VIEWPOINT

BIONDO INVESTMENT ADVISORS Q2-08 NEWSLETTER

CRUDE AWAKENING

While crude oil soared 40% to $140/barrel during the second quarter of 2008, it is no surprise that the period was yet another rough stretch for the US equity markets. For the second quarter, the S&P declined by 2.73%, the Russell 3000 Growth Index was up 1.50% and the Biondo All Cap Growth Composite was down 5.93%. Commodity-price inflation coupled with financial institutions under duress are creating a difficult outlook for the US and global economies, leaving many investors with a weary eye toward equity investments.

The US economy continues to defy expectations for a recession, at least technically, as GDP growth is tracking at around +1.4% for the first half of 2008. It appears as though investors expect the situation to worsen as monetary and fiscal stimulus begins to fade.

The financial markets were under intense pressure during the quarter as investors faced a multitude of challenges; including inflation, decreasing home prices, credit issues and earnings expectations. After surging more than 6% in April and May after the Bear Stearns bailout, June was especially difficult for the Dow, as all gains for the quarter evaporated and then some. In fact, it was the worst June for the Dow since the Great Depression.

The indexes are now officially in a bear market, having declined by approximately 20% from the peak last October. While this is never easy, it is important to note that we have been through many such markets and we know how to survive.

The median length of all bear markets has been 18 months during which equities dropped by an average of 27%. While all markets behave differently, the data suggest that we are closer to the end than the beginning of this both in terms of time and magnitude.

According to recent polls, over 80% of Americans have a negative outlook on the economy. Other surveys reveal that consumer confidence is the lowest in over three decades. With layoffs on the rise, home and equity prices declining and news footage of depositors lined up at bank branches, it is no wonder why people are feeling despair.

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While we came into the year positioned somewhat defensively, our posture did not save us from any part of this vicious decline. Energy and materials have been the best performing sectors year to date and we have unfortunately been underweight in both areas.

We believe that these areas remain vulnerable, as they have yet to feel the wrath of the bear's claws. Interestingly, our strongest convictions come from the hardest hit companies and sectors that have already had their punishment.

The oil-price induced recession is underway and the big question now is how long it may last. Traditionally during recession the best sectors are consumer staples and health care. Due to input cost pressures, consumer staples appear less attractive to us, as profit margins will be squeezed for the foreseeable future. This leaves health care as the most attractive sector, which conveniently is our largest overweight sector.

This stance appears to be paying off. These companies should continue to grow despite the inflation picture. The biggest risk appears to us that if oil and other commodity prices drop considerably, these stocks may not go up a lot because other areas will become more attractive and attract more attention.

Much has been made of this year's advance in oil prices. We would be remiss to not share our views. The media and Wall Street pundits have been quick to label this as an "oil bubble." Much blame has been placed on "speculators" and many in Congress have been jawboning about trading curbs being the answer. The facts paint a different picture as basic fundamentals are the driver behind higher commodity prices, oil in particular.

Worldwide known oil reserves are reaching a plateau. Data out of the North Sea and the Gulf of Mexico show signs of significant declines. The world's two largest producers, Saudi Arabia and Russia have shown signs of production problems. In fact, Russia has stated that the slip in production is a longer-term trend and not just a temporary problem. The Saudis are producing less oil today than they were able to just a few years back. In 2007, worldwide oil production decreased despite record oil prices and 2008 appears to be on track for further declines. Basic economics explains that rising prices should invite rising supplies – unless the supply is not to be had.

On the flip-side of the equation is demand. Although we have seen demand destruction over the past year in the US, worldwide demand continues to increase. This is being fueled by developing countries, whose appetite for energy appears insatiable. These countries are in the process of building the basic infrastructure – electricity, water and transportation. The only thing that could derail this demand growth would be a global slowdown of epic proportions – something none of us would benefit from.

The internal battle at the Federal Reserve has become increasingly public in recent months – with some worried about growth and some worried about inflation. This is serving to describe the Fed's conundrum over what policy to enact. In June's meeting, the Fed signaled an end to interest rate cuts, with a closer eye on inflation. Chairman Bernanke, in his most recent testimony, reiterated the Fed's stance that a slowing economy should help to contain inflationary pressures. The top priority appears to be the health of financial markets, as demonstrated by recent efforts to bolster Fannie Mae and Freddie Mac. It also appears, however, that the focus has become less on solvency issues and more on the ability to extend credit that is necessary for economic growth.

In the longer-term, investment results will be determined by the underlying growth of corporate earnings. We are pleased with the majority of our holdings' corporate performances and believe that they will be able to weather this current storm. We remain focused on owning great companies that deliver solid results. In the short-term, this can be painful at times.

