Investment Insights, Economic Indicators, & Market Outlook

LLC Financial Series

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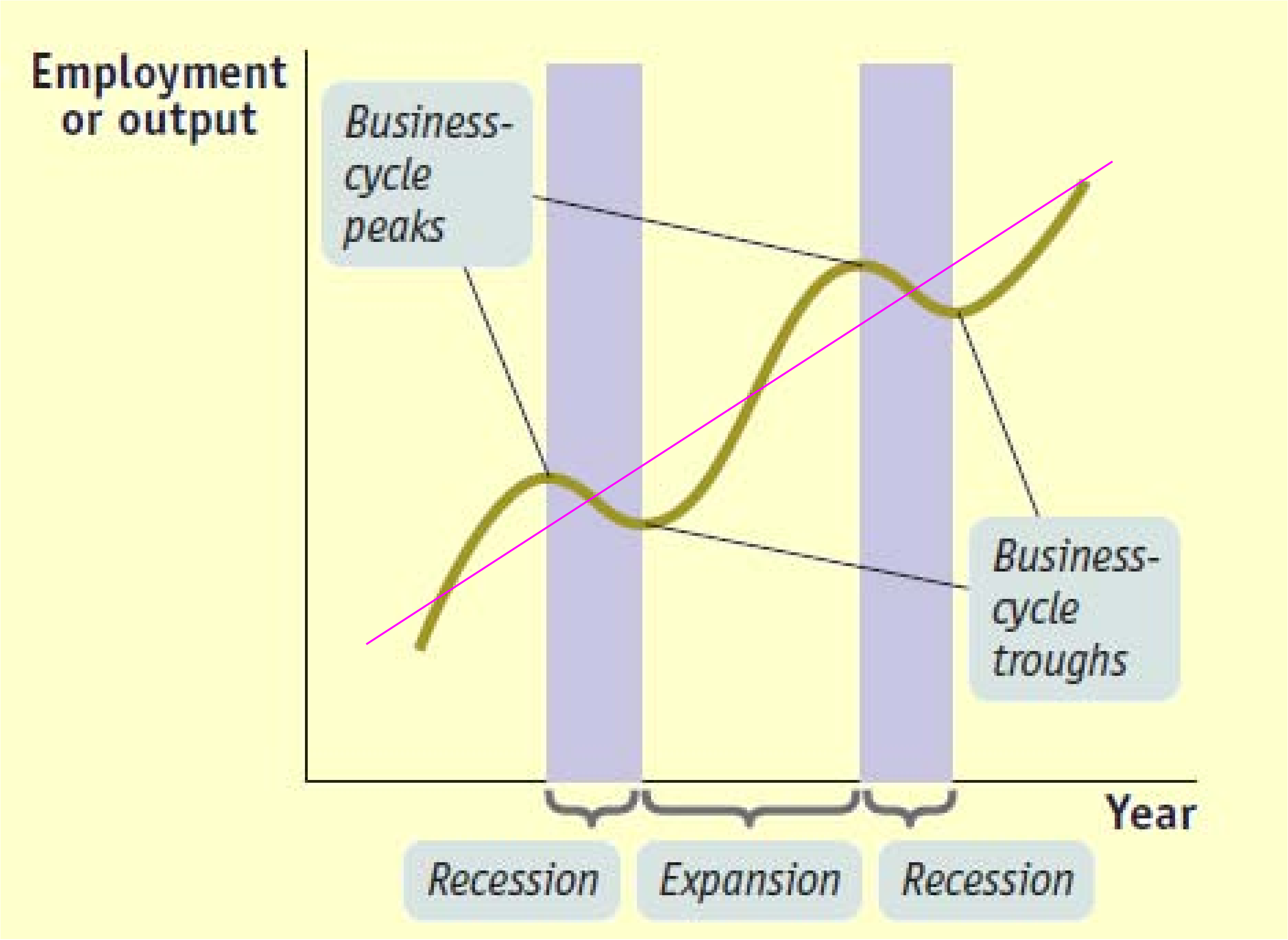
Outline

- Investment Insights
- Bulls Say/Bears Say
- Economic Indicators
- Technical Factors
- Market Outlook

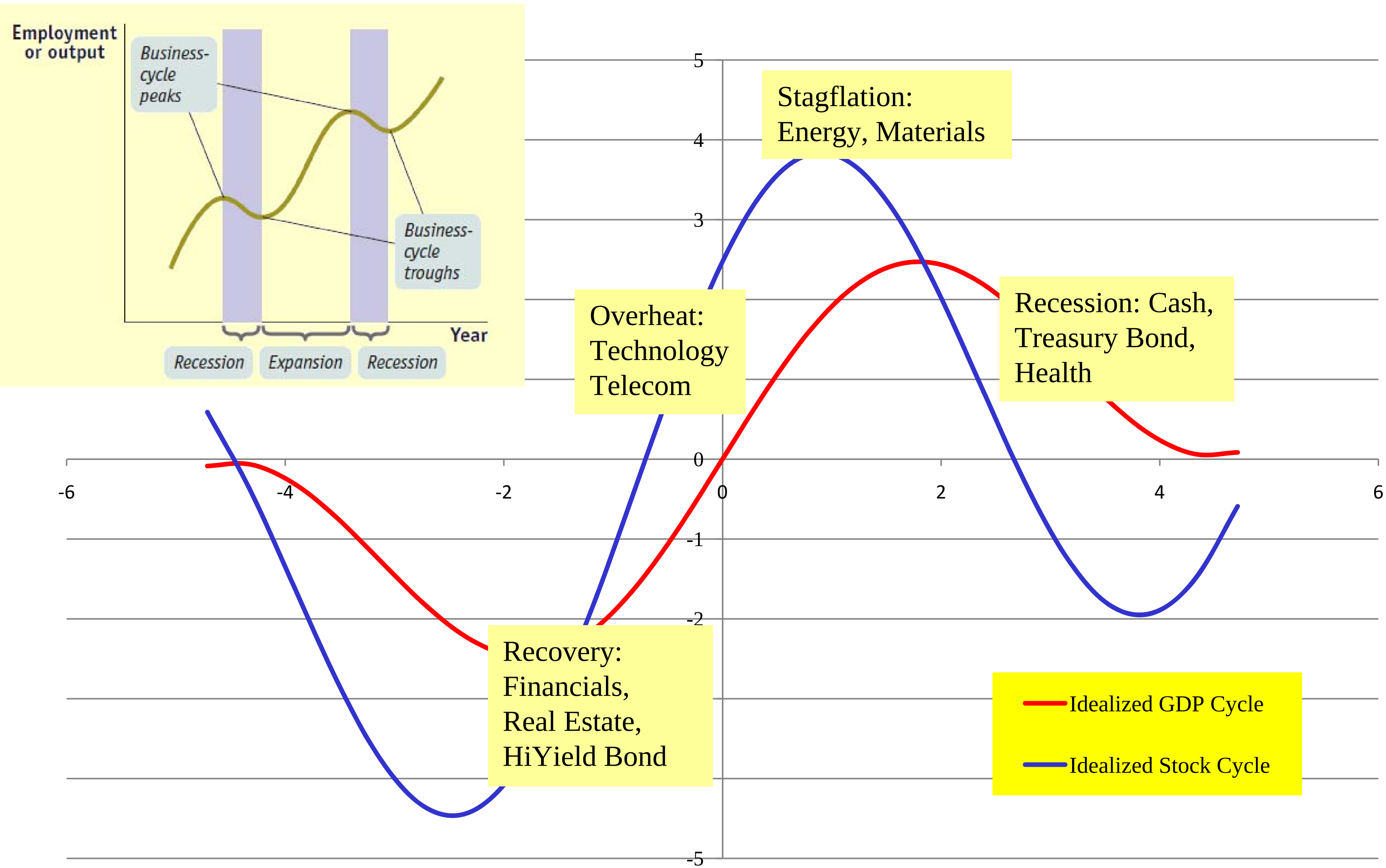
Investment Insights

The Business Cycle



Ref. Krugman & Wells, 2009

Idealized Economic/Market Cycles & Favorite Sectors



Ref: Fidelity 09, Krugman 09

Exchange-Traded-Funds (ETFs)—A 21st Century Product

- They are less volatile (instant Diversification) and behave just like mutual funds.
- They are essentially **unmanaged index funds** and sport a **low management fee** compared to mutual funds.
- ETFs are more tax-efficient (You can target a time to sell for long-term Capital Gain)
- ETF's are free to be traded on the market at any time just like a stock.

•Common ETF's include

–S&P 500 index (**SPY**), **S&P Global Financial Index (IXG), MSCI EAFE (EFA), Emerging Markets (VWO), FTSE/Xinhua China 25 Index (FXI)**

–LEH Bond Index (**AGG**)

–GSCI Commodity (**GSG**)

–Vanguard REIT (**VNQ**)

