

Leigh Baldwin & Co.

Investment Brokerage

Physics and the Laws of Investing

Was it Sir Isaac Newton who said “what goes up, must come down”, or was it David Clayton-Thomas. Thomas was the former lead vocalist of Blood, Sweat, & Tears, and wrote the Grammy award winning song “Spinning Wheel”, but he was not the father of the law of gravity, it was Isaac Newton. The markets encountered significant gravitational pull downward during the month of May, falling 14% from the highs of late April which made it the worst month of May since 1940. This has been the story for 2010 so far, big increases in the exchanges before and during the earnings announcement season (January and April) followed by dramatic sell-offs in the months to follow (February and May). Ultimately, company earnings should carry the day for investors but we believe there are three very important issues as to whether stock and bond investments will work out in the near term.

The first issue is the European credit crunch that began with Greece and has now rapidly moved into Spain. The IMF and European Union have committed at least \$1 trillion dollars to preventing a credit squeeze similar to the one we just went through 18 months ago in the US. This dramatic move will ultimately calm fears of economic collapse in Europe and although we need to be aware of happenings in Europe, the selling due to this may be overdone short term.

The second issue to contend with is the lack of confidence in the financial system. Truth be known, there was no “fat finger” that triggered the historic 1000 point sell-off mid-month in the US. Trading systems, “dark pools” and “high frequency trading”, have morphed over the last several years into electronic exchanges that now represent close to 70% of stock trading volume. The machines have taken over the humans with regards to trading, with little or no control and oversight by the powers that be. This issue needs to be addressed by Wall Street and unfortunately it is too profitable for anyone to really make changes. As investors, and the word investors is important, we need to realize that the markets will be extremely volatile, both higher and lower, for the foreseeable future, and that there will be tremendous opportunities presenting themselves in the days and weeks to come. The machines do not sense fear and they do not sense greed, but we as humans can learn to control these emotions, as best we can.

The third issue, which I believe is maybe the most important, is the deep water oil leak that is pumping thousands of gallons of oil into the Gulf of Mexico every day. This leak is going to dramatically change the way energy is found, produced, and sold throughout the world. Ultimately, the price of a gallon of gas will trend higher, maybe much higher. Alternative fuels and alternative fuel sources (think Canadian oil sands for an example) will become more and more viable. There will be a domino effect as a result of this oil spill and unintended consequences of how it is dealt with for a very long time to come. Investors stay tuned.

Successful investing is a direct by-product of owning companies that are committed to earning profits and sharing those profits either in the form of dividends, or through reinvestment in

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themselves to create more robust profits, or a combination of the two. US company earnings have been outstanding for the last 6 months as very lean companies are emerging from “The Great Recession” amidst the back-drop of government stimulus, inventory building, and the continued growth in emerging markets. Investors can take heart in the fact that nearly 80% of S&P companies met or beat profit expectations and that the S&P profit over the last quarter was 14% better than expected. Profits will eventually win the day and it takes discipline to stay the course during dramatic market swings, terrible headlines, and unforeseen volatile, difficult days. Just as baseball, beaches, and golf help define the summer, profits and earnings define investment success. And just as an apple falls from the tree, based on Newton’s law of gravity, great investments with enough velocity of earnings can grow to the sky.

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