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REMEMBERING THE FUTURE

Vol. 3, Issue 1, June 2011

OPPORTUNITIES AT THE DAWN OF THE NEW SILK ROAD: INFRASTRUCTURE AND DIVIDEND PLAYS

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Introduction

This month we continue our examination into global opportunities that will exploit the new economic regime that is unfolding. The unfolding trajectory will be shaped by a multitude of factors related to the output and demand trends that are maturing in emerging markets. These countries haven't reached the development or style of life that is typical and taken for granted in the United States or in Europe. In order to reach that level of quality of life, these emerging players will need to provide their economies the necessary support systems in areas such as transportation, communication, broadband and energy that will keep their markets productive and efficient.

In the final portion of this month's newsletter we will look at the opportunities available by dividend paying securities. Our office has been examining the underlying potential in these types of investments for quite some time and our research has revealed some strong trends of growth, income and overall financial security. We have maintained a core position in dividend paying securities since 2009.

Infrastructure: For Richer, For Poorer

In keeping with our narrative of a new productive era that creates tangible assets our analysis this month carries us into the developments engulfing the global infrastructure sector.

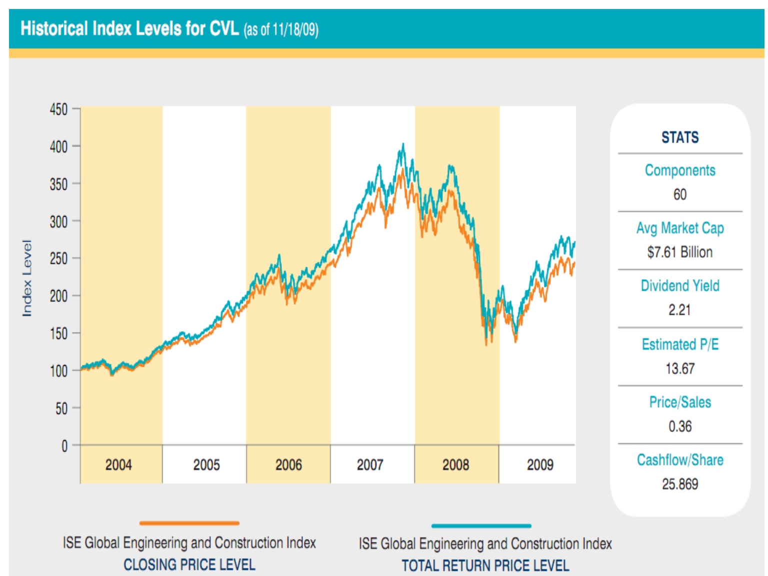
Sound and stable infrastructure, especially in the 21st century is as foundational an element for general economic activity as there exists. Infrastructure serves as the building blocks to organize and structure an economy, facilitate interactions, and employ sizeable portions of a labor force. With the ability and demand to transfer funds with the push of a few buttons, transport goods and capital, transfer technology, share videos across continents, provide long-distance education to the poor or video-conference an important business meeting, infrastructure investments will be on the rise in the coming decades as a growing number of players seek to enjoy a more sophisticated and comfortable life. Foreign Policy magazine published a special examination in September of 2010 on the coming urbanization of the emerging world. Some startling and insightful figures are included showing facts such as that India spends just $17 in services per city dweller; New York City on the other hand spends approximately $300. Clearly India has some ways to go in terms of providing the means to a higher quality of life for its people and while New Delhi may never become the Big Apple it is hard to imagine that such a paltry figure of urban investment will be the standard going forward. To get to the higher standards of living, hundreds of billions of dollars will need to be invested in order to bring India and a range of other emerging economies into the modern age.

