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Was The Decade Really “Lost”?

The phrase “the lost decade” recently has become popular on Wall Street. It refers to the fact that over the last ten years, the broad range of stocks comprising the Standard & Poor’s 500 Index did not keep pace with other types of investments. In fact, measuring from the second quarter of 1999, the S&P 500 has declined by about a third.

Of course, in reality the decade was lost only for those who bought at the market’s peak and who have bought nothing more in the years since. Even though few investors, or speculators, fit that profile, the phrase is now part of Wall Street’s lexicon.

Thus, we thought it worthwhile to review the record of a number of high-quality growth companies since 1998. Normally, we prefer to examine longer periods of time but the last ten years were punctuated by several market bubbles, two recessions, a terrorist attack, and a crisis in and near melt-down of the financial system. For the analysis, we selected our firm’s top ten client holdings -- companies we have recommended and that our clients have owned during this turbulent decade.

The table below shows the cumulative ten-year share price performance for these companies compared to the Standard & Poor’s 500 Index. As a group, the share price of these high-quality companies increased an average of 80% from 1998 through 2008 while the S&P 500 only saw an increase of 1% for the same period:

	Top Ten Client Equity Holdings											Cumulative 10-Year Increase
	Mean Price Per Share											
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	
Abbott Labs	41	41	43	50	44	41	43	44	45	54	54	32%
Automatic Data Proc.	36	46	55	52	45	34	43	44	46	48	38	6
Coca-Cola	71	59	55	52	50	44	46	43	44	55	53	-25
Colgate-Palmolive	41	51	54	57	52	55	51	53	60	73	68	66
Johnson & Johnson	38	46	43	51	54	54	57	65	63	64	63	66
Paychex	19	23	43	40	31	32	34	36	38	42	31	63
PepsiCo	36	36	40	45	44	43	51	56	61	71	65	81
Procter & Gamble	40	49	43	35	42	45	53	56	59	68	64	60
Stryker	11	15	21	27	28	36	49	48	48	66	55	400
Walgreen	23	28	34	37	34	32	36	44	46	43	30	30
10-Company Average												80%
S&P 500	1084	1341	1396	1170	975	956	1138	1205	1325	1470	1100	1

Source: Value Line Investment Survey, Standard & Poor’s

The information provided herein represents the opinions of David Wendell Associates and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

As we all know too well, stock markets can be flat or depressed for long periods of time. But dividends continue to flow into a portfolio even during such stretches. The table below shows the ten-year dividend record of our firm's top ten client holdings:

Top Ten Client Equity Holdings												Cumulative 10-Year Increase
Dividends Per Share												
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	
Abbott Labs	0.60	0.66	0.74	0.82	0.94	0.98	1.04	1.10	1.18	1.30	1.44	140%
Automatic Data Proc.	0.29	0.30	0.34	0.40	0.45	0.48	0.54	0.61	0.68	0.83	1.04	259
Coca-Cola	0.60	0.64	0.68	0.72	0.80	0.88	1.00	1.12	1.24	1.36	1.52	153
Colgate-Palmolive	0.55	0.59	0.63	0.68	0.72	0.90	0.96	1.11	1.25	1.40	1.56	184
Johnson & Johnson	0.49	0.55	0.62	0.70	0.80	0.92	1.10	1.28	1.46	1.62	1.80	267
Paychex	0.10	0.15	0.22	0.33	0.42	0.44	0.47	0.51	0.61	0.79	1.20	1100
PepsiCo	0.52	0.54	0.56	0.58	0.60	0.63	0.85	1.01	1.16	1.43	1.60	208
Procter & Gamble	0.51	0.57	0.64	0.70	0.76	0.82	0.93	1.03	1.15	1.28	1.45	184
Stryker	0.03	0.03	0.04	0.04	0.05	0.06	0.07	0.09	0.11	0.22	0.33	1000
Walgreen	0.13	0.13	0.14	0.14	0.15	0.16	0.18	0.22	0.27	0.33	0.40	208
10- Company Average												370%
S&P 500	16.20	16.69	16.27	15.74	16.08	17.39	19.43	22.22	24.89	27.88	28.39	75

Source: Value Line Investment Survey, Standard & Poor's

The cumulative increase in dividends for these companies, as a group, from 1998 through 2008 was almost 5 times the increase for the S&P 500 for the same period.

