SCHAFER CULLEN

CAPITAL MANAGEMENT

MARKET COMMENTS

James P. Cullen
President

November 2007

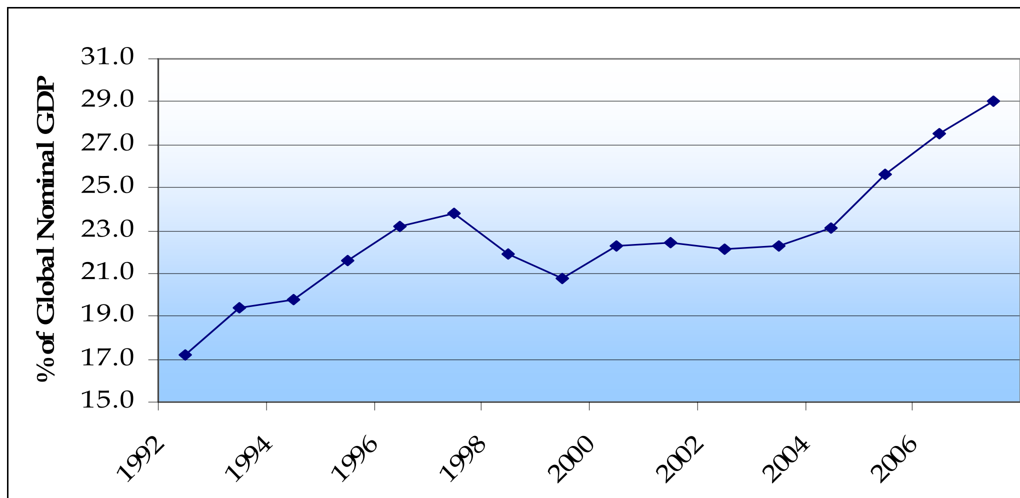
GLOBAL INVESTING
More Potential -- More Volatility

The global economy is booming. After years of being dependent on the United States, the developing countries are growing on their own. It started after the Cold War ended and despite 9-11 has been rapidly gathering momentum ever since. The Internet and speed of communications have dramatically accelerated the process. The chart below shows that the global GDP of developing economies has nearly doubled in the last 15 years and continues to pick up speed.

We can benefit from the global boom in two ways: 1) by investing in U.S. companies that show high earnings growth from international sales and 2) by investing in international companies directly through ADR's. Since our inception in 1984, Schafer Cullen has always had up to 25% of our portfolios in ADR's across all of our various value strategies.

The big question is, "What happens if the U.S. economy slows?" In the past, global markets have followed suit. Will the same thing happen again? No one knows for sure. **But we do know that in a market environment that has become increasingly volatile, our strategy of being disciplined about price (low P/E, low P/B, and high dividend yield) and investing for the long term (5 years) would seem to make more sense than ever.**

Developing Economies % of Global GDP



Source: ISI Research

645 Fifth Avenue • New York, NY 10022 • Tel 212.644.1800 • Fax 212.593.4275 • www.schafer-cullen.com

Beyond the BRICs

Much has been said about the explosive growth of the so-called BRIC countries (Brazil, Russia, India, and China). **But we've heard almost nothing about the rapid growth of the rest of the developing world.** The table below shows how broad and strong growth has been in these other emerging markets which include every continent in the world except Antarctica. **What we see is that the GDP of developing countries outside the BRICs is growing at least twice as fast as in the US (2%) and now represents 17% of world GDP -- fully a third more than the 13% share of the highly publicized BRIC countries.**

Not only are the countries outside the BRICs growing faster than the US, but unlike the situation 10 years ago, they have stronger balance sheets and are less leveraged than the U.S. **Moreover, we saw just last month that emerging market central bank reserves increased an astounding $1 trillion, 33% higher than last year.** This, while the U.S. has piled up a $3 trillion deficit.

