The US Global Consumer Franchise Stocks - A Decent Port in a Storm!

To say that the 2000s have been a difficult period for investors in risk assets is an understatement. Equities have suffered two significant bear markets and the bursting of the property bubble and resultant global banking crisis brought the global economy to its knees. And the ordinary saver, looking for a risk free return, is suffering too with generational low interest rates. And to cap it off, the Greek debacle has highlighted that even government bonds are not risk free. One might justifiably ask – is there any port in this seemingly endless financial storm?

The US global consumer franchise stocks offer the most basic of products or services yet have unique attributes that investors often overlook. They offer defensiveness in their earnings, no financial risk (currently), mixed currency and emerging markets exposure and, following the decade long bear market in equities, better value than they have in possibly two decades.

The enclosed **Table A**, which highlights the earnings and dividend statistics of the US market (i.e. the Dow Index) and the US global consumer franchise stocks, makes a number of striking points.

The first point is that the overall US equity market was substantially overvalued in late 1999. Investors were paying 27 dollars for every dollar of earnings. Looked at another way, investors were buying an earnings yield of 3.6% (100 / 27.4 = 3.6%) in late 1999 at a time when the US 10-year government bond was offering a substantially higher, and risk free, yield of 6.5%.

The second point is that at that same time in late 1999, the US global consumer franchise stocks were, in aggregate, trading on 35 times earnings and offering a dividend yield of only 0.8%. Hence, these stocks were priced at a significant premium to an already overvalued market at that time.

The third point is that the US market is substantially cheaper today, trading on 14.3 times earnings. The US global consumer franchise stocks are trading on a similar rating, a highly unusual occurrence.

Looking back over a number of cycles **(Table B)** highlights that the earnings yield on this selection of US global consumer franchise stocks was an attractive 6% back in the late 1980s. But at that same time the US government 10-year bond was offering a yield of circa 8.0% and competing hard for an investor's money at that time. Today, however, the US government 10-year bond yields a paltry 2.9%. Said another way, the earnings yield from this selection of US global consumer franchise stocks represented 0.75 times the bond yield in late 1999. Today, the earnings yield available from these stocks is more than twice the bond yield. And this does not even take into account the high probability of growth in that earnings yield from here.

The resilience of earnings in these franchise stocks and their ability to grow their earnings over time marks them apart from equities in general. For example, the repetitive nature of the demand for Coca Cola's products in difficult as well as buoyant economic conditions, its bullet proof brand and global distribution power provide its earnings with this resilience. Likewise, McDonalds' low price points, speed of service and consistency of product have allowed it to consistently dominate the fast food industry globally and to deliver reliable growth over time. Proctor & Gamble has a collection of multi-billion dollar brands in household & personal care products where, again, demand is steady in good times and bad.

If earnings from the US global consumer franchise stocks are as reliable as the income from a government bond, and they have been in the past, then surely the value now lies with these stocks and not with the bonds. Throw in emerging market exposure, a mixed spread of currencies and a history of reliable growth and the value proposition is even more promising. Most likely, investors' fears of a double-dip recession have driven them to bonds. But the value is clearly in the US global consumer franchise stocks double-dip recession or not. Bonds were the better investment in 1999…but not anymore!

As Ben Graham, value investor and author of 'The Intelligent Investor, 1949' said ***'In the short term the market is a voting machine but in the long term it is a weighting machine'***
In my view, the weight of value is strongly in favour of these resilient global giants.

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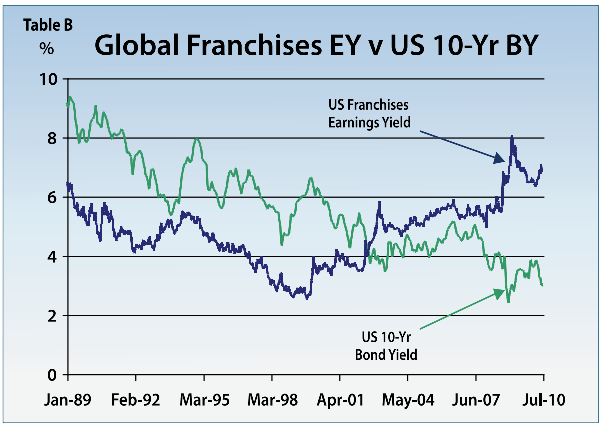
Table A

Company	Ticker	Price 06-Aug-10	P/E Ratio* 2010f	Div Yld* 2010f	P/E Ratio* 2000f	Div Yld* 2000f
Coca Cola	KO	56.75	16.2	3.1%	39.1	1.1%
Johnson & Johnson	JNJ	59.96	12.0	3.5%	28.9	1.2%
Kraft Foods	KFT	30.36	14.7	3.8%	-	-
Procter & Gamble	PG	60.02	16.0	3.2%	34.2	1.1%
McDonalds Corp	MCD	71.74	15.9	3.1%	26.2	0.5%
Wal-Mart	WMT	51.79	12.5	2.3%	47.3	0.3%
Average *(Global Franchises)*			14.6	3.2%	35.1	0.8%
DOW Index		10,654	14.3	2.9%	27.4	1.5%
US 10-Year Govt. Bond				2.9%		6.5%

* *Source of earnings and dividend data is Valueline*



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