Figure 1: The Coming Urbanization Boom, Richard Dobbs of McKinsey and Company

The status quo for infrastructure in the emerging world is not sustainable with the growth and lifestyle ambitions of a growing global middle class, and under current trends the strains of current capacity versus growth trends will hit China and India the hardest. McKinsey Global Institute estimates that one billion people in emerging Asia will move from rural to urban areas and that 40% of urban growth will be coming from Asia's two supreme rising giants. Under current trajectories, China will need to add 40 billion square meters of combined residential and commercial real estate over the next 20 years. India meanwhile needs to essentially add commercial and residential space the size of Chicago *each year* in order to satisfy its population dynamics. The firm also estimates in a March article that the poor condition of current infrastructure capacity in Asia has been holding growth rates down by as much as 4% per year, a significant figure.

Figure 2 below offers an additional visualization that encapsulates the booming demand for infrastructure and construction work around the globe. The financial meltdown, as expected, interrupted the momentum for global engineering and construction projects since credit markets were tight. Yet activity in the sector has rebounded in a pretty robust fashion and the outlook looks bright.

Figure 2: Indices for Global Engineering and Construction, International Securities Exchange



We've already seen the region of emerging Asia take some initiative on the infrastructure front. At the onset of the crisis in 2008, governments expanded their checkbooks to compensate for western demand and keep their economies humming as best as possible by increasing fixed capital expenditures and salvaging employment stability. As we explained in a commentary a couple of weeks ago this policy direction increased deficits in emerging countries, forcing them to ease their restrictions on foreign capital contributions to infrastructure projects with a greater propensity for developing Public-Private Partnerships.

Figure 3: Growing Demand Will Require New Sources of Financing, McKinsey

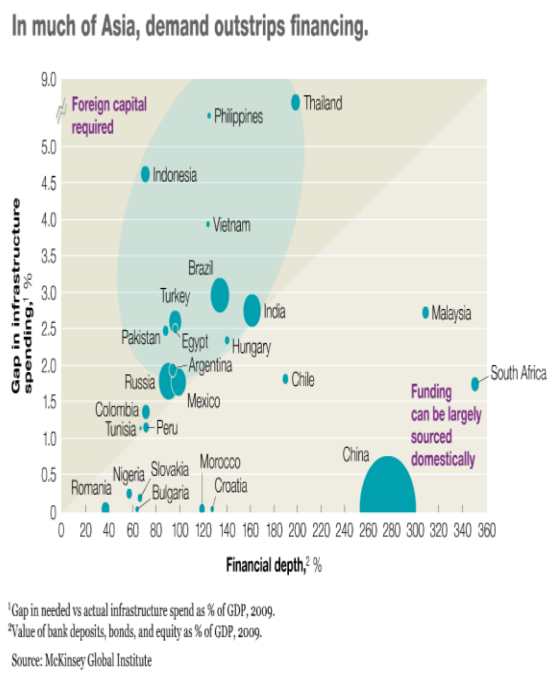


Figure 3 above is an excellent visual illustration of the phenomenon we are describing. Global economic growth and demand is in the process of being diffused among a greater number of actors, the well known (China, India, Brazil) and those who are also experiencing growth without the same headlines (Colombia, Turkey, Indonesia, Argentina, Chile, Vietnam, and more). As the illustration shows, financial market development in many of these places is not a sufficient source of capital for needed infrastructure investments, paving the way for foreign capital to play a dynamic role. Given Asian dynamics, we believe that Australian construction companies may be among the major winners.

