Economic Update

Broadleaf Partners, LLC

Good Times for Growth Stocks!
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We increasingly are of the belief that 2007 could shape up to be a great year for the stock market and, in particular, for many beleaguered growth stock investors. While many pundits and investment strategists have been calling for a rebound in growth stocks for years now (particularly large cap growth stocks), there are a few reasons why we believe the probability of outperformance is higher today.

1. **The Fed is on Hold.** For most of the last three years, the Federal Reserve Board has been raising rates in an attempt to slow growth, avert inflationary pressures, and return to some state of "normalcy". And believe it or not, until the last few months of 2006, the markets just hadn't responded to the significant earnings gains achieved by corporate America over the last three years. As a result, earnings multiples have contracted. Though eternally "vigilant", the Fed is now on hold and the monkey may finally be off the market's back.

2. **Lower Energy Prices.** The upward pressure placed on many commodity prices has been partially relieved by the cooling housing market and slower overall worldwide economic growth. Energy prices have declined significantly and while we suspect they will stabilize around current levels given undeniable trends in global demand, we are doubtful that they will return to levels seen more recently. Higher prices of energy, fears of dependence on the Middle East for oil, and an awareness of the issue of global warming (real or not), have given birth to the economic and political wills to both increase capacity and to find alternative energy substitutes in products like the sun, corn, the wind, and perhaps things yet "unseen".

3. **A Shift in Economic Momentum and Industry Focus.** A portion of the last few years of stellar economic growth was likely achieved by the pass through of higher input costs for oil and other commodities to buyers who knowingly or not became speculators. Many transportation companies, for instance, will reluctantly admit and bemoan the loss of fuel surcharges, which until recently, had become attractive profit centers. Materials, energy, utilities, and to a certain extent industrials, have been dominant performers during the first few years of this decade, partially reflecting this phenomenon and its cyclical underpinnings. If employment levels stay so fabulously strong and companies are less able to raise prices, they will resort to doing more with the same or perhaps even less. A return to productivity focused earnings growth may favor a different set of industries over the next few years.

Money almost always moves to what has been working, at least until it stops working. This is human nature. On this front, investment dollars have surged into the

international, value, and private equity arenas for several years, while drying up and in some cases turning negative for growth styles. The pace became so frenzied that some high profile private equity funds and former corporate mavericks became involved in a high society bidding war over what we had thought were some downright ugly industries.

In both 1985 and 1995, the Fed stopped raising rates. Perhaps because of or in spite of the decision to halt rate increases, the economy softened, stabilized and then resumed its path of non-inflationary growth. In both periods, the stock markets were propelled higher on the strength of an expansion in earnings multiples, particularly as long term rates declined. The impact of higher earnings multiples more than overwhelmed the impact of slower earnings growth, and the so called growth style of investing excelled. For the next five years, a shift in the economy of the nature recently seen should make growth stocks shine.

Rightly or wrongly, growth and value investors have tended to prefer certain industries over others and then increasingly crowd into what is working. To the extent this is the reality, the macroeconomic landscape could be calling for a regime change. Growth could be the new value.

Stay tuned!

Kindest Regards,

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