

Investment Outlook

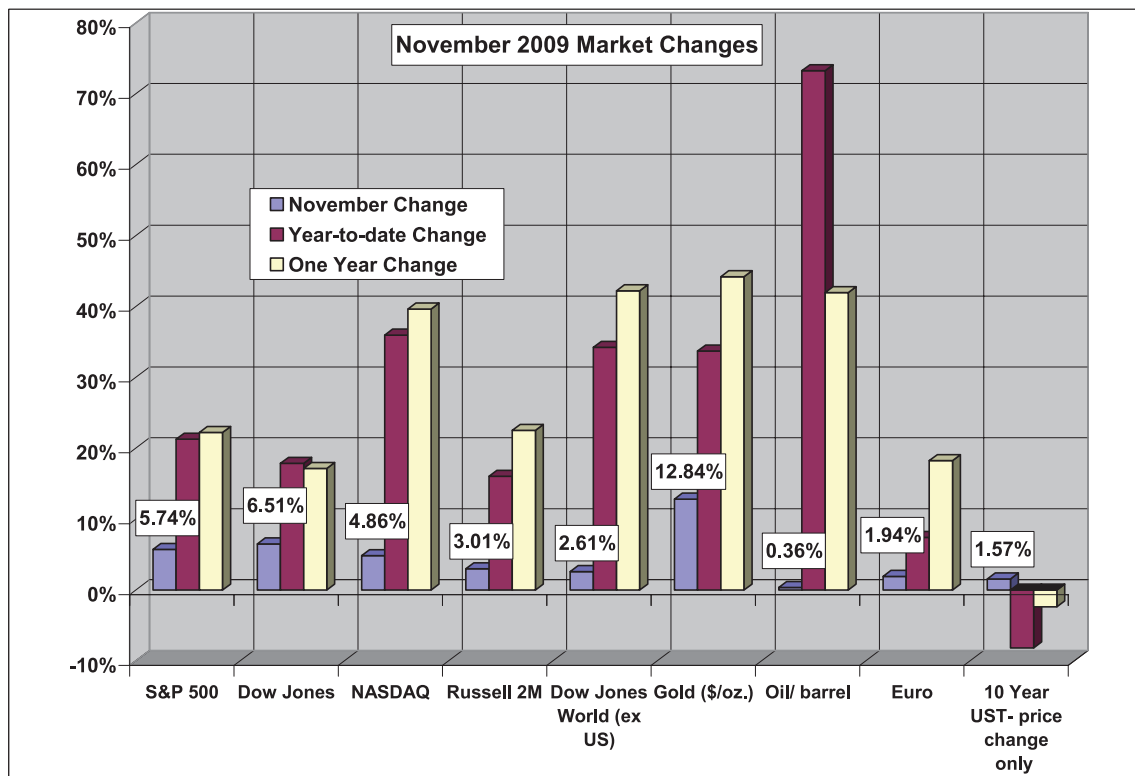
December 2009

Paths to prosperity



November Markets *An international flavor...*

November markets took on an international tone as equities rebounded from October's mixed finish. While U.S. economic data during November was inconclusive at best, reports from two consecutive weekend conferences of global finance ministers, first the G-20 followed by the Asian meeting,



confirming that their various forms of economic stimulus would be deployed "as long as necessary" encouraged the equity bulls and pushed stock prices to new 2009 highs.

News during the Thanksgiving holiday that debt burdened Dubai will need to "reschedule" some of its debt payments jolted global markets with a reminder that the market recovery has not resolved all risks. Some clarifying information and a subsequent pledge of credit support by the emirate's neighbors allowed for an end of month recovery in stocks. Although the Dubai-inspired flight to quality bid up Treasury bond prices during November, those who bought Treasuries in the midst of the credit crisis last year end will find their return to

be the worst performing asset class of those measured on the chart above.

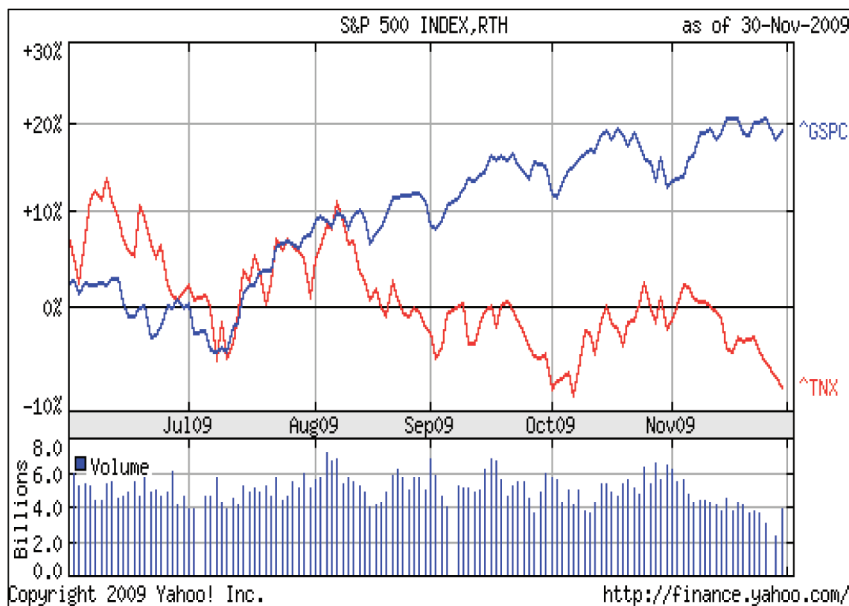
While oil prices remained virtually unchanged in November, their 73% increase since year end 2008 should provide some pause when one contemplates the impact on upcoming inflation reports. Although not news to policy makers it will spark the attention of headline writers and commentators in the months to come.

