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### **TRAUB CAPITAL 3rd QUARTER 2008 MARKET OUTLOOK**

In our last outlook, we expected some market troubles in the short-term and we surely got it, although despite the awful month of June (when the market fell 9.0%, the biggest monthly drop since September 2002), the quarter's return was a modest decline of 2.7%. We also thought we might see a positive return for the market for the year, although that may be tough to pull off as we think we could see an additional small sell-off from here (the market is already down another 4% in July as we write this). That said the market now looks undervalued. Even though we continue to see earnings estimates lowered, the p/e for this year is just 13, below the average over the last 20 years when we've had estimated earnings. On the other hand, interest rates are also below average with the 10-year Treasury at just 3.9%, another positive for the market.

Normally the market multiple moves up as interest rates decline although sometimes this effect takes time to play out and has gone the other way recently. The p/e could also be looked at as an earnings yield by inverting the p/e (to an e/p), which would show an earnings yield of about 7%. Over long periods the market multiple moves up and down such that the earnings yield has been similar to the 10-year Treasury yield. Yes, estimates are still likely to come down but in order to get the earnings yield in line with bond yields, they would need to come down almost 50%, an unlikely event. Even if they were to come down 20% (a more likely scenario than 50%), the multiple (and the stock market) would need to move up about 50% or bond yields would need to rise 3% to put the market at "fair value". As crazy as this sounds, keep in mind that in my former life at SSgA, I noted the same level of undervaluation at the end of September 2002 (ironically the last time the market fell so far in just one month)- and was met with great skepticism about the level of undervaluation. At that time the market fell another 5-6% during the next month before gaining the suggested 50% over the next 18 months. Ultimately the market more than doubled from its October 2002 low by the time it peaked last fall. How quickly we forget.

Regards,  
*Heydon*