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**Outlook for US Multinationals more promising than market believes, says Legg  
Mason Capital Management**

**- US multinationals best placed asset class for long-term investment success -**

**December 9, 2010 [London]:** Legg Mason affiliate Legg Mason Capital Management (LMCM) believes that the long-term outlook for US multinationals is much more promising than many other commentators believe, due to their ability to benefit from global growth opportunities and capitalise on attractive profit margins from investments made in developing markets.

**Robert Hagstrom, Senior Vice President and Portfolio Manager of the Legg Mason Capital Management Growth Fund explains,** “The market currently believes the S&P500 index will have flat earnings growth for years to come. I do not share this gloomy outlook, especially for US multinationals.

“More than one and a half million people across the globe move to cities each week. This population shift is occurring in all emerging economies, including Southeast Asia, Eastern Europe, the Middle East and North Africa. This shift is not merely geographic, it is economic as well. By 2020, approximately 40 per cent of the world’s population will reach middle class status, up from less than 20 per cent today. In 10 years, the developing world’s middle class will spend about \$20 trillion annually, almost triple their current consumption rate of \$7 trillion and double the current US consumption rate of \$10 trillion. Large cap companies are leading the race to capture these fast growing sources of revenue, an edge they are likely to maintain, or grow, given the advantages of operational scale they enjoy.”

**Robert Hagstrom continues,** “It is a mistake to think that US multinationals will have little or no competition in the land rush to capture new consumers. European multinationals such as Unilever, Nestle and Heineken are making their mark in these new markets.

“However, where economic opportunity is still expanding, competition increases profits from innovation, which in turn encourages research and development. This is having a direct effect on the pre-tax margins on foreign business for companies in the S&P 500.”

Between 1995 and 2009, pre-tax margins on foreign business for companies in the S&P 500 grew significantly in absolute terms and as compared to pre-tax margins on domestic business. LMCM argues that during the same period, companies in the S&P 500 grew foreign sales as a percentage of total sales from 26 per cent to 33 per cent. Much of this growth in foreign income has been the result of global cyclical investments in technology, industrials, energy and materials, sectors that are most exposed to the global economy and that typically have higher pre-tax margins.

**Robert Hagstrom adds**, “When you consider that almost half of global capital spending occurs in emerging markets, you can begin to appreciate that the higher margin sales of global cyclicals will continue to drive profit margins higher in the S&P 500 for many years to come. The outlook seems even better when you consider that the return on equity from foreign operations of US multinationals is about 16 per cent, well above the cost of capital. Investments made in growing markets that earn above their cost of capital can turbo-charge growth in business values.”

LMCM argues that the investment case for US multinationals must be considered within the strength of the global economy and that the current concern regarding the strength of US multinationals appears to reflect worries about domestic economic growth. Robert Hagstrom argues that viewing these stocks in this way is a mistake.

“Over the last 15 years, we have seen the correlation between S&P 500 revenues and world GDP strengthen, along with a corresponding weakening of the correlation between S&P 500 revenues and US GDP. In determining the health of S&P 500 stocks, it is therefore increasingly important to gauge the strength of the global economy. The recent financial crisis and the subsequent raft of protectionist actions taken by policy makers has not had a meaningful impact on global trade, in fact the emerging economies of the G20 are importing and exporting 10 per cent more than their pre-crisis peaks.”

**Hagstrom concludes**, “The current hesitation to invest in US multinationals appears to reflect worries about domestic economic growth. This hand-wringing may prove costly because it underestimates and undervalues the continued growth in developing markets that is a near certainty. All we need to do is sit and wait for the currently undervalued stock prices of US multinationals to catch up with the economic accomplishment of these great companies.”

**-Ends-**

*Notes to Editor*

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