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PLANNING

Quarterly Earnings

In the current earnings season, 3/4 of companies that have reported earnings have exceeded market expectations. Volatility continues and I do not see any real reason to think that it will abate any time soon. With more and more trading taking place via computer-driven "program trading", I expect that we will see price fluctuations increase as we move forward. This generates a great deal of noise in the information cycle. The volatility breeds news coverage about "what ifs" and that spawns even more price fluctuations. To a greater extent than we have previously seen, understanding the "why" in our investments will be even more important in the future.

Pepsi was one company that did NOT meet the expectations. Pepsi reported total beverage volume rose 13% in their "Americas" drink business, which includes Latin America and North America. In North America volume fell 1%. That means the growth in volume came from Latin America. Coke's report was similar. Caterpillar also reported earnings, but they beat the estimates and cited strong growth in Asia and Latin America, and not in USA. If the US stock markets generate any "good" returns in the coming years, I would argue that it is not because of any recovery in the US, but rather that the companies based in the US are making concerted efforts to grow their businesses in economies that are actually growing. If we avoid a "double-dip" recession in the US, the growth in Asia and Latin America will be the reason.

Apple

I promised you an update after some time testing the iPhone 4 and digesting the earnings report for the most recent quarter. This phone surpassed my expectations, keeping pace with my experience with my Mac computers. My non-scientific analysis of the antenna: When I squeeze the "magic spot" on the antenna, I get about the same reception that I got with my old 3G. When I do not press that spot, I get better reception than I used to get with my 3G. The return rate that Apple has experienced with the 4 is less than it was with any previous phone they have offered for sale. The free case will cost Apple between \$1 to \$3 per phone and they already allocated that expected cost into their most recent quarterly financials. With over \$46 billion in cash, Apple can and should give the cases away.

The quarterly financials were very good. Apple hit company records in sales, earnings, and cash flow. Most interestingly, sales of Mac computers were higher than ever at 3.7 million sold in the quarter. This is during the same quarter that the iPad was released and quelled fears that the iPad would cannibalize Mac sales. To the contrary, the Mac had its best quarter ever, including the latest holiday quarter. In my view, the Mac computer business is the product with the greatest potential for long-term growth for Apple. With market share still under 7% in computers, this is the market with the greatest potential for gain. For the past few years, I have viewed Apple's new products, first the iPod, then the iPhone, now the iPad, as merely introductory products. Products with lower price points that can reintroduce people, especially the younger generation, to the Apple brand and ultimately to the Mac computer. This quarter, Apples revenue from "the Americas" (North & South America), totaled just over 40%. With the iPhone rollout to many other international markets, I expect that Apple will continually shrink the amount of revenue that comes from US sales.

BP

The cap on the well remains intact as of this writing. The well pressure continues to slowly increase and stands right now at a little above 6,900 PSI. The casing cementing process will complete over the weekend in the relief well. Once completed, the relief well will stand ready to intercept the Macondo well. The "kill procedure" will entail using the existing cap and the relief well.

BP reported a quarterly loss of \$17 billion, including an estimated charge of \$32 billion related to the leak. Quarterly operating cash flows came in at \$8.9 billion and they are going to reduce their already low debt levels even further within the next 18 months. They plan to reinstate the dividend in February, 2010. Also of note is the change in the CEO with Tony Hayward's replacement by Bob Dudley. Good move. Hayward was horrible on TV, always looking like the cat that just ate the canary. Also, Mr. Dudley is an American and has roots in the gulf coast. Mr. Dudley previously led BP's joint ventures in Russia during the time period when Russian President Putin was jailing the heads of many russian oil companies. Mr. Dudley deftly navigated a very precarious political situation and BP emerged from the debacle relatively unscathed. Mr. Dudley even had to evade Russian agents who raided his office during the turmoil. In my view, that was pretty good training for dealing with the US administration. I'm optimistic with this investment and depending upon how the restructuring turns out, may hold this one a little longer than first anticipated.

India Raises Rates

The Reserve Bank of India raised their equivalent to our Discount and Fed Funds rates, to 5.75% and 4.5% respectively. While the US is stuck in the conundrum of low economic growth and a Federal Reserve that has already shot all their stimulating bullets, the forecast for economic growth in India stands at real GDP growth of 8.5% this year.

The Commonwealth games are coming to New Delhi later this year. That will put the Indian city in the international limelight and has spurred more government cooperation to allow investment into infrastructure, the lack of which hampers even faster growth. In India, securing government approval for a project continues to nag business investment. While the "red tape" has lessened over the last decade, some quirks remain. The government has taken strong, positive steps in making their regulations more fair and transparent and the trend is certainly positive. The Commonwealth games appear to have positively influenced the rate of change. I would be very encouraged if this proves to be the beginning of a new era in government-business cooperation, but only time will tell.

Our investments in India have been a bright spot this year, gaining 14% for this calendar year to date.

Portfolio Adjustment in Latin America

This doesn't happen very often, but it did happen recently. There was a management shake-up at Fidelity which caused me to lose confidence in the decision making for our investment in their Latin American fund. The new Fidelity manager had made some moves in the fund that displayed a lack of attention to the balance sheets of the underlying companies. This troubled me and I had to find an alternative for investment in this important region. Thus, I sold the Fidelity Fund and recently reinvested the proceeds into T. Rowe Price's Latin America fund. The fund manager, Jose Costa Buck, has been at the helm of this fund for 10 years and during his tenure, the fund has an average annual return of just over 18%. As always, past performance is not a guarantee of future results. Jose Costa Buck is based in Argentina and has always kept a tight leash on political developments in the region. Combined with his track record and emphasis on solid balance sheets, I feel much more comfortable with this choice for our Latin American investments. On average, the fund holds only about 50 companies at any one time and to give you a sample of some of those, the fund holds shares of PetroBras (Brazilian Oil Company), America Movil (mobile phone network provider), and Wal-mart de Mexico.

As always, if you have any questions, please feel free to contact me. Have a great remainder of the week.

Best Regards,

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