–SPDR Utilities (**XLU**) **http://www.ishares.com/**

https://personal.vanguard.com/us/funds/etf

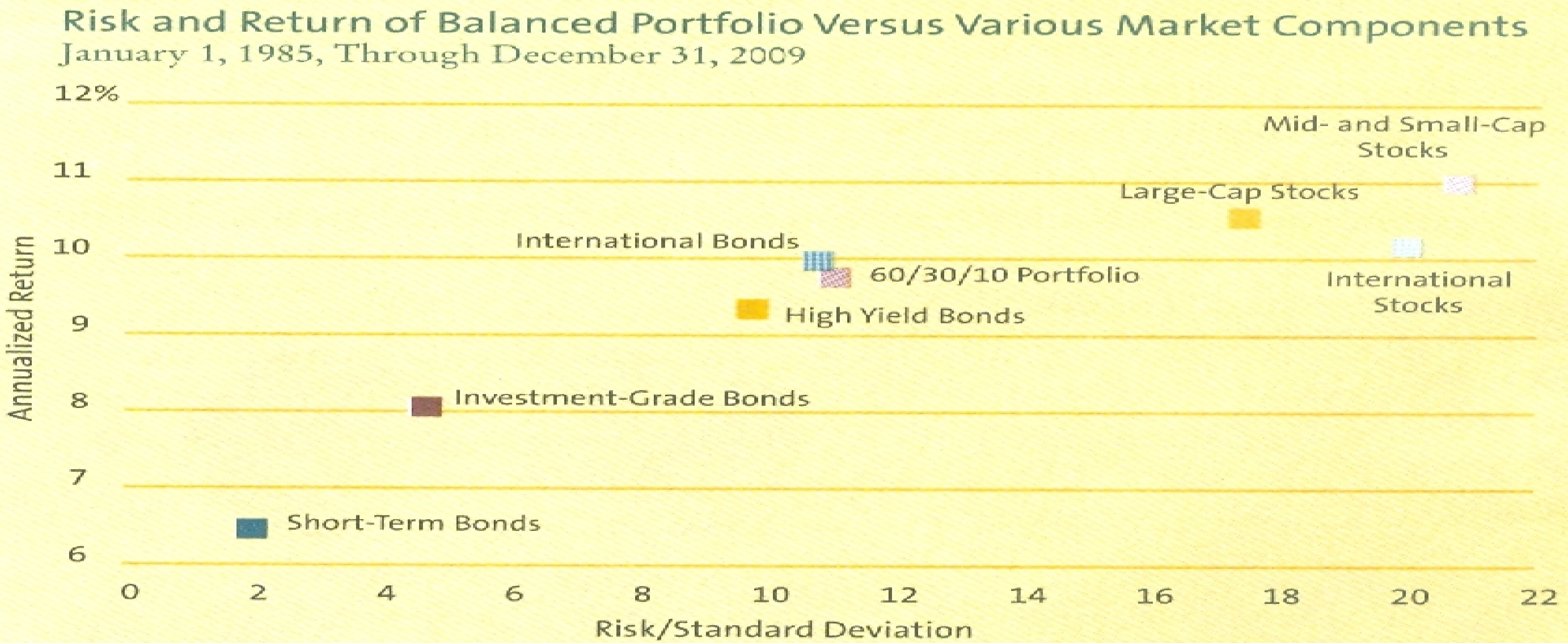
Dividend Investing

- $V = d1/(k-g) = d1/(1+k) + d2/(1+k)^2 + d3/(1+k)^3 + \ldots$
- d1= next dividend
- k=rate of return in %
- g=dividend growth rate in %
- V=stock intrinsic value
- Example: k=7%; g=2%; D=2; V=40

Selection Criteria:
Dividend Yield > 2.1%
Long-term Dividend (or Earning) Growth > 3%

- **A stock's value to an investor exhibits in its dividend payout (or in company's action of stock buy-back)**
- **Reward:"A bird in the hand-that is, dividends-is to be favored relative to the growth rate in the bush"** (Bill Gross, Barron, Feb 1, 2010).
- **Currently Wall Street only offers a little 2% dividend yield compared to a long-term average of 4.5%**

Risk vs. Return 1985-2009



The well-diversified balanced portfolio provided 95% of the return of the S&P 500 Index with only about 62% of the volatility. However, investment-grade bonds had unusually strong returns over this period as interest rates had a secular decline. The equity portion of the balanced portfolio includes 36% large-cap stocks, 12% mid- and small-cap stocks, 12% international stocks; the bond portion includes 10% short-term bonds, 21% investment-grade bonds, 6% high yield bonds, and 3% international bonds. The historical performance is based on the following indexes to represent these asset classes: Barclays Capital U.S. Aggregate, Barclays Capital Govt./Credit 1-3 Year Bond, Barclays Capital U.S. High Yield Bond, Citi World Global Bond Index non-U.S., S&P 500, Russell 2500, and MSCI EAFE. Allocations are considered static and are rebalanced monthly. The time period chosen is based on the availability of the indexes. The Citi World Global Bond Index non-U.S. is not depicted in the graph.

Source: T. Rowe Price Associates. Data provided by Ibbotson Associates.

Current Market Views

Bulls Say (I)

- There is $3 trillion-plus sitting in money market funds earning next to nothing, I suspect returns will be 5% to low-teens gains. (**Brian Rogers of T. Rowe Price, USA Today, Dec. 14, 2009)**

- Don't wait for a sizable pullback. We don't think there will be one. (**David Bianco, Bank of America Merrill Lynch**)

- Our view for 2010 is that growth will continue. We think there will be moderate 2% to 2.1% GDP growth (**Abby Joseph Cohen, Goldman Sachs**)

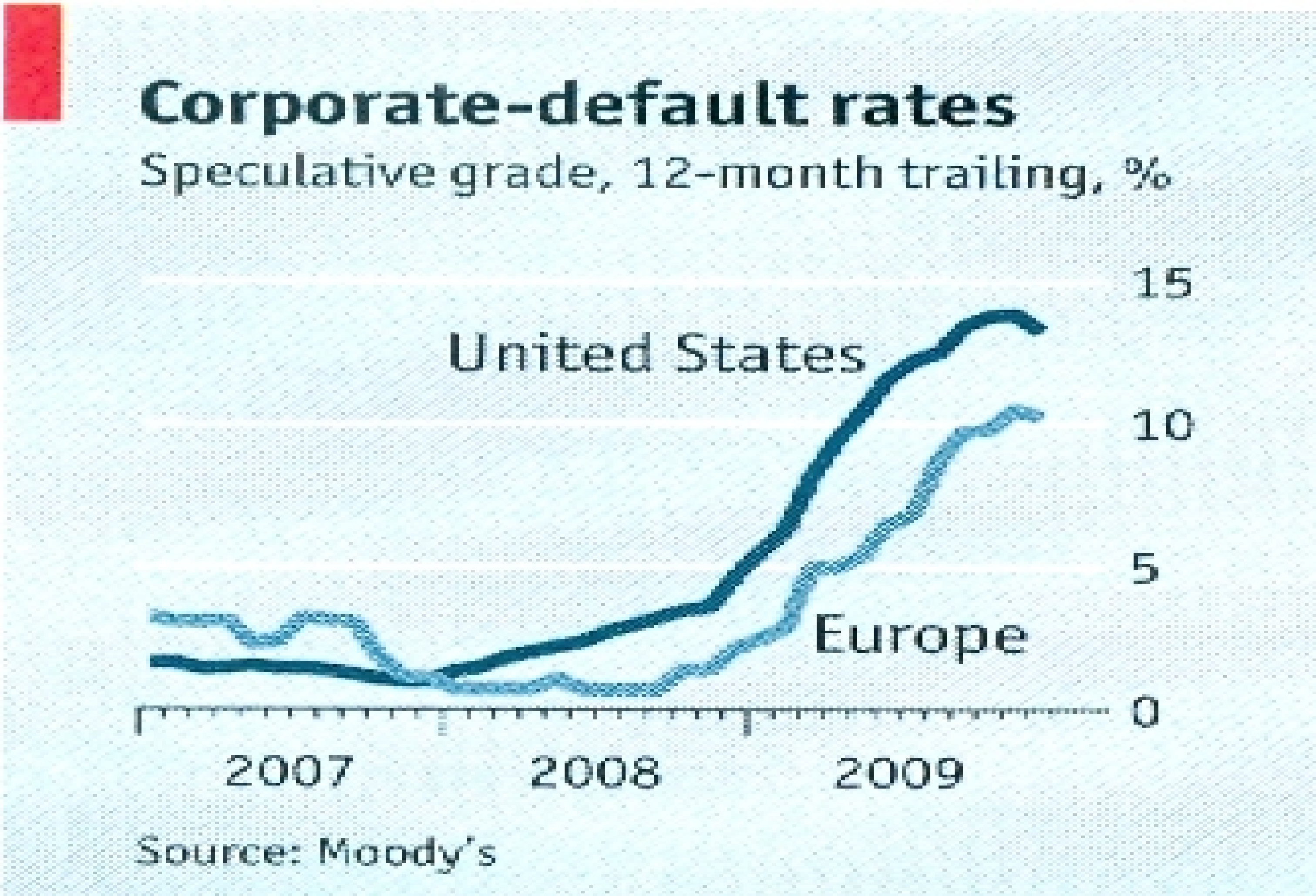
- The decline in the unemployment rate was confirmed by a drop in U-6, the broadest measure of unemployment, which fell in January to 16.5% from 17.3% (**Barron's, 02/08/10**).

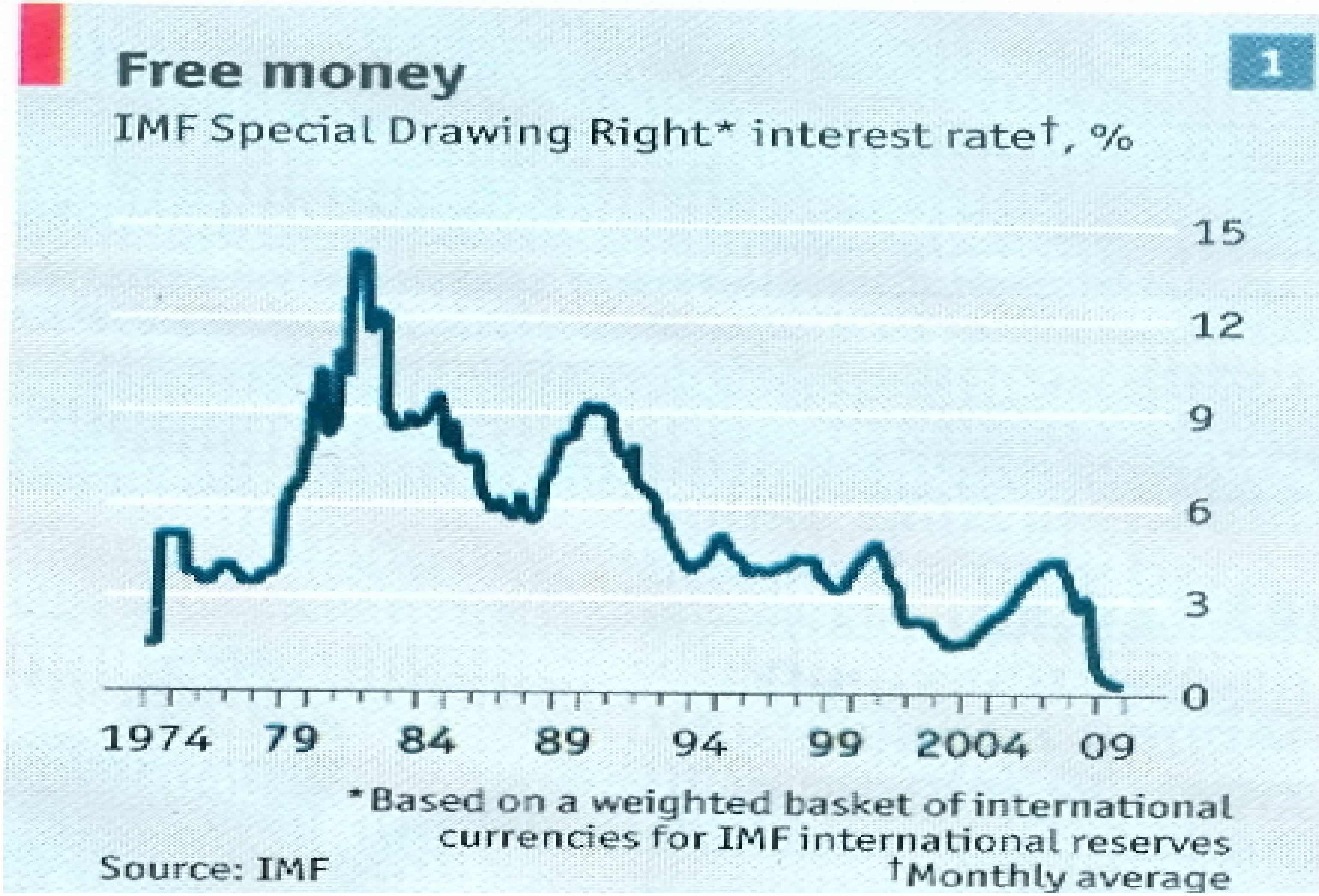
Bulls Say (II)