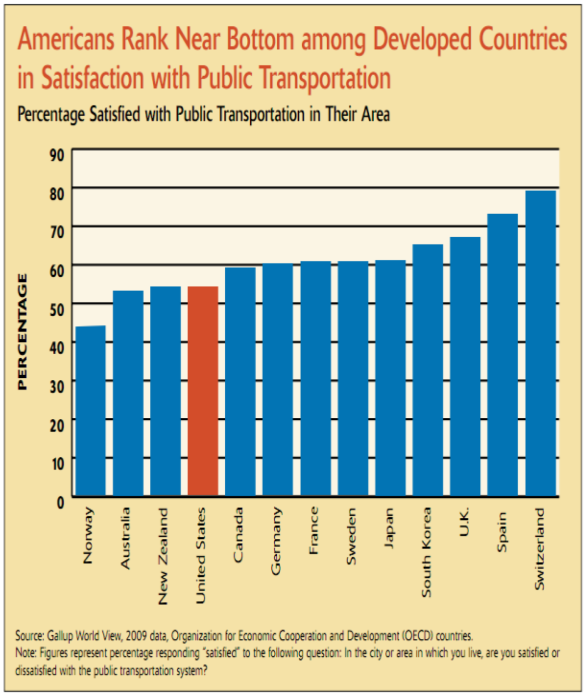
Developing countries will not be the only contributors to strong returns in the infrastructure sector. As part of the recovery process many different countries from the developed world will embark on infrastructure projects, maintenance, and modernization to supply employment and update their transport, communication, and power networks. Roads, bridges and power systems all need to be considerably modernized and maintained in the U.S. In addition, here at home our country could also benefit from additional broadband penetration. New and more efficient energy systems will be an additional venue for spending in the U.S. and may dominate infrastructure investments in much of the developed world. Moreover, if the news on new energy sources are verified, then the savings from the oil imports could easily be translated into infrastructure divedends.

Infrastructure in the United States has experienced a gradual deterioration. Federal investments on such systems peaked in the 1970s and have been on the decline ever since. Despite the fact that numerous studies suggest stimulus funds averted deeper disaster in terms of economic contraction and employment, unfortunately infrastructure investments do not inspire public support; they are investments often taken for granted and not recognized as a critical backbone to a modern economy. Figure 4 below is indicative of the current state of major infrastructure projects in the US. Are we approaching a level of disrepair?

Figure 4: U.S. Infrastructure Grades, Army Core of Engineers

2009 GRADES	
Aviation	D
Bridges	C
Dams	D
Drinking Water	D-
Energy	D+
Hazardous Waste	D
Inland Waterways	D-
Levees	D-
Public Parks & Recreation	C-
Rail	C-
Roads	D-
School	D
Solid Waste	C+
Transit	D
Wastewater	D-

Figure 5: American Satisfaction with Public Transportation, Ernst and Young



Hopefully the dullness that infrastructure investments inspire in most people is near its end. As the chart from the Army Core of Engineers demonstrates U.S. infrastructure grades can't get much worse from here on out. The World Economic Forum places the United States as 23rd in the world in terms of infrastructure quality and heading south. With a 40% rise in population expected over the next 40 years the time cushion for salvaging infrastructure is dwindling. To achieve a passing grade the Army Corps of Engineers has estimated that the U.S. needs to invest $2.2 trillion over five years, including more than doubling the amount of funds dedicated towards improving highways. We may need to educate the public about the fundamental role that infrastructure plays, otherwise schizophrenic statistics like the one in figure 5 will continue hanging over our heads.

Hopefully the impetus for considerable changes in U.S. infrastructure will pick up as the recovery progresses and as the nation's leaders understand that the country will lose its competitive advantages if it abandons dreaming and planning about its infrastructure. Continued economic recovery should revitalize tax revenues, especially in states' budgets who are the primary financier of infrastructure activity in the United States. Combined with greater federal investment (via bond programs, grant initiatives, or other investment models) infrastructure construction and maintenance will be a key sector to observe going forward even in developed nations.

Dividend Plays

To conclude our newsletter this month we are taking our theme in a new direction. We have been consistent and steady in our principle of tangible and productive assets as being a vital component in portfolios given the new economic era upon us. Items such as food, energy, roads, metals (base and precious) do not have their value wrapped up in paper asset upon paper asset upon paper asset; the value and worth is upfront and of substance as opposed to illusory. When it comes to dividend investments we are following the "cash is king" motto. Robust and consistent payouts while maintaining sound fundamental and technical credentials are a great opportunity to protect assets.