These companies were able to increase their dividends so much because their earnings were growing at above-average rates. The next table shows the cumulative ten-year increase in earnings per share for our firm's top ten client holdings:

Top Ten Client Equity Holdings												Cumulative 10-Year Increase
Earnings Per Share												
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	
Abbott Labs	1.51	1.66	1.78	1.88	2.06	2.21	2.27	2.50	2.52	2.84	3.03	101%
Automatic Data Proc.	0.99	1.10	1.31	1.52	1.75	1.67	1.56	1.79	1.85	1.83	2.20	122
Coca-Cola	1.42	1.30	1.48	1.60	1.65	1.95	2.06	2.17	2.37	2.57	3.02	113
Colgate-Palmolive	1.31	1.47	1.70	1.91	2.19	2.46	2.42	2.64	2.91	3.38	3.66	179
Johnson & Johnson	1.34	1.49	1.70	1.91	2.23	2.70	3.10	3.50	3.76	4.15	4.57	241
Paychex	0.28	0.37	0.51	0.68	0.73	0.78	0.80	0.97	1.22	1.35	1.56	457
PepsiCo	1.16	1.23	1.48	1.66	1.96	2.05	2.32	2.69	3.00	3.34	3.21	177
Procter & Gamble	1.28	1.43	1.48	1.56	1.80	2.04	2.32	2.53	2.67	3.04	3.50	173
Stryker	0.38	0.41	0.55	0.67	0.88	1.12	1.43	1.75	2.02	2.40	2.78	632
Walgreen	0.51	0.62	0.74	0.85	0.98	1.12	1.32	1.52	1.72	2.03	2.17	325
10-Company Average												222%
S&P 500	44.27	51.68	56.13	38.85	46.04	54.69	67.68	76.45	87.72	82.54	49.51	12

Source: Value Line Investment Survey, Standard & Poor's

The earnings of these high-quality companies, as a group, expanded at a pace more than 18 times that of the average company in the S&P 500 index.

Why did the earnings of these high-quality companies expand at such above-average rates? Because their products and services are superior to the competition, their markets have steady, long-term growth characteristics and their management teams are experienced in navigating changing market, economic and business conditions.

The next table shows the cumulative growth in revenues over the last ten years for our firm's top ten client holdings compared to the companies in the S&P 500:

Top Ten Client Equity Holdings												Cumulative 10-Year Increase
Revenue (\$ billions)												
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	
Abbott Labs	12.5	13.2	13.7	16.3	17.7	19.7	19.7	22.3	22.5	25.9	29.5	136%
Auto. Data Proc.	4.8	5.5	6.3	7.0	7.0	7.1	7.8	8.5	8.9	7.8	8.8	83
Coca-Cola	18.8	19.8	20.5	17.5	19.6	21.0	22.0	23.1	24.1	28.9	31.9	70
Colgate-Palmolive	9.0	9.1	9.4	9.4	9.3	9.9	10.6	11.4	12.2	13.8	15.3	70
Johnson & Johnson	23.7	27.5	29.1	33.0	36.3	41.9	47.3	50.5	53.3	61.1	63.7	169
Paychex	0.5	0.6	0.7	0.9	1.0	1.1	1.3	1.4	1.7	1.9	2.1	320
PepsiCo	22.3	20.4	20.4	24.2	25.1	27.0	29.3	32.6	35.1	39.5	43.3	94
Procter & Gamble	37.2	38.1	40.0	39.2	40.2	43.4	51.4	56.7	68.2	76.5	83.5	124
Stryker	1.1	2.1	2.3	2.6	3.0	3.6	4.3	4.9	5.4	6.0	6.7	509
Walgreen	15.3	17.8	21.2	24.6	28.7	32.5	37.5	42.2	47.4	53.8	59.0	286
10-Company Average												186%
S&P 500	636.1	679.5	745.7	736.9	674.6	710.8	788.2	874.3	953.5	1025.1	1042.5	64

Source: Value Line Investment Survey, Standard & Poor's

The revenues of this group of high-quality companies grew at almost 3 times the pace of the average company in the S&P 500 -- even through two recessions and a financial crisis.