- Productivity growth is at a 6.9 annual rate in the second quarter and 9.5 percent in the third quarter (fastest rise in 40 years).
- Estimated year-end S&P 500 is 1340, (a 20% Gain) (**Jeremy Siegel, Yahoo Finance, 12/15/09**).
- The IMF raised its forecast for world economic growth in 2010 to nearly 4%
  - U.S. 2.7%
  - Euro zone 1.0%
  - Japan 1.7%
  - China 10%
- "key emerging economies in Asia are leading the global recovery." (**The Economist, Jan. 2010**)

Corporate Default rate is expected to decline from 12.5% worldwide to 3.3% by the end of 2010

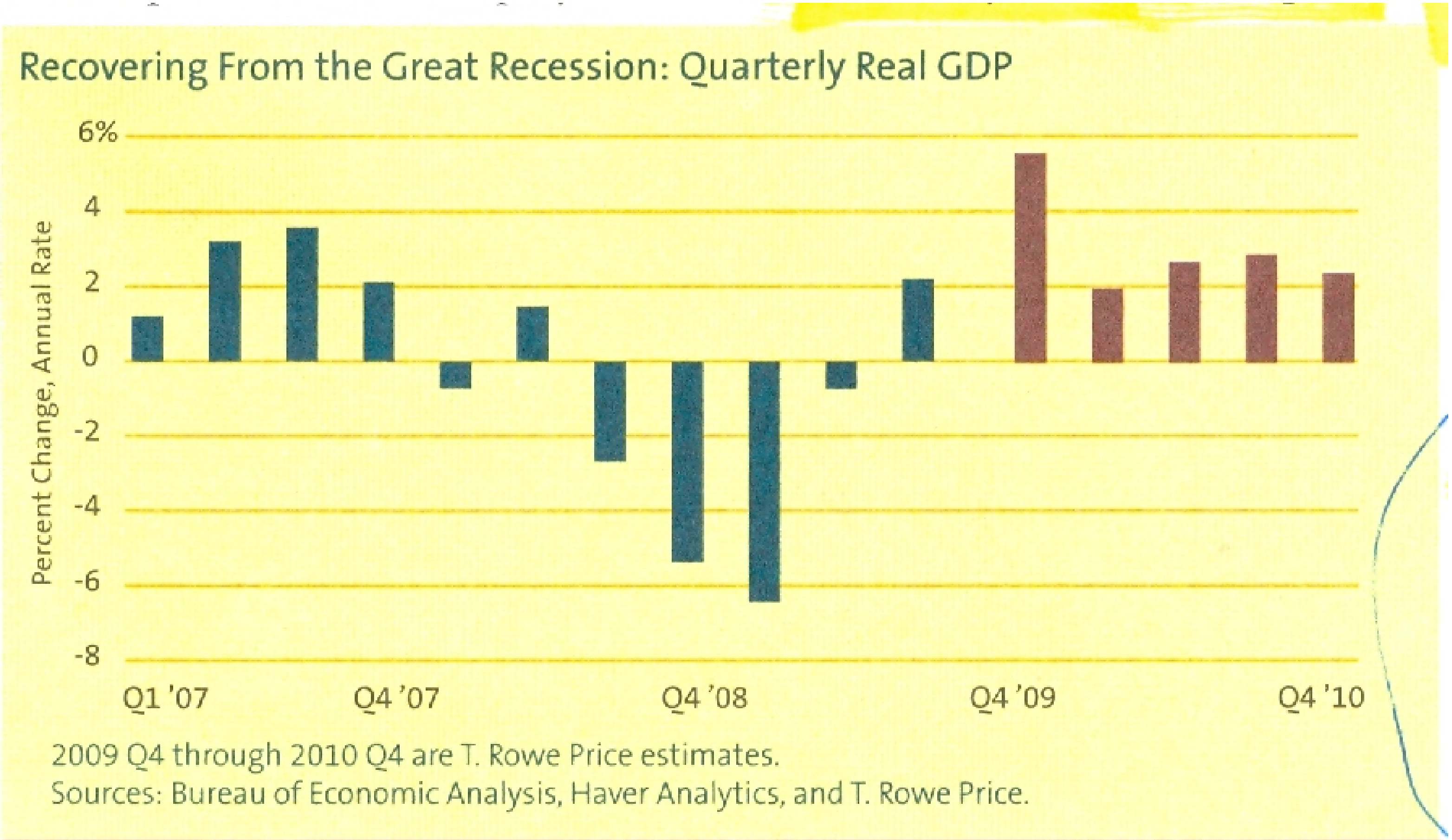
The Economist, Jan 16-22, 2010





Near- zero interest rates discourage fixed income investments and amount to free money to encourage borrowing & investing in risky assets such as equities

The Economist, Jan. 9-15, 2010


Recovering From the Great Recession: Quarterly Real GDP
6%
4
2
0
-2
-4
-6
-8
Percent Change, Annual Rate
Q1 '07
Q4 '07
Q4 '08
Q4 '09
Q4 '10
2009 Q4 through 2010 Q4 are T. Rowe Price estimates.
Sources: Bureau of Economic Analysis, Haver Analytics, and T. Rowe Price.

Bears Say (I)

- The market is due for a correction (10% decline in the March-to-August). (**Dan Chung, Alger Funds**)
- Fiscal situation at the state and local level is dire (Michigan and California).
- Medium-small banks are experiencing additional losses in commercial real estate (**USA Today, 01/26/10**)
- Dividend yields have dropped close to their all-time 1999 levels. Market bottoms are accompanied by sky-high dividend yields; not yields around 2 – 5%. (**Simon Maierhofer, ETF Guide, 01/28/10**)
- The Standard & Poor's 500-stock index is worth "850 or so." (**Jeremy Grantham, Market Watch. 01/29/10**).

Bears Say (II)

- "multi-year headwind more akin to the bumpy 1970s over the next 7 years (Jeremy Grantham, Market Watch. 01/29/10).
  - Large-cap U.S. stocks = 1.3%
  - Small-caps : 0.5%;
  - High-quality U.S. stocks: 6.8%.
  - International stocks : 4.7%,
  - Emerging markets :3.9%.
  - Treasuries: 1.1%;
  - Inflation-indexed Treasuries: 0.8%;
  - Short-term Treasuries − 0.6%
  - International bonds: 0.3%;
  - Emerging market bonds: 2.1%.

Bears Say (III)

- There are two dark clouds: One is the financial condition of the American household, and the second is the financial condition of our banking system.

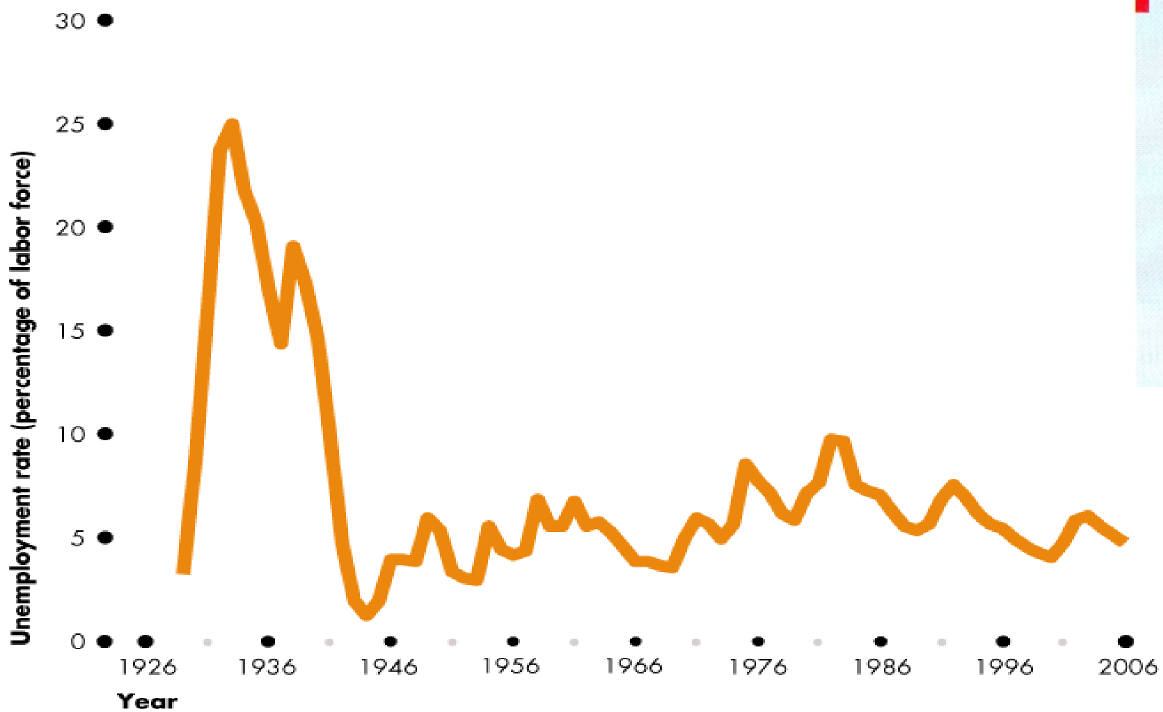
- Average American household income was ~ $50,000, and there was a 20% hit to net worth with a debt equaling about 140% of your income.