Sharp-eyed readers will also note the addition of the price change of the Euro, as measured in dollars, to the monthly chart. In earlier issues we have commented on the continued weakness of the dollar over the last year, as evidenced by the 18% increase in the value of the Euro. The declining value of the dollar is also evident in the 40%+ yearly gains in the *Dow Jones World* stock index, as well as the price of gold and oil. We hope including the currency data adds to the understanding of some of these changes.

Commentary *A tale of two markets...*

Markets are generally considered to be “discounting mechanisms” as current prices reflect, or discount, anticipated events. Consequently it would seem reasonable to associate rising stock prices with the expectation of favorable economic conditions; while rising bond prices, especially those of “risk-free” U.S. Treasuries, would reflect uncertainty about the future at best and anticipated adversity at worst. To have both of these markets

rallying concurrently is a conundrum for investors and advisors alike.



The adjacent chart plots the change in the S&P 500 (^GSPC) against the change in market yields for 10-year US Treasury bonds (^TNX). Noting that declining yields result from rising bond prices, we would understand that lower values for the Treasury yields

(red line) are associated with higher bond prices. With reference to the chart we can see that stock and bond prices have both been gaining in value since early August.

In previous issues we have noted that the current stock rally does not appear to be supported by prevailing corporate or economic fundamentals, it is the result of extremely thin trading volumes which can distort results, it is impacted by the movement of a few high volume stocks as well as other concerns that have caused some to label this a "*Dangerfield rally*", in that it "*...gets no respect*". Regardless, the fact remains that stocks have continued to gain in value much to the delight of those who hold them and the frustration of those seeking opportunities to buy.

At current prices stock buyers are expecting corporate earnings in the S&P 500 to expand a minimum of 46% next year, or they are admittedly overpaying for their purchases. Alternately, today's Treasury bond buyer expects conditions to be such that an annual return of 3.32%, before any inflation, will be satisfactory over the next ten years.

Obviously these are significantly diverging opinions. It is noteworthy that opinions among even the best informed individuals tend to have the widest divergence at major inflection points, as that is generally when there is the most uncertainty.

We would consolidate the current myriad of uncertainties into two categories:

- When can the U.S. economy have a sustained growth rate without the support of fiscal and monetary stimuli? The longer it takes the more risk there is to current and future levels of equity appreciation.
- How much of the current price appreciation in equities, bonds and commodities will revert when the Fed increases interest rates? Said differently, how much of the current market is a low interest rate, liquidity induced "asset bubble" and what happens when the Fed pricks it?

It would seem that both of these questions concern the issue of when they will happen rather than if they will happen. While we continue to seek answers to these two questions we are reminded that the first step in successful risk management is properly identifying the risks to be managed. We believe we have done that. In the meantime any reversal in the trends charted above will indicate that the markets have recognized them as well.

Outlook and Strategy ***Closing the door on 2009...***

We are rapidly closing out one of the most extraordinary years in investment history with the various impacts and recoveries second only to those experienced in the Great Depression of the 1930's. In the previous section we outlined the near term risks that seem evident in our various markets. Protecting our new found gains and recovered value is our current objective.

The concurrent rally in both stocks and bonds provides a unique opportunity to reallocate portfolios to adjust to any changes in investment objectives. Although interest rates remain low there continues to be opportunity to exchange corporate bonds for slightly longer dated Treasuries to the extent an improvement in credit quality is desired. Alternately we continue to see yield opportunities in intermediate term, tax-exempt issues which may warrant some profit taking in longer dated issues and reinvesting if a shorter maturity schedule is desirable.

Last month we summarized opportunities that we believe will continue with a weak dollar. *(Please call if you want a copy or check our web site.)* Nothing has happened in the succeeding month to alter those views, other than the heightened equity valuation risk we cited earlier.

Next month we will publish our outlook for 2010 and the opportunities we expect it to bring. Defining the "new normal" and the trends that will accompany it is an exciting prospect.

At this time we want to thank all of our clients, contacts and friends for your confidence and support through these most turbulent times and extend our very best wishes to all for the most joyous of Holidays and prosperity in the New Year. Our relationship with each of you is deeply valued.

S&P 500: 1109.24
10 year U.S. Treasury Yield: 3.32%

Mark Fingerlin
December 2, 2009