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September's Musing -- What's Going On?

As I studied for law school exams at Vanderbilt University in the spring of 1971, the country was embroiled in a raging debate over the Vietnam War as well as over the social and cultural events flowing from integration.

The song, [What's Going On](#), addressed those two issues. Written and sung by Marvin Gaye, it served as an anthem for the troubles which seemed to overwhelm the world at the time -- the Vietnam War, the challenges inherent in a nation struggling with decades of segregation, and the need the world over for less George Wallace hate and for more Gandhi-John Lennon type love.

We could just as easily ask that same question forty years later. Christine O'Donnell beats Mike Castle in the Delaware Republican Senate primary? What's going on?

That's like 35-to-1 underdog Buster Douglas KO'ing Mike Tyson for the heavyweight championship in 1990, Joe Willie and the Jets upending the Baltimore Colts in the '69 Super Bowl, Jack Fleck beating Ben Hogan in the 1955 U.S. Open. All rolled into one.

Some things I can explain. Some I can't. Which brings me to the stock market.

Used in a different context, "What's going on?" means "What have you been up to?" This missive will bring you up to date on what we've been doing for you the last several months.

Our thesis is that there are three drivers of investment selection and performance: fundamental analysis, technical analysis and macro events.

Just as a football team is comprised of an offense, defense and special team so these three are the components which are necessary for investment decision making. And just as any of the three football parts can determine the outcome of a game, the same is true of the Big Three in our investment world.

Today, the macro events are predominant -- the issue of unemployment, the economy, government regulation, tax policy, our deficit and debt issues, the threat of developed country sovereign debt default.

Accordingly, our thinking for the last quarter has been principally driven by responses to those macro events, more so than by fundamental or technical analysis, although the latter two are always a necessary element in our final decision making.

Here are four macro themes we have observed over the summer, and our investment responses to them for you:

1. Until recently the large caps (think the Dow Jones Industrials and the S&P 500 indexes) and the small caps (Russell 2000) didn't always move in the same direction. No more. All three major US indices and the international one (the MSCI EAFE index) now move in concert, practically as one. That's not good for our belief in using diversification as a hedge for falling markets.

2. Economic growth in the globe is now found in the emerging countries. The developed ones, including the U.S. and Europe, are healing self-inflicted fiscal and monetary wounds making their ability to grow their economies circumspect for the present.

3. While we continue to wait for the inevitable healing to strengthen the patient, we need to hold assets which are less correlated to those traditional markets.

4. The chances for either deflation or inflation in several years resulting from the actions of the Fed and the Washington policymakers is a greater threat than at any time since the inflation-ravaged '70s.

In recognition of these realities we have taken the following actions:

- A. Bought both a large cap as well as a mid/small-cap emerging

market ETF.

B. Bought a wireless telecommunication company which pays a nice dividend and has its 32 million customers in 13 emerging countries, principally in Central America, South America and Africa.

C. Bought a bond ETF which holds the debt of emerging market governments, all of which have lower debt-to-GDP ratios than developed country sovereigns. Its yield is also higher than comparable developed government ETFs holding bonds of comparable durations.

D. Bought a gold ETF which should serve as a hedge against a weak dollar as well as inflation-deflation concerns.

E. Bought a real estate investment trust ETF, again a strong dividend payer. It holds a portfolio of senior living and medical office buildings. That type of real estate should weather the recessionary environment better than other types of real estate.

F. Bought a conservatively run and managed diversified U.S.-based industrial company. Once again, this is another strong dividend payer. (Do you spot a theme?) It has operating units in 57 countries. It also has heavy exposure in China and India with regard to the infrastructure projects going on in those countries. Its business was up 37% in the first quarter of 2010.

G. In order to make those moves we had to sell some holdings. Our sales on your behalf included one or two private education companies, depending on your particular account profile. But in either event we got you out of another industry Uncle Sam announced he was entering.

We also took nice gains in a world-class rock salt and potash company, figuring next winter wouldn't be as severe and therefore the demand for road salt would diminish. An energy LP which caused some accounting consternation to some of you at tax time because of their K-1 issuance delay was jettisoned after very handsome gains.

A rent-to-own company which may have run out of stock market pricing steam notwithstanding this continued lousy economy was sent packing. Finally, a small viatical life insurance settlement company whose SEC accounting we began to question was dropped like a bad habit.

"CAR 54, WHERE ARE YOU?"

On an unrelated matter, some of you read the [article](#) I wrote for the *News Journal* editorial pages last week discussing the real life consequences of government tax policy as it affects small businessmen and entrepreneurs. I had earlier sent that letter to Wilmington Mayor Jim Baker before the *News Journal* asked me to send them a copy. I've heard from many, many folks in response, but the Mayor must be as lost as Car 54 in that old TV show. He has yet to respond. If he waits too long he won't have our employees to tax any more.

And, as the saying goes, that's what has been going on.

ARE YOU GOOD AT ANAGRAMS?

I saw this one on CNBC the other day. There was a famous and controversial singer back in my law school days who sang this refrain in his song *L.A. Woman*:

Mr. Mojo Risin'
Got to keep on risin'
Risin' risin'

The phrase, Mr. Mojo Risin', was also an anagram for his name. Clever fella', wasn't he? Who was that dude?

The first client to give me the answer will win a \$50 dollar certificate to the restaurant of your choice.

Notwithstanding the overwhelmingly negative headline news, do you realize that the stock market has actually been up the last six weeks? And that, believe it or not, the major indexes are in positive territory for the year? Dow 5.29%; Russell 2000 7.20%; S&P 500 3.71%. We trust that the actions Westover has taken on your behalf over the summer will continue to build your portfolio's value.

Chip, Jenn, Catherine and I hope you had a great summer.

September 22, 2010