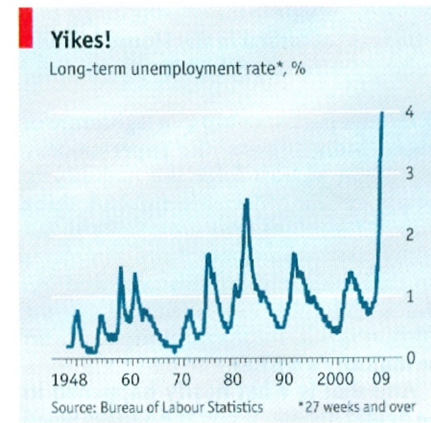
- The banking system continues to shrink, because the it is also still recapitalizing itself. Consumer and industrial loans in the U.S. have declined for 10 consecutive months. **(Roger Altman, Barron's, 02/08/10)**

Risks

- Health care reform
- Financials sector regulation
- Energy policy
- Residual fragility in the financial system
- Federal Reserve's exit strategy
- U.S. budget deficits
- Possibly higher tax rates
- Weakness in the commercial real estate

US Unemployment Rate





Long-Term Unemployment (>27 wks) 4% *The Economist, Jan. 16, 2010*

Underemployment rate (U-6) of 16.5%

Unemployment may peak at 10.5% in 2010

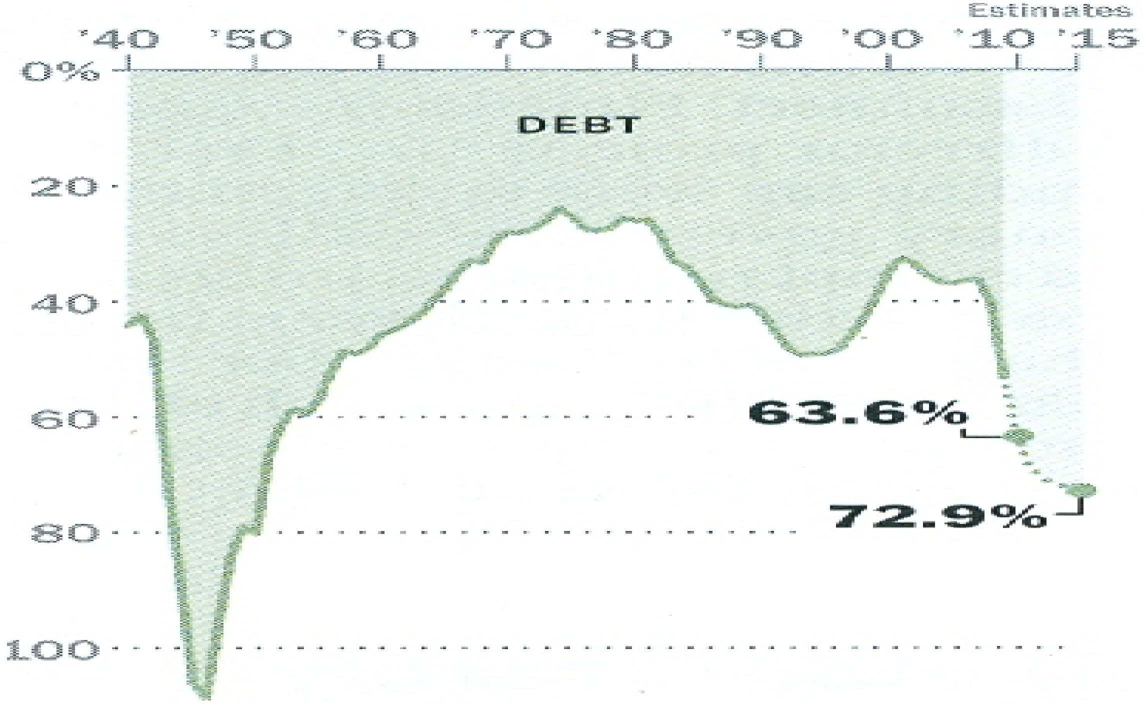
Hit 10% in 1982 and 2009-10, *Google.com, 2010*

During the 1930s, the unemployment rate hit 25 percent. *T. Rowe Price, Rpt 2Q 2009*

Debts, Taxes, and Interest Payments

U.S. Debt

Debt held by the public as a percentage of GDP



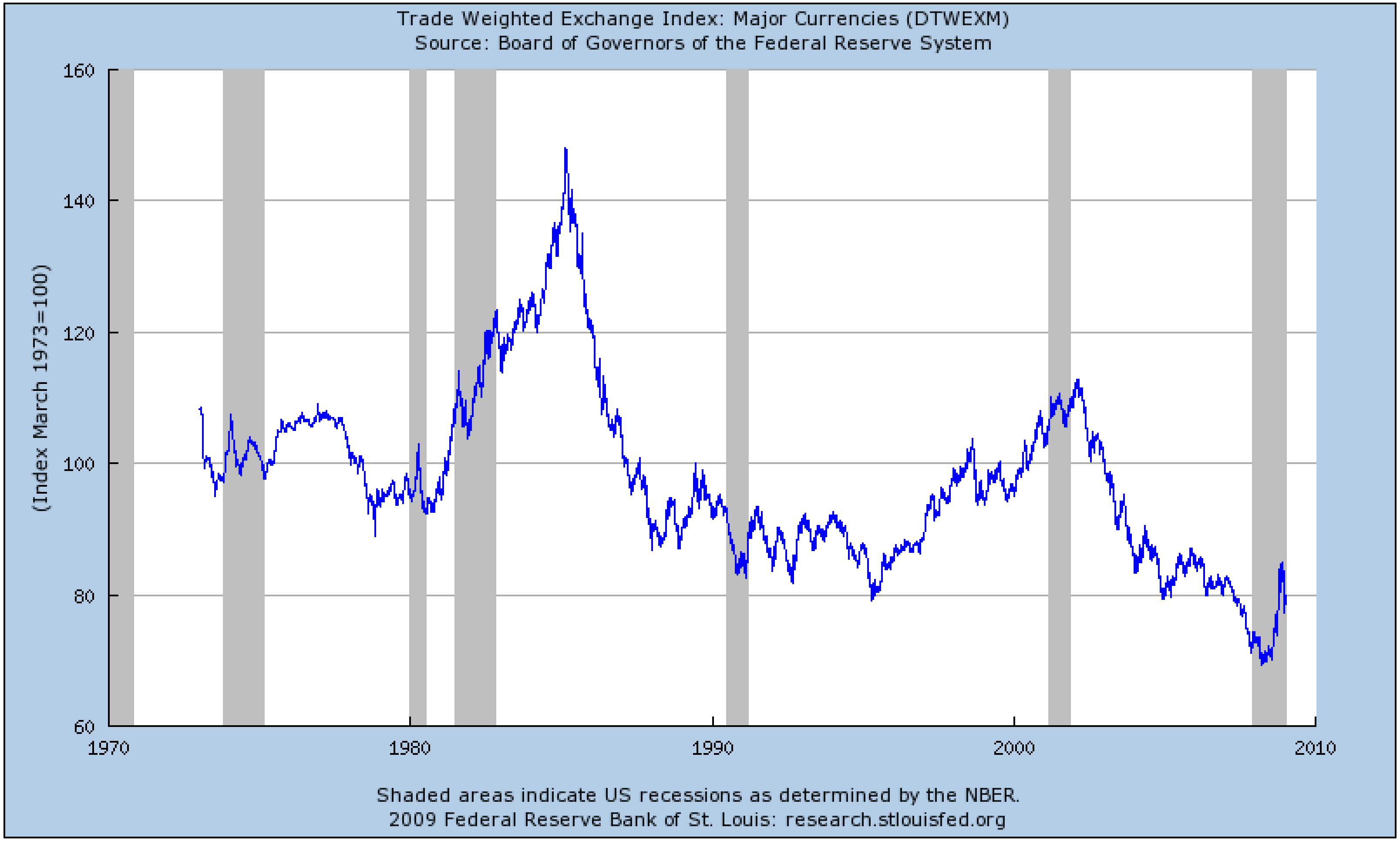
DANGER ZONE

Public debt is soaring as a share of GDP. Taxes will have to rise or spending will have to be cut to make room for rising interest payments on the debt