We have selected and analyzed a wealth of dividend paying securities and funds (some of which utilize a covered call strategy) and encourage you to contact the office with any questions you may have. There are a number of investments that can be made by targeting dividend yields that will experience growth, generate consistent streams of income, diversify portfolio holdings, and protect against risks in the economy, both domestic and global, as the following graphs show.

Figure 6: Dividends Enhance Returns, Standard and Poor's

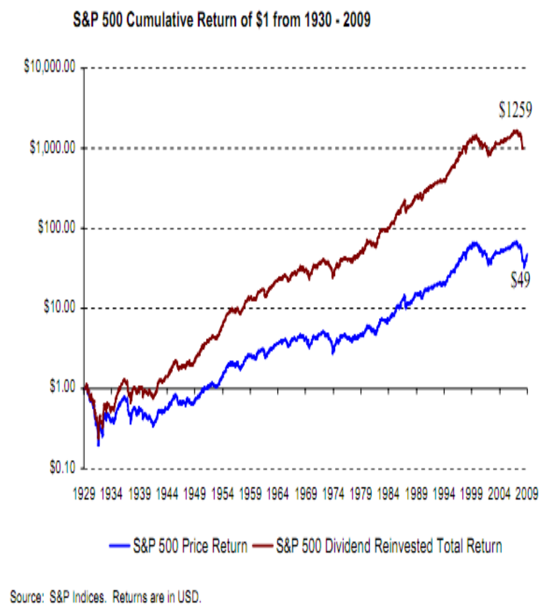


Figure 7: Dividends Provide A Buffer In Down Times, Nuveen Investments

Dividends after a Bear Market
(January 11, 1973 – October 9, 2002)

Hypothetical Example of Last Ten Completed Bear Markets

	S&P 500 Index Dividend-Paying Stocks Annualized Return After Market Bottom			S&P 500 Index Non-Dividend Paying Stocks Annualized Return After Market Bottom		
	1 Year	3 Years	5 Years	1 Year	3 Years	5 Years
Average	26%	17%	15%	28%	10%	9%
Median	28%	20%	17%	35%	15%	12%
High	67%	29%	29%	92%	27%	20%
Low	-12%	-4%	4%	-42%	-17%	-6%

Figure 6 above shows that returns from stocks that pay dividends are not only superior to simple stock price fluctuations but have withstood the test of time. In addition, as the table in the next figure demonstrates, dividend paying stocks are on the whole considerably superior to their counterparts in downturns. Not only do they limit losses but dividend paying stocks also grant higher returns years after a bear market arrives. As an additional illustration we offer Figure 8 which demonstrates that dividends are a substantial driver of value among the S&P Index. Moreover as chart 9 below shows, dividend paying stocks are reflective of overall profitable and healthy companies for the past 30+ years.

Figure 8: Dividends are a Significant Portion of Total Returns, Nuveen Investments

