

The following is a transcript from "Bloomberg On The Money PM Edition" on 02-Aug-06 with Scotty George, Chairman of du Pasquier Asset Management. (Reprinted with permission from Bloomberg Inc.)

I'm Howard Lieberman.

And I'm Charlie Stein and this is Bloomberg on the Money.

HL: And we want to talk stocks now, joining me here in the Bloomberg World Headquarters studio, Scotty George, the Chairman of du Pasquier Asset Management. Scotty thanks for being with us.

SG: Good afternoon Howard, Charlie.

HL: I know that you look at things more in a long-term basis and you're kind of a macro guy. You look at a lot of factors to decide where people should be putting their money when it comes to stocks, but we have to kind of ask on a day to day basis as well, what's moving the market today? We see stocks rallying once again. What is the investors' major focus now? Is it the 50-50 shot next week for the Fed rate hike or is it the earnings we've been getting?

SG: It's probably not earnings, and I don't believe that it's the Fed either. We're really stuck in the throes of a conundrum in here in which, on a day to day basis the market deals with, "are we going up or are we going down?" And yet if you look at the pattern of the market, the market is stabilizing to such an extent that at least we're not showing negative returns on a consistent basis daily. So I think that what's leading the market in here is psychology and you can ascribe it to the Fed, you can ascribe it to the Middle East, or you can ascribe it to earnings, but it's really psychology trumping fundamentals.

CS: Let's talk about those fundamentals. Do they look good going forward, or is it in fact the Fed kind of hanging over the market like a sword of Damocles makes it unclear?

SG: The Fed is really a non factor in here, Charlie. Irrespective of the Fed choosing to characterize the economy strongly or negatively, the market has a bias globally and it's going to perpetuate with or without the Fed. The fundamentals look relatively good, but with one big white elephant sitting in the middle of the room, and that's global inflation on commodities prices. As an earnings driven investor, I'm very sensitive to the fact that the rate of expansion in profits and earnings has been diminishing and it's showing up in, not a change in leadership in the market, but it's showing up in the number of stocks which characterize that leadership. More stocks seem to be on the down-cycle than on the up-cycle and yet the economy seems to be relatively strong.

HL: Scotty, going into Phil Gregory's report talking about worldwide commodity prices, now for a long time we've seen gold at record levels. We've seen silver and copper and the base metals and certainly oil has been at record levels. Yet it really hasn't seemed to slow Wall Street down all that much. Everybody that follows commodities would tell us that, "well it's different this time, because of China and India, and the demand is so huge that that's what's driving the price and that it's not necessarily cause for concern about inflation." Are they right, or are the people that say that missing something?

SG: No, I think that the cycles are there proving the value of these tangible assets and their potential for earnings and profitability, and speaking as a portfolio manager, for adding capital gains in our portfolios. The real key as you alluded to earlier in your introduction of my work, Howard, is that we're looking to try and identify which trends are macro, which trends are enduring. And in doing so we're trying at the same point to underweight those categories, those equities, which have a probability of underperforming the market. So it's not an easy task but it makes the job of allocating money into the market much easier. There's no need to dispel the momentum of Energy and Basic Materials if in fact they're continuing to perform based upon demand. Those are two of the sectors that we favor right now.

CS: If you favor Basic Materials and Energy, would you want to stay away from companies that use those to a great degree as inputs?

SG: No, because in the end the core costs of applying those materials will be passed on to the end user, the demand consumer. Where we're underweighting the market right now is in sectors that are not being driven by discretionary spending, not being driven by unabated psychology and euphoria, sectors like retails and automobiles and to a certain extent the electronics portion of the technology sector.

HL: In the note that you wrote on Monday to your clients, Scotty, you talk about predicting "food stuffs will be the next global trend to accelerate", and you're talking about everything from agriculture related companies to fertilizer harvesting. What sorts of companies are we talking about here and why is agriculture the next area you want to be putting money into?

SG: Well, tangible assets are the key to this market and demand. They are both in short supply and they are being used on a global basis indiscriminately, not relative to capitalization within the markets or consumer economics. We've already exhausted, over the last two years, a lot of the momentum in the Energy sector and in the Basic Materials,

specifically the precious metals. So we need to look elsewhere for tangible assets and if the theme endures I believe agriculture is the next theme.