Real GDP Growth in Developing Economies ex BRICs

4.0% Growth or higher 2007: 1Q Y/Y%

Developing Economy	Real GDP Growth	Developing Economy	Real GDP Growth	Developing Economy	Real GDP Growth	Developing Economy	Real GDP Growth
Azerbaijan	39.6%	**Argentina**	7.7%	**Costa Rica**	6.3%	**Israel**	5.4%
Macau	24.3%	**Vietnam**	7.7%	**Zambia**	6.3%	**Sri Lanka**	5.3%
Angola	19.3%	**Qatar**	7.6%	**Romania**	6.2%	**Kenya**	5.3%
Iran	17.9%	**Peru**	7.5%	**Singapore**	6.2%	**Malaysia**	5.2%
Mauritania	14.3%	**Poland**	7.4%	**Indonesia**	6.1%	**Oman**	5.1%
Sudan	11.7%	**Slovenia**	7.0%	**Honduras**	6.1%	**Senegal**	5.1%
Latvia	11.4%	**Nigeria**	7.0%	**Czech Rep**	6.0%	**South Africa**	5.1%
Kazakhstan	10.1%	**Croatia**	6.8%	**Bangladesh**	5.9%	**El Salvador**	4.9%
Estonia	10.0%	**Philippines**	6.7%	**Ghana**	5.9%	**Guinea**	4.7%
Slovakia	9.4%	**Egypt**	6.7%	**Kuwait**	5.8%	**Nicaragua**	4.7%
Dominican Rep	9.2%	**Bahrain**	6.6%	**Chile**	5.7%	**Levant**	4.6%
Panama	8.9%	**Tanzania**	6.6%	**Hong Kong**	5.6%	**Greece**	4.6%
Venezuela	8.8%	**UAE**	6.6%	**Botswana**	5.6%	**Guatemala**	4.5%
Cambodia	8.5%	**Laos**	6.6%	**Uganda**	5.6%	**Saudi Arabia**	4.5%
Lithuania	8.3%	**Tunisia**	6.5%	**Mali**	5.6%	**Bolivia**	4.4%
Ukraine	8.2%	**Turkey**	6.4%	**Jordan**	5.5%	**Cameroon**	4.3%
Mozambique	8.1%	**Uruguay**	6.4%	**Finland**	5.5%	**Thailand**	4.3%
Columbia	8.0%	**Bulgaria**	6.4%	**Ethiopia**	5.4%	**Taiwan**	4.2%
Iraq	7.9%	**Pakistan**	6.3%	**Algeria**	5.4%	**Namibia**	4.0%
Trinidad	7.8%	**Congo**	6.3%	**Libya**	5.4%		

Source: ISI Research

Some of the countries here might cause some raised eyebrows. We are not saying you should invest in any of these countries, but we are saying that the world order is changing and providing opportunities. United Technologies (UTX), based in Connecticut, is one company going after business all over the world and is now doing business in every single country in the world.

A recent *Washington Post* article with the headline, "Everyday Kenyans Taking Stock in a Growing African Economy," highlighted the progress that Africa has made. Kenya ranks only 63rd on the list above, but stock market fever is sweeping the country. Its people traditionally invested only in cows and land; they are now learning to trust in the abstraction of corporate shares. The number of investors has risen from 50,000 in 2002 to more than 750,000 today. During the same period, the Nairobi exchange's total value jumped from $1 billion to $12 billion. Last year's listing of state-owned KenGen had people waiting in line for hours to buy shares.

The *Post* article concluded, "More Kenyans are taking vacations abroad these days. Huge billboards around the city advertise the accoutrements of wealth – weekend jaunts on Kenya airways to Paris, slender cell phones, credit cards. Sleek bars and restaurants are packed on week nights with young well heeled, cosmopolitan drinking Kenyans. Glossy GQ like magazines offer images of a glamorous life sometimes alongside features on wise investing". This is not how most Americans picture Africa.

Globalization – Earnings Impact

Because business is booming abroad, U.S corporate profits from international sales now represent 25% of total earnings. This is up from only 5% in the mid-1960's. Also, for the large cap S&P 500 companies, over 50% of sales revenues come from sources outside the U.S. **The international contribution has been accelerating; in the first quarter of this year, for example, international profits for U.S. companies grew at a stunning 16.4% compared to year earlier results, while domestic earnings rose by only 2.7%.**

The literal bottom line for **value** investors is corporate earnings. **Today, the companies that are the most successful in growing their earnings are those that are the best at figuring out how to be competitive and do business in the global marketplace.** A hundred and fifty years ago, corporate profits came from agriculture and commodities; then from steel and heavy manufacturing; then autos, radio and television. Today, the new driver of U.S. corporate earnings is international business.

Like United Technologies, General Electric (GE) has shown how an American company adapted to changing business environments. Fifty years ago, GE made light bulbs; twenty years ago it produced radios and televisions; today, over 50% of its business is done overseas and its fastest growing units sell medical and electrical generating equipment in Asia. The chart below demonstrates that for the past 100 years, U.S. companies like UTX and GE have had a phenomenal capacity to adjust to change and consistently grow their earnings.

S&P Earnings (1900 - 2006)

Source: ISI Research

More Growth -- More Volatility

Global growth means that 3 billion potential new consumers will be gradually coming to buy goods and services in the marketplace. The impact will be felt in fits and starts, but momentum should continue to build.