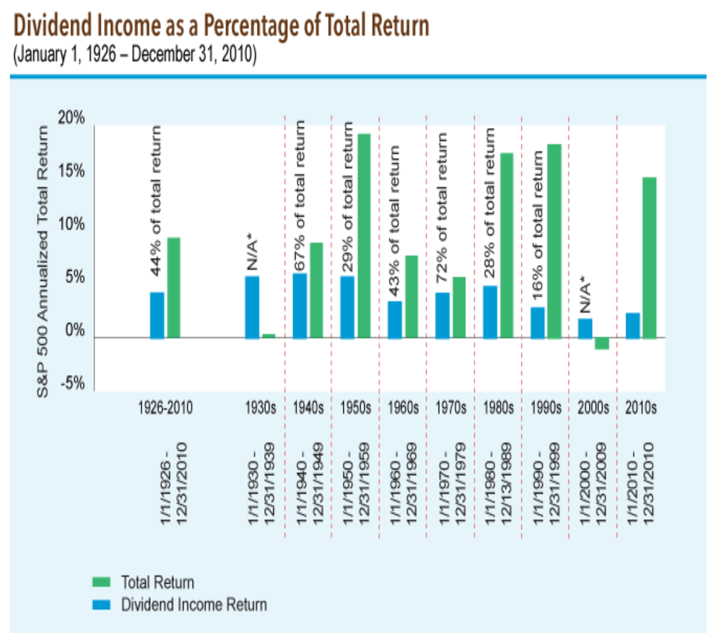
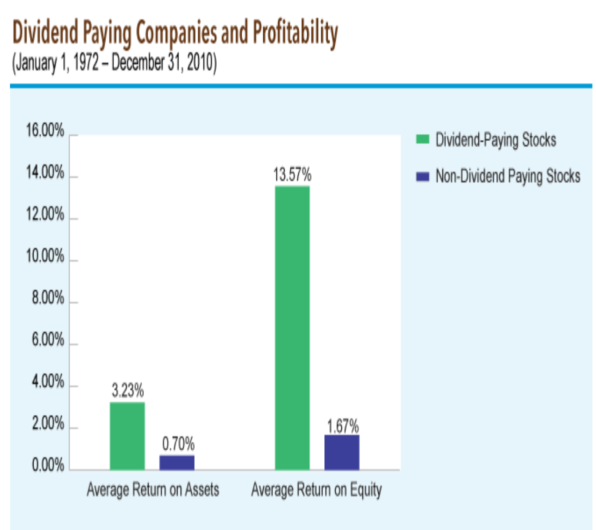
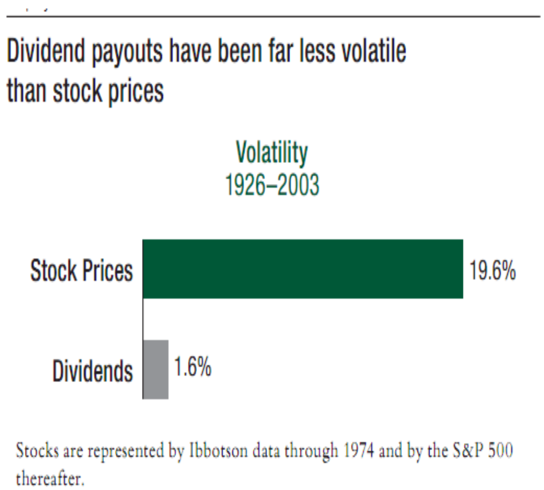


Figure 9: Dividend Paying Companies Are Often The Healthiest Companies, Nuveen Investments



Finally, dividend payouts have been far more stable and secure over the course of the past 80 years as Alliance Bernstein, an investment research company, discovered. As the chart below shows dividends have been far less volatile when compared to stock prices since 1923.

Figure 10: Dividend Payouts Have Been Less Volatile, Alliance Bernstein



Conclusion

New ventures and environments often have a stagnating effect on people given the uncertainty of how to travel in new circumstances. The financial meltdown signaled the limited lifespan of an old economic era and ushered in a new age. World economic growth will now be reliant upon a greater number and more diverse range of actors compared to the post-WWII times. After decades of disappointment these emerging markets have figured out their development models and have been building up middle classes with increased consumptive demands and capacity. As a result, a new lifestyle is being born out that demands new networks of transportation, broadband, and energy so as to allow productivity rates and output to climb. Given emerging markets' trajectories along with current economic trends, investment allocations to infrastructure related companies seem to be a sound option capable of capturing this global growth story. Moreover, those companies can assist in offsetting the pressures on the soil reserves, which are so much needed for food production and distribution.

Of course, and given our strategic positions and holdings, the very encouraging thing is that we can have holdings that are both in the strategic sectors that we like and believe in, and enjoy healthy dividends in those sectors at the same time. To aim at companies with positions in the strategic sectors and which have strong dividend payouts backed by solid cash flows is truly a marvelous story. Not only do they provide streams of consistent income and raise returns on ownership, they mitigate downfalls and reduce volatility.

Ode to holdings that enhance income and advance real tangible investments!