Earnings expectations continue to be ratcheted lower by Wall Street analysts. While we tend to favor periods of rising earnings expectations, our sense is that we are near a point of inflection. Historically, downward revisions on the scale that we see today are most intense at turning points in the economy, and while analysts are supposed to be forward-looking, the bias is usually skewed by the most recent experience. We are more optimistic about expectations, although we do not expect a real acceleration in earnings over the next 12 months.

We maintain our belief that in the short to intermediate-term, it will be difficult for equities to move meaningfully higher without stability in housing and some relief at the gas pump. In the meantime, we continue to monitor our positions and are pleased with the overall health of the companies that we own. Our focus remains on the long-term, as we continue to battle the near-sighted volatility on a daily basis.

There were three companies added to the All Cap Growth strategy...

Murphy Oil (MUR)
Murphy Oil is a fast-growing integrated oil company. Its exploration and production business, bolstered by its Malaysian (45% production) and Canadian properties, is expected to grow output at least 30 percent/year for the next few years, one of the highest in the industry. This past year it acquired full control of its UK refinery and increased its refining output by 35 percent. The company has also boosted its refining capacity and expanded its gas station footprint. MUR continues to build out its retail presence, largely located at Wal-Mart locations in the South, and its gas stations now represent more than 2 percent of total U.S. retail sales. In addition, Murphy Oil's strong production growth profile and integrated business model should represent a low-risk way to invest in energy should oil or natural gas prices fall. At an initiation price of $91.18 on 6/16/08, our price target for MUR was $120.

Philip Morris International (PM)
On March 31, 2008, Philip Morris International was spun out from Altria Group ("MO"), the largest cigarette manufacturer in the world. PM represents the former international business segment of Altria, and its brands include Marlboro, L&M, Chesterfield, Parliament and Virginia Slims. The company has consistently exhibited faster earnings growth than its consumer staples peers, yet trades at a significant discount. This discount gap should close as investors realize its true long-term growth potential. The company has strong management in place known for effectively navigating through fierce legal hurdles, shown an ability to raise prices, and has efficient manufacturing prowess. The company is also just starting to gain traction in China and India, the two largest untapped markets in the world. Given this landscape, PM still has much earnings growth left. As of 6/30/08, PM's stock price closed at $49.39; our price target was $60.

Research In Motion (RIMM)
Research In Motion is the global leader in smart mobile phones, and is best known for the "Blackberry." The smart phone market is early in its adoption cycle with less than 20 percent of the mobile phone market. In particular, RIMM has two new potentially large markets, the retail consumer and China. Historically RIMM has appealed primarily to the corporate user. However, beginning in 2007, the company made a big push into the consumer market and has become the leader surpassing Palm, Motorola, etc. Later this year RIMM should also begin selling in China. As a result, we expect long-term earnings growth rate of 30 percent for the next few years. As of 6/30/08 RIMM's stock price closed at $116.90, and our price target was $165.

continued...

Sources: Energy Information Administration, Decision Economics, Inc., Yahoo Finance ®,Zephyr Style ADVISOR, The DowTheory.com, Gallup, Energy Information Administration, US Dept. of Interior, McClatchy Washington Bureau.

POSITIONS OUT

There were three companies removed from the All Cap Growth strategy….

Garmin (GRMN)
Garmin is the leading personal GPS equipment manufacturer in the world. Over the last few years this space has grown at 50 percent plus and, as a result, the sector attracted the interest of many other companies. With more competitors, average selling prices and margins have begun to fall. While the space is still growing at 30 percent/year, the increased competition has and will continue to erode Gamin's earnings growth rate. Like many other technology hardware companies early in the adoption phase, the leaders in these sectors can be great investments. However, as these sectors become more mature, product commoditization leads to diminishing competitive advantage and falling earnings growth rates. We expect maturation is approaching in the personal GPS sector, and that the same is about to happen to Garmin.

Prudential Financial (PRU)
Prudential is one of the leading diversified insurance companies in the world. It is known for judicious underwriting and having above-average growth and returns for its sector. Lately management discipline might have been lacking as the company has been hurt by asset-backed securities. In addition, a new CEO has also been put in place, and the annuities and insurance underwriting business have become more competitive. Given the uncertainties, we are skeptical that Prudential can be an above-average stock in a space with many strong competitors, and believe its historically above-average financial metrics are in question.

Whole Foods Market (WFMI)
Whole Foods is the category leader in organic grocery. However, in recent years traditional groceries have made progress in selling organic products. Consumers now have more options. In addition, the nature of organic food is that it sells at a much higher premium than regular groceries. Therefore, in the face of more competition in combination with a weakening consumer, we believe that Whole Foods' long-term growth prospects have diminished.

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