

*January 4, 2010*

## ***Market Perspectives for 2010***

### **2009, A Year of Quick Recovery**

After the worst stock market decline since the great depression, the stock and bond markets roared back since the March, 2009 lows. Will the rally last and what are the opportunities and risks lying ahead for investors? The positives, as we see it, are the continued moderate recovery in the economy coupled with the low interest rate environment, which should continue to drive stocks and markets higher. The negatives are that unemployment will probably remain in the 8% to 10% range and new job growth minimal. Secondly, banks are very strict with lending standards, especially to small businesses which employ over 75% of the U.S. workforce. Thirdly, federal and state budget deficits, historic U.S. debt levels and the threat of rising income taxes pose challenges for the markets.

### **Stock Market Opportunities**

Even in the midst of a recovery filled by low interest rates and various federal government bailouts (bank and financial loans, cash for clunkers and first time home buyer credits) we see a longer protracted recovery going forward. The U.S. economy will probably remain in a sluggish state for a period longer than most economists predict. The Federal Reserve has announced its continuing policy of easy money, concentrating on unemployment rather than inflation. This policy will continue for most of 2010 and should be positive for stocks, high yield bonds and commodities. The consumer driven economy of the U.S. will probably not recover quickly because the consumer is finally beginning to save money and becoming more financially responsible. In the long run, this is great for the U.S. but, in the short term it means retail sales will continue to struggle, which will cause a continued decline in the commercial real estate market. The second real estate bubble is currently in full gear and we will see foreclosures in retail and office real estate. This will hurt the earnings of the large and regional banks which we are hesitant to invest in at this time.

We continue to favor the consumer staples because of their international sales, consistency of earnings, high dividends and recession proof business models. Additionally, we favor technology, healthcare, energy, and emerging markets. The market trend is currently up, but after a 50%+ increase from the market lows, it appears as though the easy money has been made. Valuations relative to long term averages are still below normal. Although stocks have begun to recover we are still 28% below the November, 2007 highs, when the Dow reached 14,279!!!

### **Bond Market Opportunities**

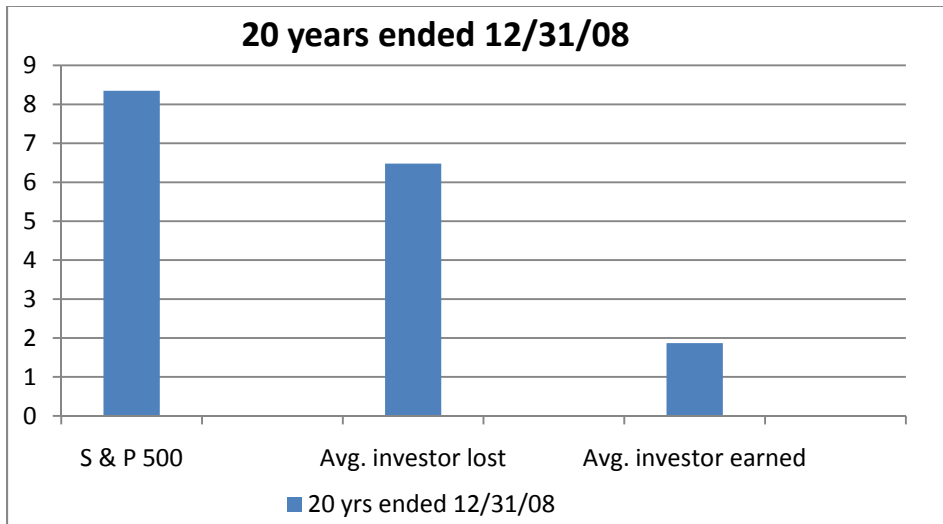
In 2008, corporate and municipal bonds declined dramatically, especially high yield issues. In 2009, the valuations reversed and we saw dramatic recoveries. We continue to see opportunities in high yield corporate bonds, convertible securities, and TIPS (Treasury Inflation Protected Securities) however, we share no interest in U.S. Treasury or U.S. Agencies, as the interest rates are dramatically low. We also see opportunities in ETF's (exchange traded funds) that short U.S. Treasuries. During the last year the total debt of the U.S. has increased from approximately \$10 trillion to \$12 trillion and there is no end in sight. Eventually, there will be an increase in interest rates as investors shy away from investing in U.S. securities and consequently, inverse bonds should do well.

### Summary

Investing in stocks is for the long term but, when they go down dramatically, emotions take over, resulting in a “flight to safety” and often the “do it yourself investors” only get back in the market when things get better (stock prices are higher and the news is good). The academic studies reflect that those investors who attempt to time the market consistently underperform the long term averages by 6% to 7% annually. We continue to remain fully invested and will adhere to the long term fundamentals supported by proven academic principles.

This decade ends as one of the worst for investors in a century, with nearly zero returns for the last ten years. Stocks remain attractively priced after this severe bear market which sets up normal market returns for the next decade. We see no reason why stocks will not return 10% to 12% before inflation for the next decade. Compare that to fixed income alternatives and it is clear that a portion of investors’ asset allocation should be in stocks.

**The Grand Illusion-returns reported by the S&P 500 index versus the average “do it yourself stock investor.” When the going gets tough, average investors panic and miss the big upswings in the market resulting in average annual gains of 1.87% versus 8.35% for the S&P 500 index, a loss of 6.48% per year!!!**



Source: DALBAR, March, 2009

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