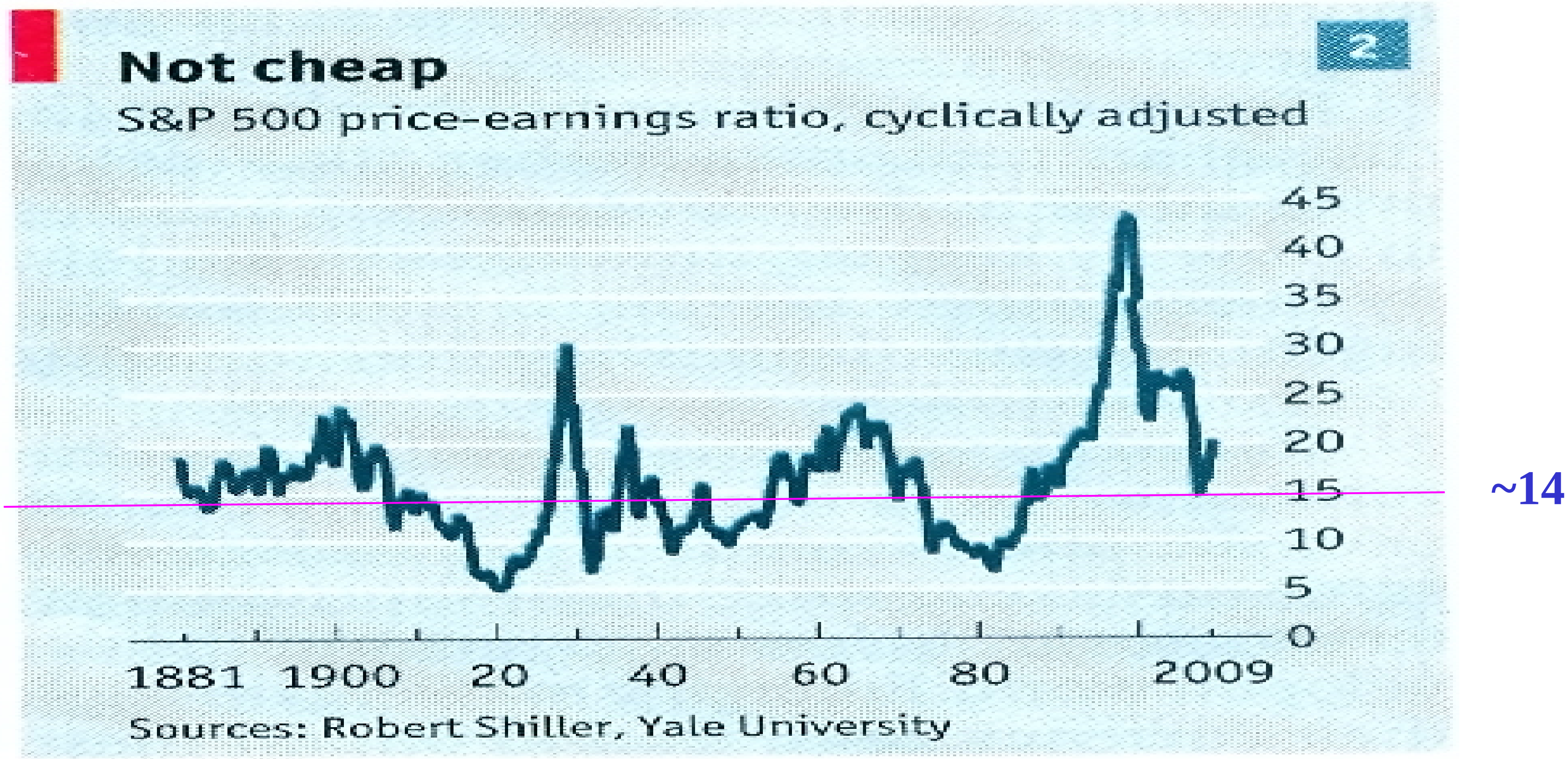
Time
Feb. 15, '10

International Imbalances

Falling UD Dollar



A weighted average of the foreign exchange value of the U.S. dollar

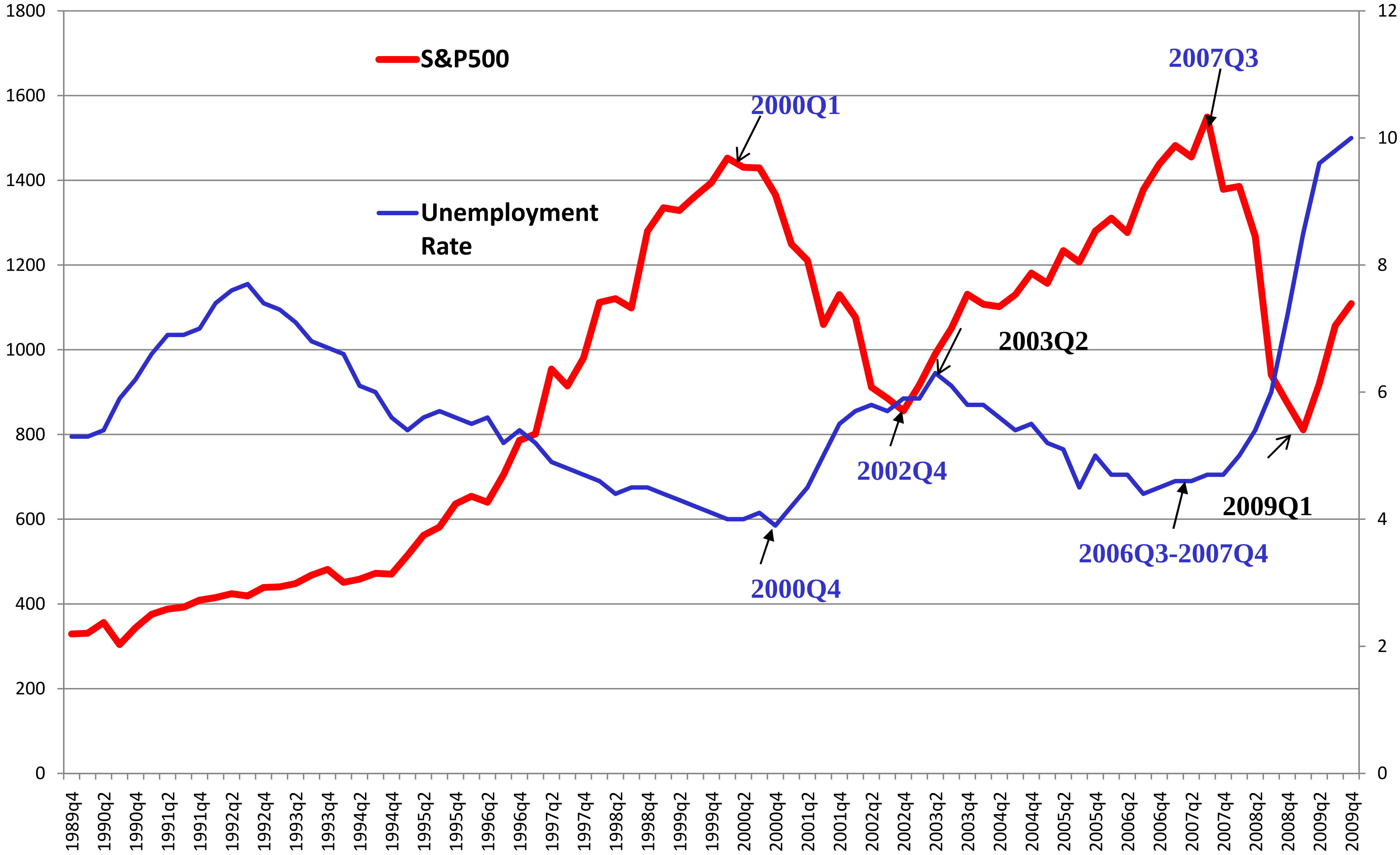


However, today's cyclically adjusted P/E Ratio (~20, based on the average profit over the previous 10 years) is still higher than the historical mean of ~14