At the heart of a company's ability to grow both its earnings and revenues is its reinvestment rate. As we have discussed in prior newsletters, the reinvestment rate indicates the rate at which a company is able to fund future growth internally, without taking on debt. High-quality growth companies typically have above-average reinvestment rates:

Top Ten Client Equity Holdings												
Reinvestment Rate												
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009E</u>
Abbott Labs	25%	21%	19%	19%	17%	15%	13%	15%	15%	14%	15%	16%
Automatic Data Proc.	13	13	14	16	16	14	12	12	11	11	12	11
Coca-Cola	24	17	21	19	18	19	16	15	16	13	17	15
Colgate-Palmolive	29	45	75	nmf	nmf	nmf	86	78	78	52	65	47
Johnson & Johnson	18	17	16	16	20	20	19	18	18	17	19	17
Paychex	20	20	19	17	13	12	11	13	14	11	11	8
PepsiCo	16	16	19	23	27	21	20	21	21	19	22	19
Procter & Gamble	22	25	23	24	25	24	25	26	8	9	11	10
Stryker	21	22	24	24	23	20	20	21	19	17	19	17
Walgreen	14	14	15	14	14	14	14	15	15	16	14	11
10-Company Average	20%	21%	25%	19%*	19%*	18%*	24%	23%	22%	18%	21%	17%
S&P 500	11	12	12	7	9	10	12	12	13	10	5	7

nmf -- not meaningful due to share buybacks

*9-company average

Source: Value Line Investment Survey, DWA Estimates

Finally, the last twelve months have been harrowing for investors of all stripes, but now many high-quality companies with superior fundamental characteristics and above-average prospects are appraised at levels not seen in the last decade. As an example, the shares of this group of high-quality growth companies are currently appraised at a significant discount to the S&P 500:

Top Ten Client Equity Holdings												
Average Annual Price/Earnings Ratio												
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009E</u>
Abbott Labs	27x	26x	24x	27x	22x	19x	19x	18x	18x	19x	18x	14x
Automatic Data Proc.	29	36	37	38	30	22	26	24	24	26	20	15
Coca-Cola	51	48	38	31	30	23	23	20	19	21	18	14
Colgate-Palmolive	32	34	33	30	25	22	22	20	21	21	20	15
Johnson & Johnson	28	32	26	27	26	19	18	19	17	15	14	12
Paychex	48	54	52	65	50	35	44	33	31	28	25	16
PepsiCo	32	30	28	28	24	22	22	21	20	21	21	14
Procter & Gamble	31	31	30	21	22	22	21	22	22	21	19	15
Stryker	27	36	37	40	33	32	33	28	24	28	22	12
Walgreen	34	43	38	46	37	28	26	28	26	22	17	13
10-Company Average	34x	37x	34x	35x	30x	24x	25x	23x	22x	22x	19x	14x
S&P 500	25	26	25	30	21	18	17	16	15	18	22	16

Source: Value Line Investment Survey, DWA Estimates

Over the last 30 years, since our firm was founded, our investment philosophy has been based on three premises. These have been proven time and time again:

- The main goal of investing in growth companies is to participate in the superior long-term expansion of earnings and dividend paying ability.
- The most certain and least risky method of accomplishing this is through owning the shares of high-quality, well-managed companies with superior growth characteristics.
- The market value of their shares will reflect their underlying earnings growth over the long-run, although this may not happen in each and every quarter or even in each and every year.

The last decade may indeed have been “lost” for investors owning average, run-of-the-mill companies, chasing “hot”, speculative concepts, or making purchases regardless of price or valuation. But for investors in high-quality growth companies, the last decade was not “lost” at all. In fact, you could say it was found -- in fundamentals and quality.