The catch is that some of the new markets and economies are small and thus tend to be volatile. There is also the matter of political instability. But as communication among global market participants gets faster and better, the new economies and markets are now far more immune to external shocks than they have been in the past.

An example of the difference in performance and volatility in emerging versus mature markets is the case of the U.S. (emerging) and U.K. (mature) at the beginning of the last century. From 1900 to 1929, the U.S. market shot up 400% while the gain in the U.K was a modest 10%. When stocks worldwide dropped from 1929 to 1932, the U.S. equities went down twice as much as those in the U.K. Then in the recovery, from 1932–1945, the U.S. market went up 400% versus 100% for the U.K.

The Solution: Be Disciplined / Be a Long–Term Investor

Dealing with crises of all kinds and persistent market volatility is nothing new for investors. During the last forty years, they have experienced the collapse of two of the worst speculative bubbles in market history: the Nifty Fifty and the Tech Boom. There was also a time when most of the S&L's in the country were bankrupt and interest rates climbed to 20%. Then, there was Black Monday when the market dropped 25% in one session. Nor have investors forgotten two Gulf wars and six economic recessions during the forty year period, not to mention the horrors of 9-11.

Despite the turmoil, the table below, which we have referred to in previous letters, shows how the combination of using a disciplined (low P/E) investment strategy, combined with a long-term, five-year time horizon, has provided remarkably consistent annualized returns.

Rolling 5-Year Performance: Bottom 20% of the S&P 500 By P/E

(Annualized Rates of Return)

Period	S&P 500 Bottom 20% by P/E	Period	S&P 500 Bottom 20% by P/E
1968-1972	**9.66%**	1986-1990	**6.14%**
1969-1973	**0.00%**	1987-1991	**10.53%**
1970-1974	**1.11%**	1988-1992	**15.37%**
1971-1975	**12.44%**	1989-1993	**14.54%**
1972-1976	**17.81%**	1990-1994	**10.10%**
1973-1977	**17.02%**	1991-1995	**23.17%**
1974-1978	**24.71%**	1992-1996	**17.92%**
1975-1979	**34.30%**	1993-1997	**22.01%**
1976-1980	**24.67%**	1994-1998	**17.79%**
1977-1981	**18.20%**	1995-1999	**18.22%**
1978-1982	**22.18%**	1996-2000	**13.90%**
1979-1983	**24.53%**	1997-2001	**13.26%**
1980-1984	**26.07%**	1998-2002	**4.74%**
1981-1985	**26.46%**	1999-2003	**12.14%**
1982-1986	**27.63%**	2000-2004	**16.01%**
1983-1987	**18.92%**	2001-2005	**15.39%**
1984-1988	**18.22%**	2002-2006	**15.98%**
1985-1989	**16.29%**		

Source: SCCM Research

Remember the Discipline

Two things jump out from the table above: first, consistent annual returns in almost all of the five-year periods despite bouts of extreme market turmoil and second, no down periods. **However, if investors chose to only focus on the five-year time periods alone and ignored the P/E discipline, the outcomes would be very different and in many cases disastrous.** We need only to remember that NASDAQ, which scorned any price discipline, was still down 50% five years after its 2000 highs. Other memorable examples of the penalty for ignoring a price discipline are: The Nifty Fifty Bubble stocks of the 1960's, which after 5 years were still down 50% from their highs in the 1970's; gold in the 1980's, which was still down 50% ten years after it peaked; and the Japanese market, which was also down 50% ten years after its high in the 1990's. History provides a constant stream of examples of how certain sectors of the market get overly popular and price discipline gets ignored.

Be Cautious with ETFs

One such area of popularity today is the Exchange Traded Fund (ETF), which, as an index fund, enables an investor to participate in various global markets or specific sectors of the market. ETFs can be very useful, giving an investor some diversification in markets in which it is difficult to pick individual stocks. **The danger is that in almost all cases ETFs, like other indexes in the past, are dangerous when they become so popular that valuation goes out the window.**

Conclusion

The boom in the global economy has given a strong boost to corporate earnings and provided investors with an opportunity to benefit from making international investments. However, some international markets are illiquid and volatile, and thus subject to substantial unpredictability. Accordingly, in a global economy, maintaining a price discipline and investing for the long term have become more important than ever before.

Jim Cullen

Disclosure:
Past performance is no guarantee of future results. All opinions expressed constitute Schafer Cullen Capital Management's judgment as of the date of this report and are subject to change without notice. This information should not be used as the primary basis for investment decisions. It should not be assumed that any security transactions, strategies, holdings or sectors discussed were or will be profitable, or that future recommendations will be profitable or will equal the investment performance discussed herein. Investing in equities involves risk to your principal. Individual client account performance will vary.