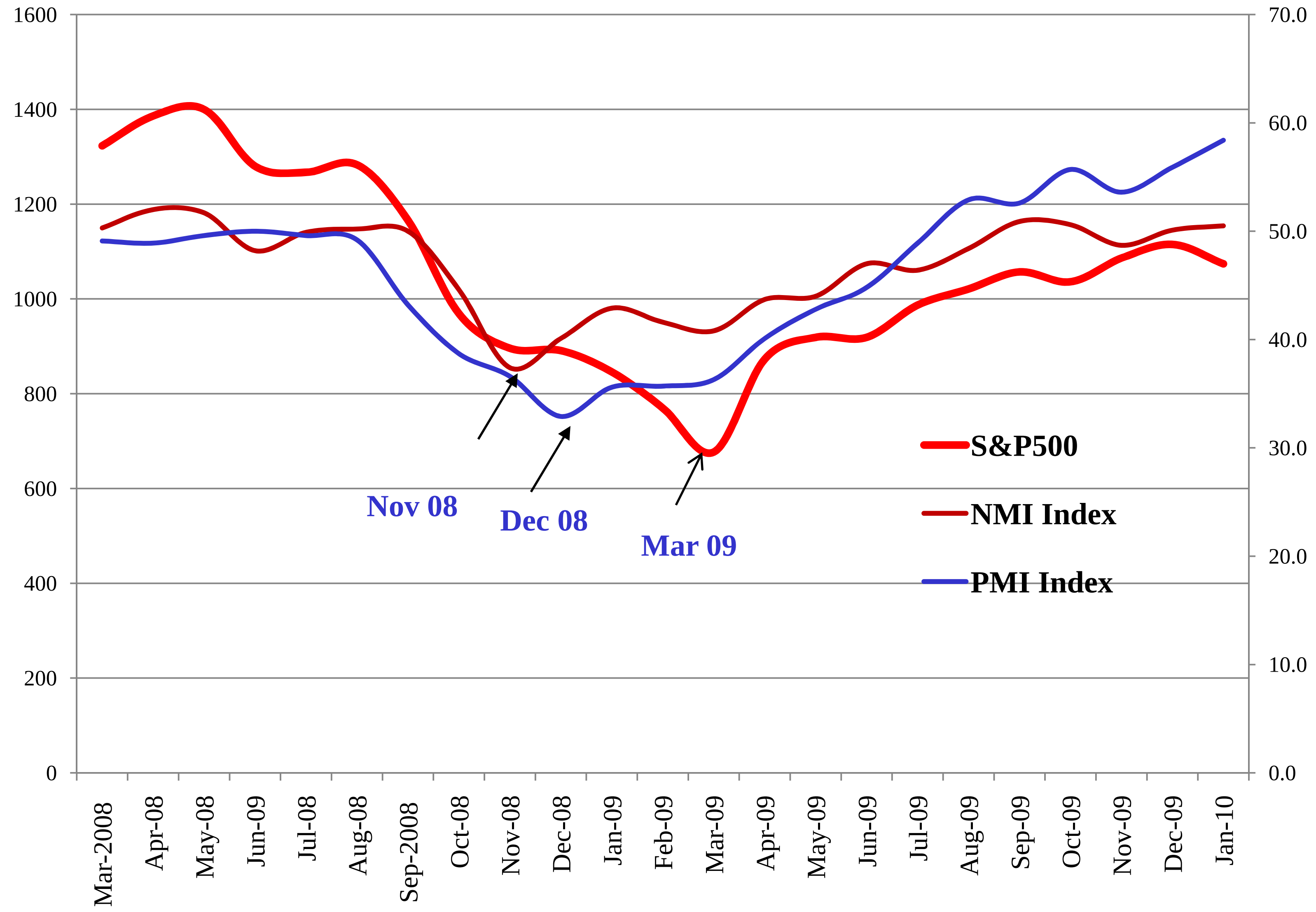
The Economist, Jan. 9-15, 2010

Economic Indicators

Unemployment Rate may be a lagging Indicator



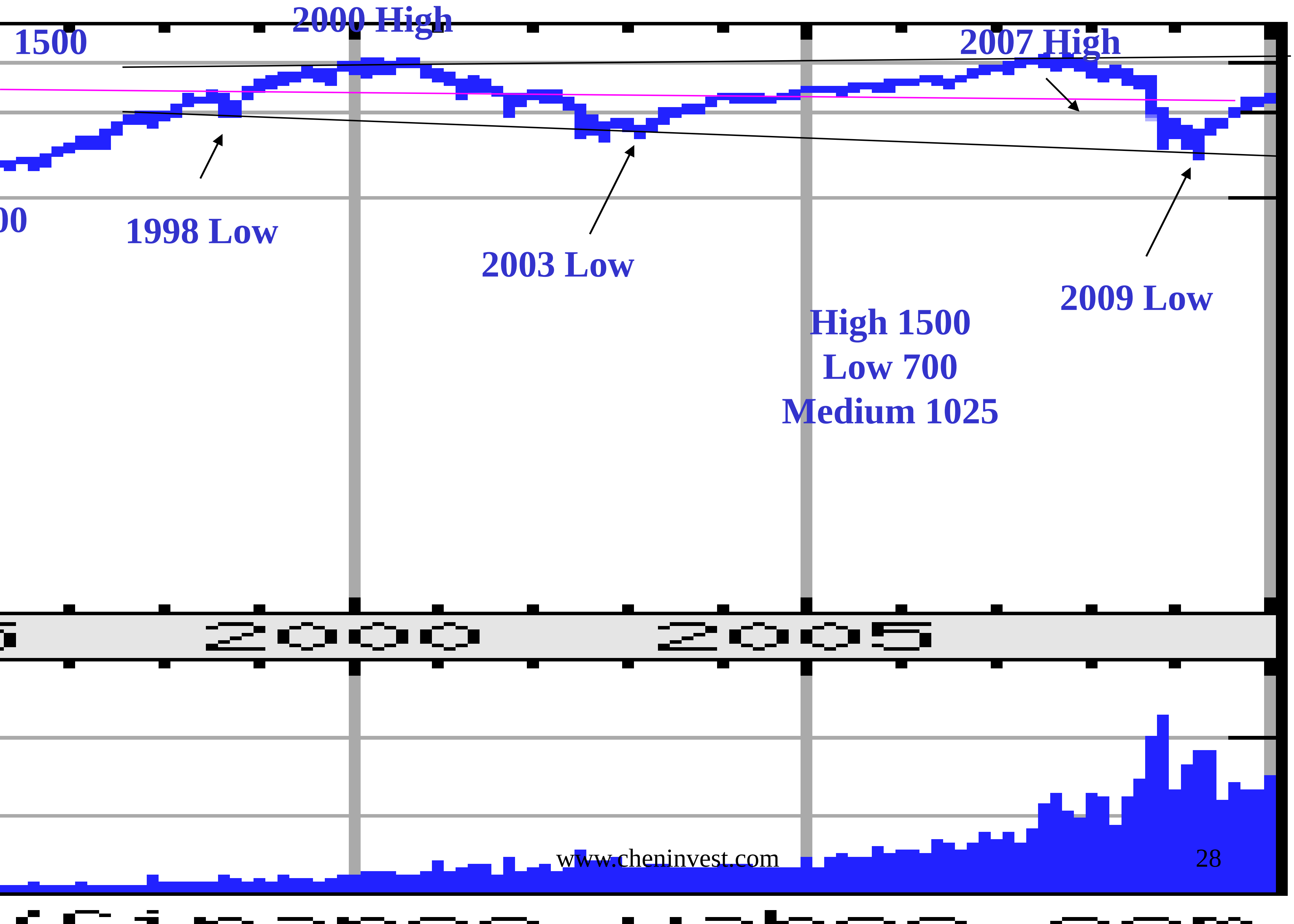
NMI & PMI are Economic Leading Indicators



PMI: Purchase Managers Index; NMI: Non-Manufacture Index

Technical Factors

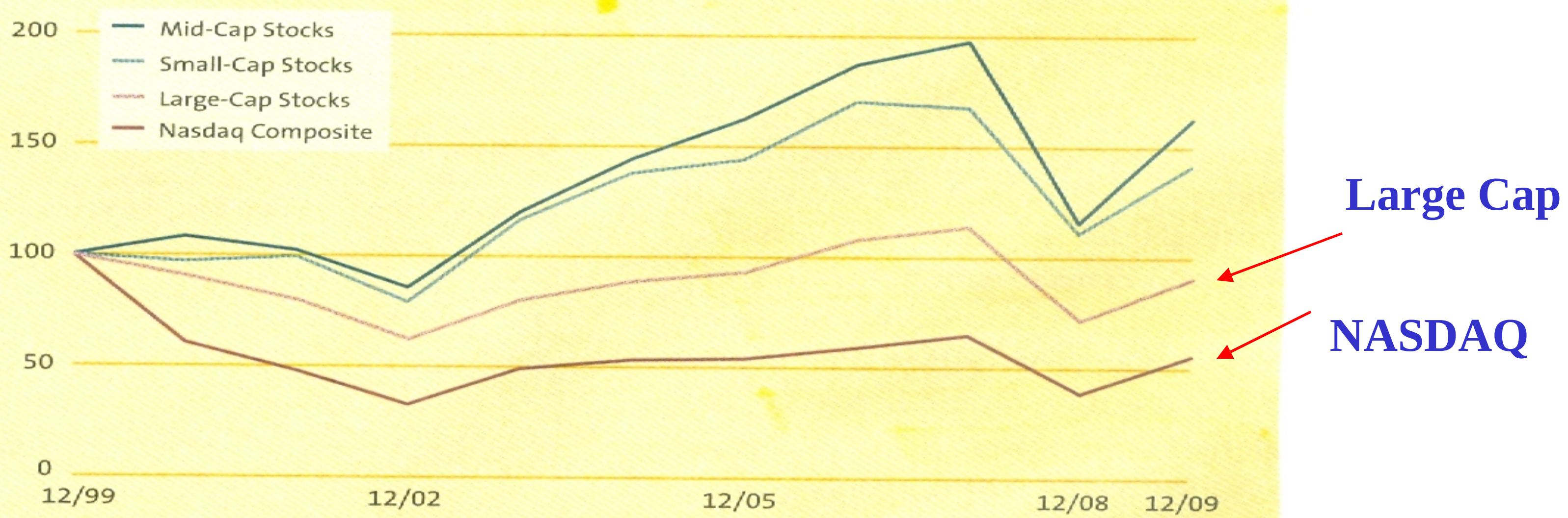
Market Outlook: 10 Yr Trend lines (S&P 500 Index) (More Volatile)



A Lost Decade (1999-2009) for Large Cap & NASDAQ

A Tough Decade for Equity Investing: Performance of Various Market Sectors

Total Return From December 31, 1999, to December 31, 2009, Indexed to 100

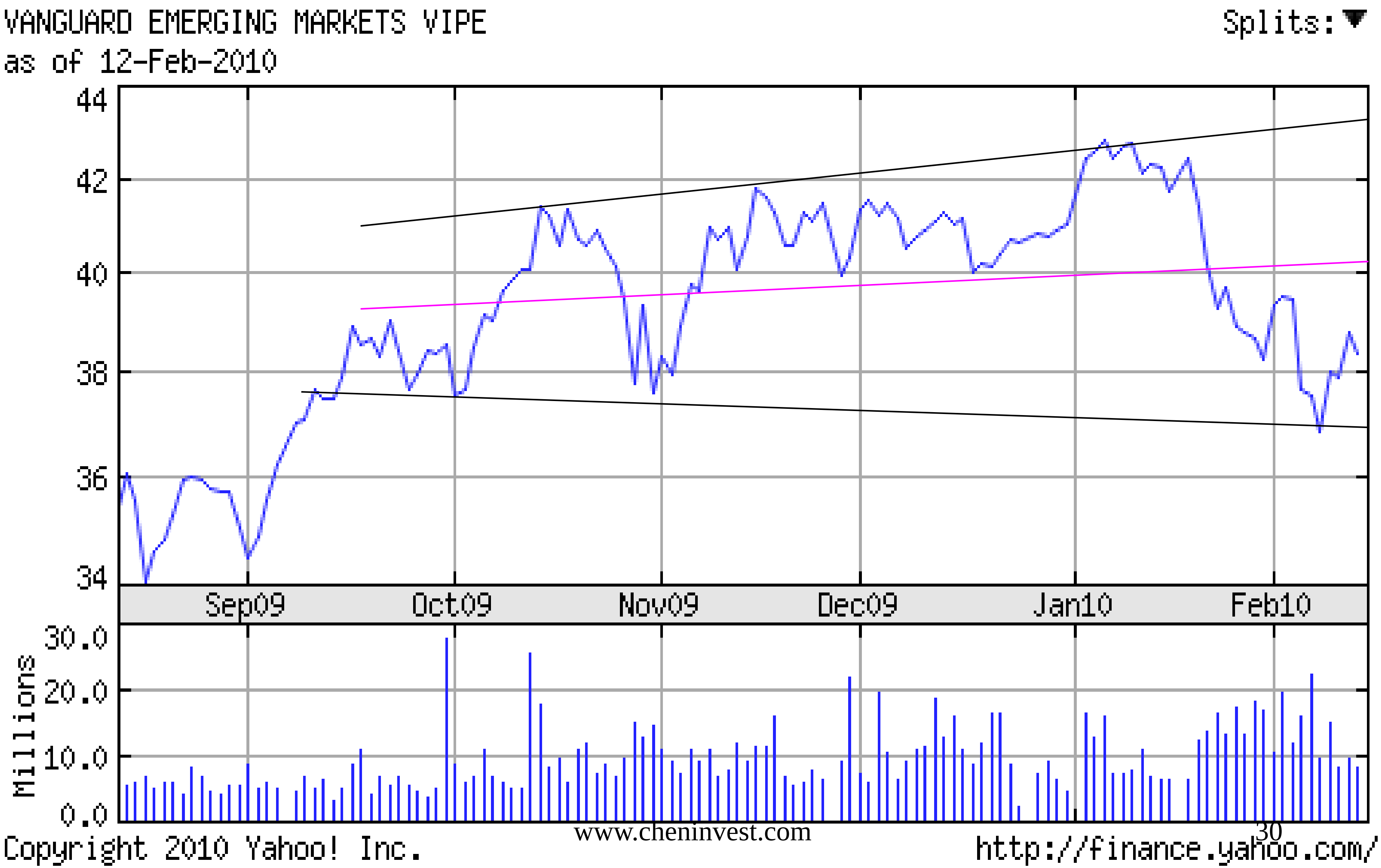


In a decade marked by two severe bear markets at the beginning and the end, large-cap stocks (S&P 500 Index) and technology stocks (Nasdaq Composite) lost money while mid-cap stocks (Russell Midcap Index) and small-cap stocks (Russell 2000 Index) managed modest gains. It also marked the first decade when the S&P 500 had a negative total return. However, it followed two straight decades of extraordinary returns. In the 1980s and 1990s, the S&P 500 had annualized returns of 17.5% and 18.2%, respectively. Small-cap stocks had an annualized gain of 14.5% in the 1980s and 13.4% in the 1990s.

