

# INVESTMENT QUARTERLY

**STILL.....**

**“Progress – but a ways to go”**

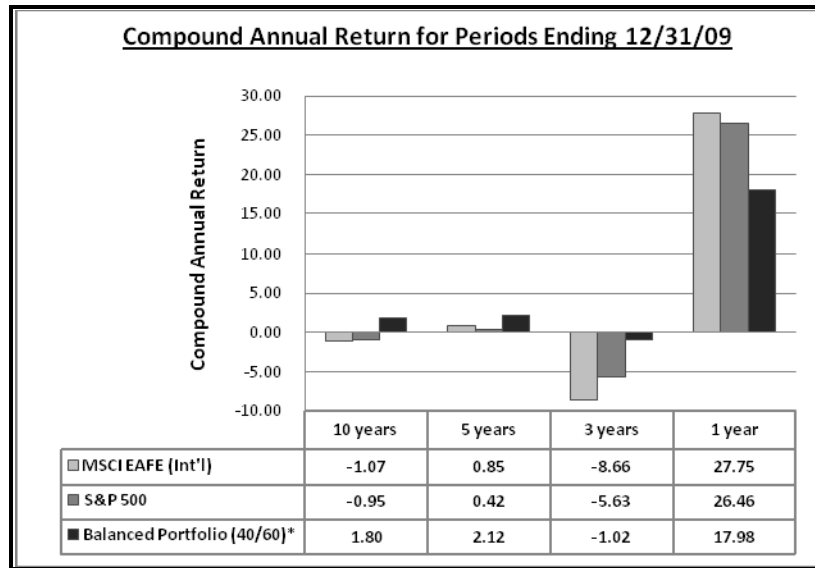
In our last Investment Quarterly written by Jack Driscoll, the above title was the basis for his discussion on the recovery and what might lie ahead. Three months later, indeed there is still “a ways to go” and we see increasing evidence that the elements necessary to fuel the progress are faltering. There are numerous theories as to the tenacity of the recovery we have seen to date. As always, economic data is ripe for interpretation and monthly data is often inconsistent offering fodder for a wide gamut of conclusions. The government’s attempt at “spendulating” us out of the recession has worn out its welcome and there are indications that the recovery has slowed. The initial recovering growth of GDP in the second half of 2009 resulting from the stimulus has slowed significantly; estimates of 5% and 6% tossed around 9 months ago have been tempered to the 3% range. And, conviction in the new number is not universal. The economy is expanding but at a weaker pace than in previous recoveries which translates to continued pressure on job growth. With Europe engulfed in a financial crisis and China beginning to slow its economy, we cannot assume that the lack of domestic expansion will be replaced by global economies.

Consumer spending has been weak and directed to services rather than goods, housing remains under pressure, credit is tight and unemployment remains high resulting in a recovery to date that has been driven by business with consumer spending considerably lower than it was following the previous recession. Job creation is a key to continuing progress in the recovery from the recession. The general consensus with which we concur is that the economy will continue to grow at a reduced rate but until the unemployment picture changes, there will be little to encourage the consumer to jump back in. And, as was alluded to in our last Quarterly, there is clear evidence that our economy going forward must be fueled by ingredients other than simply the domestic consumer.

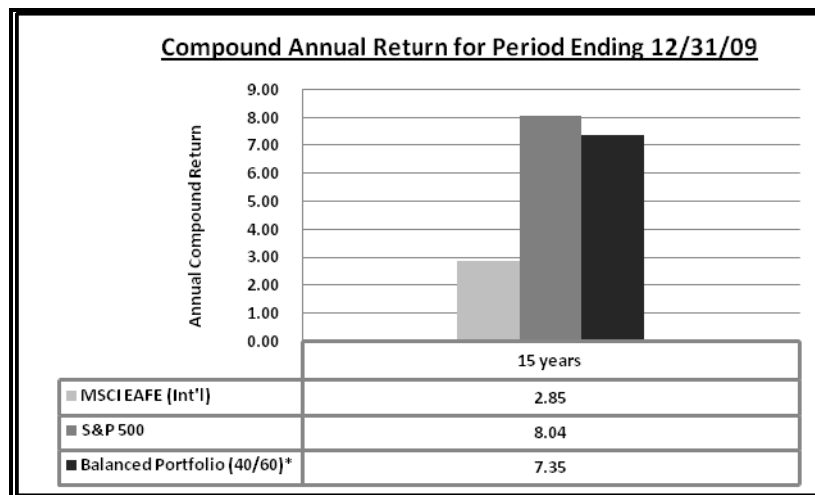
After a brief and minor respite in the middle of the first quarter it appeared to many that the equity markets would continue to climb despite history suggesting that the secular pattern of a bear market recovery includes a correction of about 25% after the initial rebound rally. And, in keeping with history, the rally faltered and began what appears, based on history, a very normal correction leaving some investors “caught”. The S&P 500 returned -11.43% for the quarter bringing its year to date loss to -6.66%. The fixed income markets were relatively stable with fluctuations primarily tied to expectations that the Federal Reserve would remain passive with respect to interest rates. The BarCap Intermediate Government Credit Index returned 2.97% for the quarter.

The last decade has been one of the worst in history for stocks and the markets have become increasingly difficult to navigate. To be sure, it has been an unprecedented decade with two “bubbles” and two recessions. Investors look to equities to make money and to bonds to preserve principal and/or generate current income. Increasing volatility in the equity markets has become the norm not simply from year to year or quarter to quarter but even now on a day to day basis. It is human nature to want to make up losses and understandable how easily one can become caught up in trying to chase the short term swings. But it can be costly if you are wrong. If one is retired or hopefully soon to be, trying to recoup a significant principal loss while also depending on one’s assets for living expenses can be an exercise in futility. To put it in perspective a loss of 50% requires a rebound of 100% simply to break even. We have found that focusing on reducing principal loss relative to the equity markets through a disciplined balanced approach while adhering to our stock and mutual fund selection discipline has provided over the longer term solid results that approach those of the equity

market with less volatility of returns. The chart below illustrates the philosophy with respect to the markets (domestic and international) over the last decade. Although a balanced portfolio lagged the equity markets for the one year ending 12/31/09, the strategy served an investor well over the longer term because the principal was not subjected to the significant losses during the two bear markets. (For illustrative purposes we have used a moderate balanced portfolio allocation of 40% BarCap Intermediate Govt Credit Index and 60% S&P 500 Index.)



For those who are still trying to digest the disturbing reality in black and white of the returns for the last decade, which by historical standards has been unique, the following chart that depicts the last 15 year period should provide a brighter picture. A balanced portfolio affords the investor nearly comparable returns but with risk and volatility with respect to one's principal reduced by approximately 30%.



Finally it is also interesting to look quickly at a longer period in history. Using average annual returns (as opposed to a compound annual return) for the 40 year period ended 12/31/09, the average annual return of the S&P 500 was 9.87%. The average annual return of a balanced portfolio invested 40% in the BarCap Aggregate Bond Index and 60% in the S&P 500 was 9.10% over the 40 year period.