CS: How would you play that Scotty? About thirty seconds and then we'll continue.

SG: We're looking at the retailers, the food supply companies. I don't want to name names, but you can look at the "Heinz's" and "Tyson's" of the world, but you would also look at the growers and the agriculture companies as being long-term enduring plays, particularly on the profit side.

CS: Ok, we're going to ask you to hang on. We're speaking with Scotty George, Chairman of du Pasquier Asset Management, talking about some of the groups he likes, particularly on the Basic Materials and Energy, and agriculture side. Some of the groups he might avoid would be retail, auto, and the electronic parts of technology. We'll ask Scotty about some other stocks like Financials and healthcare when we continue. All three markets we follow are higher right now; the Dow was up two-thirds of a percent, the S&P up six-tenths of a percent and the NASDAQ up eight-tenths of a percent.

CS: The data check on the Bloomberg shows the Dow Jones Industrial Average up six-tenths of a percent, 64 points to 1190, the S&P 500 Index up half a percent, 6 points to 1277, the NASDAQ Composite Index up seven tenths of a percent, 14 points to 2076. Oil finished the day at \$75.81, that was up 90 cents. Gold is at \$651. 83, that's up \$5.00, today. We'll continue our discussion with Scotty George, Chairman of du Pasquier Asset Management. Scotty, before we broke you identified a few groups that you were somewhat leery of including retail, autos and technology. I can certainly understand the first two. Explain the technology, particularly with an emphasis on electronics.

SG: Well as we define technology we pick it up as a much bigger basket, let's say, than the S&P would define it. We include biotechnology, the technology retail stores, the semi-conductors, etc., so within that broad segment of the market, we tend to look at the fragments and lump them all together. Now, biotechnology certainly has a lot of potential in pricing and profit potential, but the retail side of the technology group looks to be performing almost like the cyclical companies and we tend to underweight those stocks.

HS: When you talk about biotechnology do you start to think about other pharmaceutical type companies? Do you start to think about healthcare? Certainly the population is aging, the baby boomers are getting set to retire, they're all going to be going to the doctor more often. They're getting hips and knees replaced, and there are all sorts of medical things happening with the aging boomers. You would think that this is an area you would want to be investing in and yet for quite a while healthcare did nothing and now it's an area that a lot of money managers are looking at again. What's your take on healthcare?

SG: Well I'm glad to hear you talking like a portfolio manager at du Pasquier Asset Management because these themes in fact are the kind of things that resonate throughout our portfolios. It's not just the United States population that's getting older. It's the world, it's the globe. And that relates to the infrastructure of the globe, (for example, industrial companies, roads, trucking, etc.). And it relates to the physical and emotional health of the persons of the globe. So, to that extent, I like healthcare as it relates to biotech, biopharmaceuticals, the traditional pharmaceutical companies and the healthcare delivery system. This is a very, very strong theme that we think can have profit potential in the long term.

CS: You mentioned the industrial and the infrastructure side. Does that fit one of your enduring themes going forward, and do you play it with companies like Emerson Electric or Caterpillar? How do you take a hold of it?

SG: Well you're getting me into the stock side and I'm going to recoil from that, but the answer is yes, we do play that theme. Certain sectors which are neither leaders nor laggards we call "coincidental performers" and that means that their day to day performance as well as the characteristics of their trend over the long term tend to look a lot like what the market looks like. The industrial companies, although resonating this "infrastructure theme" for the long-term, tend to perform on a daily basis a lot like the market does. That is, they are neither counter cyclical, moving up when the market moves down, nor do they take a leadership position. So we do play the industrials, but we're playing them right now cautiously as a kind of coincidental performance characteristic.

HL: We have about thirty seconds left here Scotty and I don't know if it's a fair question based on the way you do your business and manage the portfolios, but are you fundamentally at this point bearish or bullish on where stocks are going?

SG: I'm bullish, but concerned because the degree of acceleration has diminished. Since 2002 to early 2003 when this current bull market began yet again, we've seen a slowdown in the rate of acceleration and profits, and that's due in large part to pricing pressure as opposed to unit volume growth. As a result of which, companies have to become more inventive about how they pass along prices or maintain the margins in their business. Absent a strong demand economic cycle, and in that marketplace, I've become concerned that the stock market can't sustain.

HL: Scotty George, as always thanks for taking the time to be with us, we appreciate it.