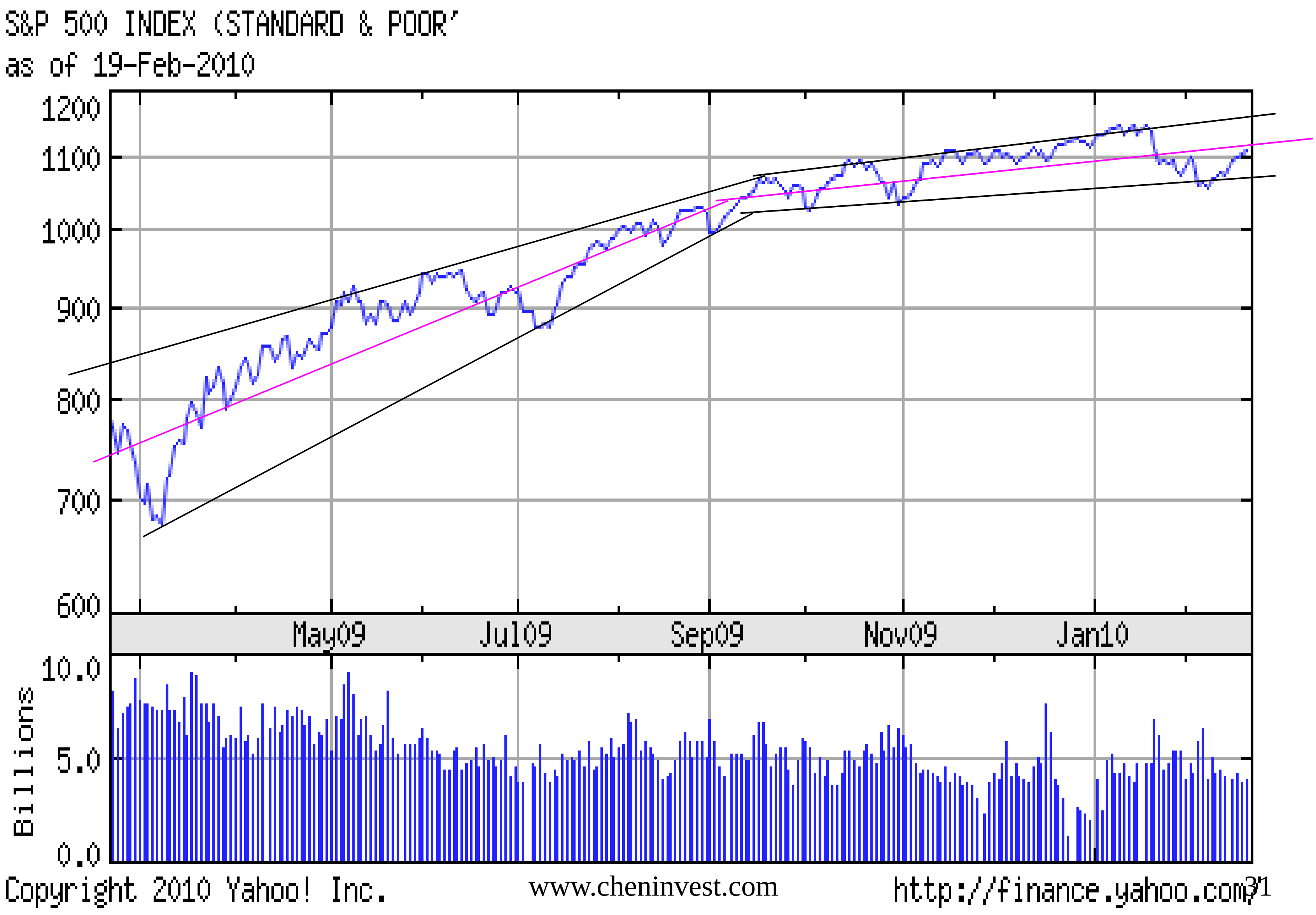
Note: Performance for the Nasdaq Composite reflects principal only.

Emerging Market Index Fund (VWO)

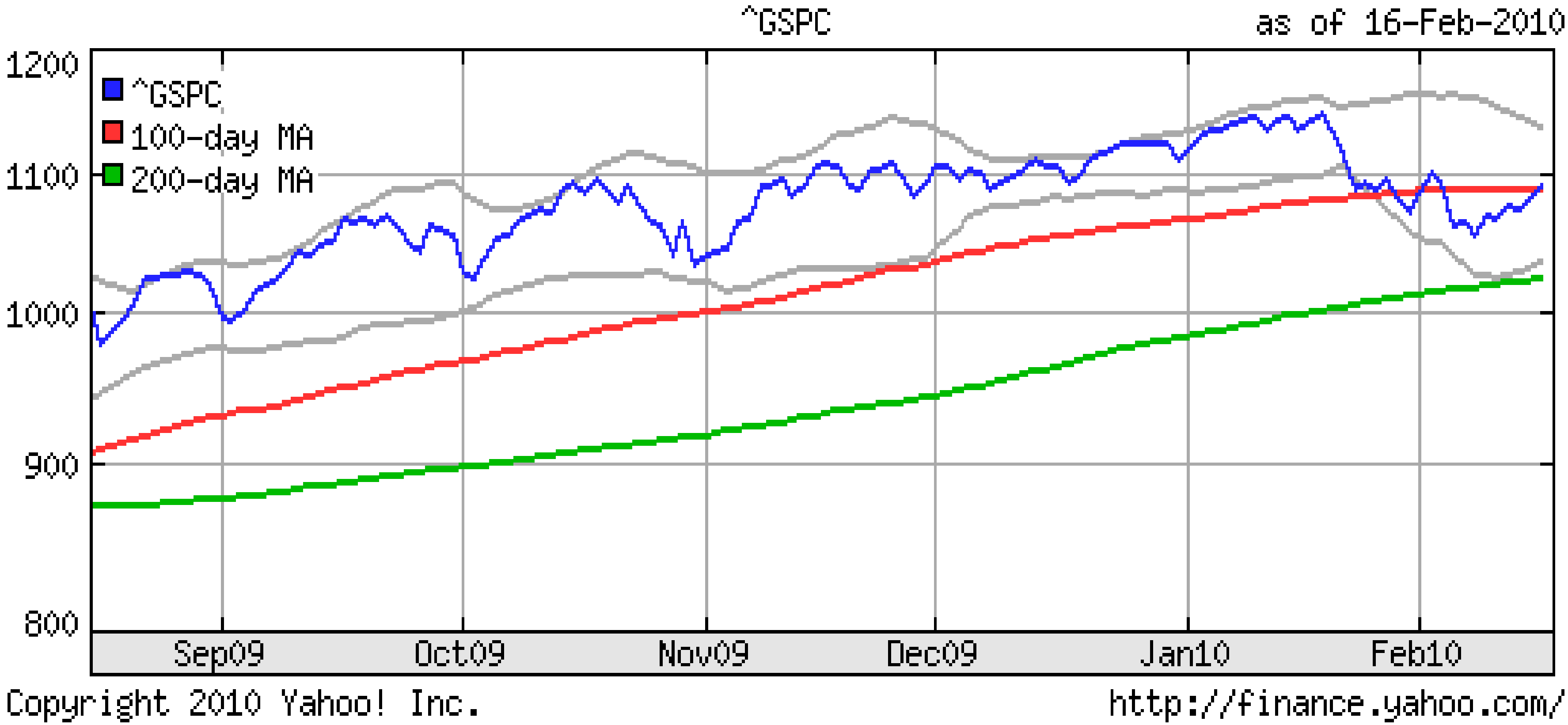
5- Mo Trend Lines & Sideway Channels: More Volatile



S & P 500 Index: 12 mo. Trend Lines (Changing Slope)



S & P 500 Index: Moving Averages & Bollinger Bands



- Simple moving averages (MA): A 100-day MA is the average of the stock prices of the past 50 trading days.
  - $MA_t = \Sigma\, y_t / 100$

Middle Bollinger Band = **20-period simple moving average (Not Shown)**

Upper Bollinger Band = Middle Bollinger Band + **2 * 20-period standard deviation**

Lower Bollinger Band = Middle Bollinger Band - **2 * 20-period standard deviation**

