining proper diversification while focusing on investments in established, well-managed companies with growth opportunities.

The market has come a long way; nevertheless, there is room for further growth. A moderately growing economy generally creates an environment for individual companies to outperform the overall market. We believe that investors, who are selective in their strategies, can participate in that growth. We encourage you to work with your financial advisor to revisit your equity strategy and identify well-positioned investments.

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