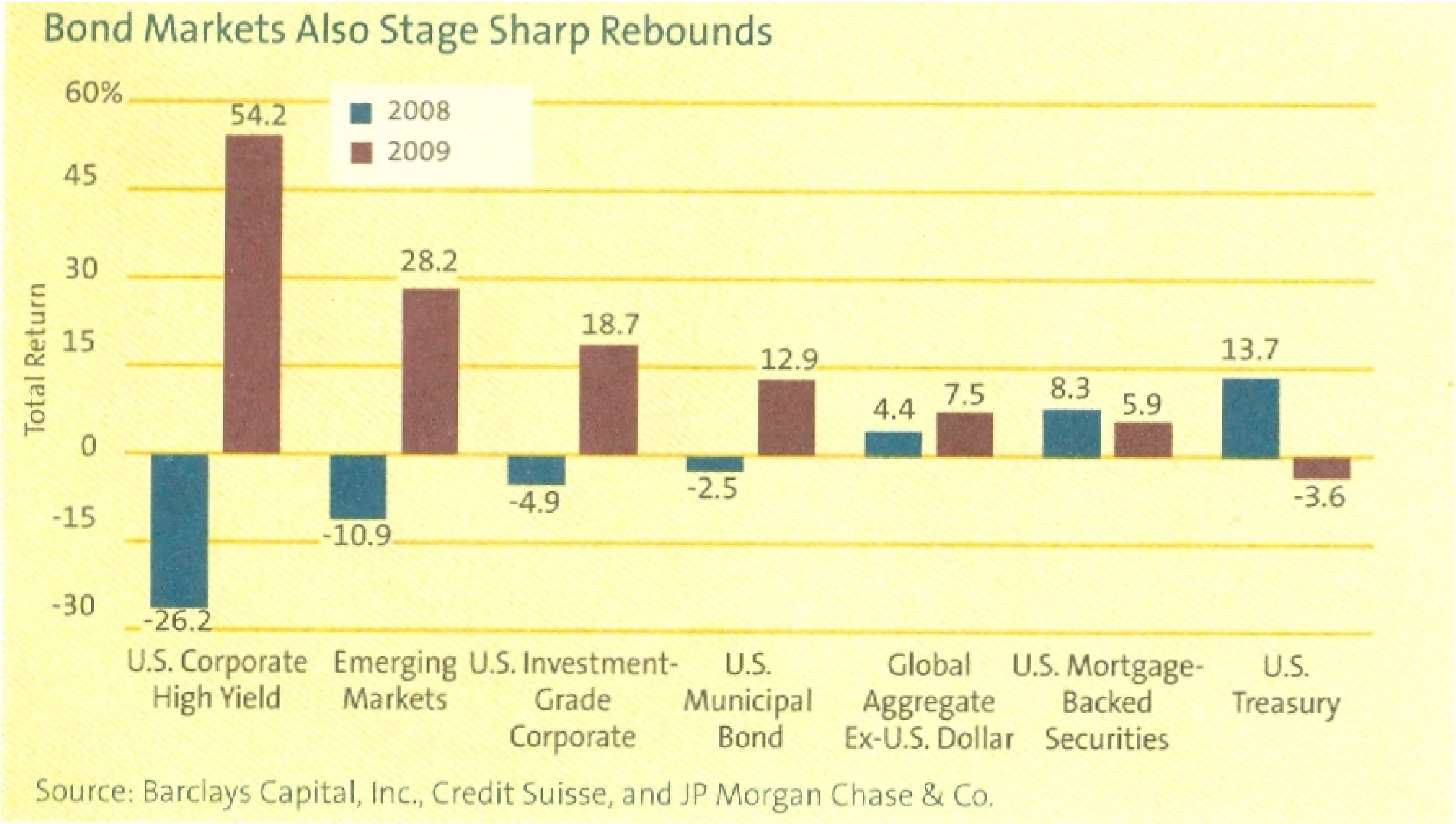
Market Outlook

“Bull markets climb a wall of worry”
(Wall Street proverb)

Market Outlook 2010

- **Economy is expected to turn the corner (2-3%)**
- **Fed fund rate is currently at the 0% level. It may go up as early as 2Q of 2010 & may continue to rise through 2012.**
- **Discount Rate was raised from 0.5% to 0.75% on 02/19/10.**
- **Market should continue to recover through 2011.**
- **Technical corrections of 10% or so, however, are likely in 2010-2011.**
- **Dollar-cost-average investing & Buying at dip**

2008-2009 Bond Markets



Market Allocation is for 10 years to Retirement

For every year reduction in time horizon, bond/cash holding should increase by 1%

Fixed Income & Cash Equivalent

- **Cash & Reserves: 6 mo. Living Expenses (Contingency Fund)**
- **Besides Diversified Bonds (BND), emphasizing High yield corporate bonds (HYG, JNK) & Foreign Bonds (EMB). Anything with Government support is not attractive (30%).**
- **Preferred Stocks (PFF)**
- **Bond Picks**
  - Emerging Market Bond Funds (EMB, FNMIX, PREMX)
  - High Yield Corporate Bonds (HYG, FAGIX,SPHIX)
  - Multi-sector bond funds (FSICX, RPSIX)
  - US bond Index fund (BND, FBIDX)

Disclaimer

S&P gained 24% in 2009

- Given the market rally in 2009, many investors may have some concerns about the market's sustainability in 2010.
- The S&P 500® Index is still down 29% from its pre-crash high, and an analysis of 13 previous bear-bull cycles suggests the market may have room for potential growth in 2010.

2nd year Avg. 7.5%

January 14, 2010
Fidelity.com

Experts Call for 2010: -**10 — +20%, Avg. 5 %** for Domestic Stocks

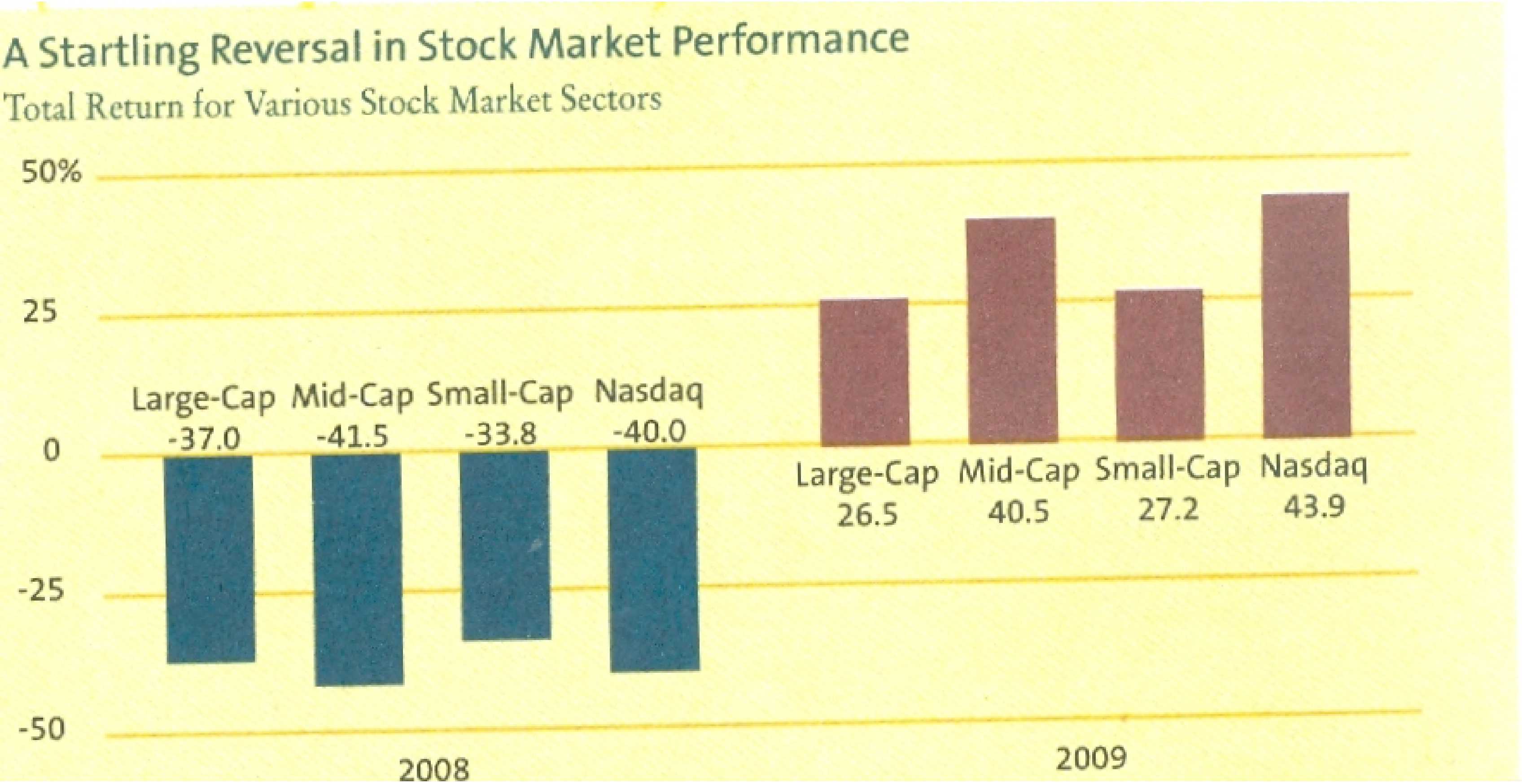
Disclaimer

Historical Stock Market Performance During and After Bear Market 1929-2009

Bear Markets	Bear Market Return	Return in First Year of New Bull Market	Return in First 2 Years of New Bull Market	1-Year Round-trip (Bear & First Yr. of New Bull)	2-Year Round-trip (Bear & First 2 Yrs. of New Bull)
1929-1932	-86%	169%	124%	-63%	-69%
1937-1942	**-60%**	**54%**	**59%**	**-39%**	**-36%**
1946-1949	-30%	42%	59%	0%	12%
1956-1957	-22%	31%	44%	3%	13%
1961-1962	-28%	33%	56%	-4%	13%
1966-1966	-22%	33%	42%	4%	10%
1968-1970	-36%	44%	60%	-8%	2%
1973-1974	**-48%**	**38%**	**67%**	**-29%**	**-13%**
1976-1978	-19%	13%	25%	-9%	1%
1980-1982	-27%	58%	62%	15%	18%
1987-1987	-34%	23%	57%	-18%	4%
1990-1990	-20%	29%	38%	3%	10%
2000-2002	**-49%**	**34%**	**45%**	**-32%**	**-26%**
2007-2009	-57%	65%*	?	-29%*	?
Average	-37%	46%	57%	-14%	-5%
Median	-30%	34%	57%	-8%	4%

*Reflects March 9 to Dec. 31, 2009. Bold denotes bear market returns that are most similar in magnitude (-48% to -60%) to 2007-2009 bear market. Bull and bear markets defined as a 20% or more increase or decrease in the S&P® 500 Index. Source: ISI, Bloomberg, FMRCo (MARE) as of 12/31/09.

NASDAQ & Mid Cap did best in 2009



Large Cap for 2010?

Disclaimer

International Investing

International Market Valuations Attractive Relative to U.S.

As of December 31, 2009

	Europe	Japan	Emerging Markets	U.S.
Price/Book*	1.73	1.20	2.15	2.21
Price/Earnings**	12.78	19.95	10.19	14.42
Dividend Yield, %	3.25	1.69	2.05	1.90
Return on Equity, %	9.29	-3.42	10.45	7.73

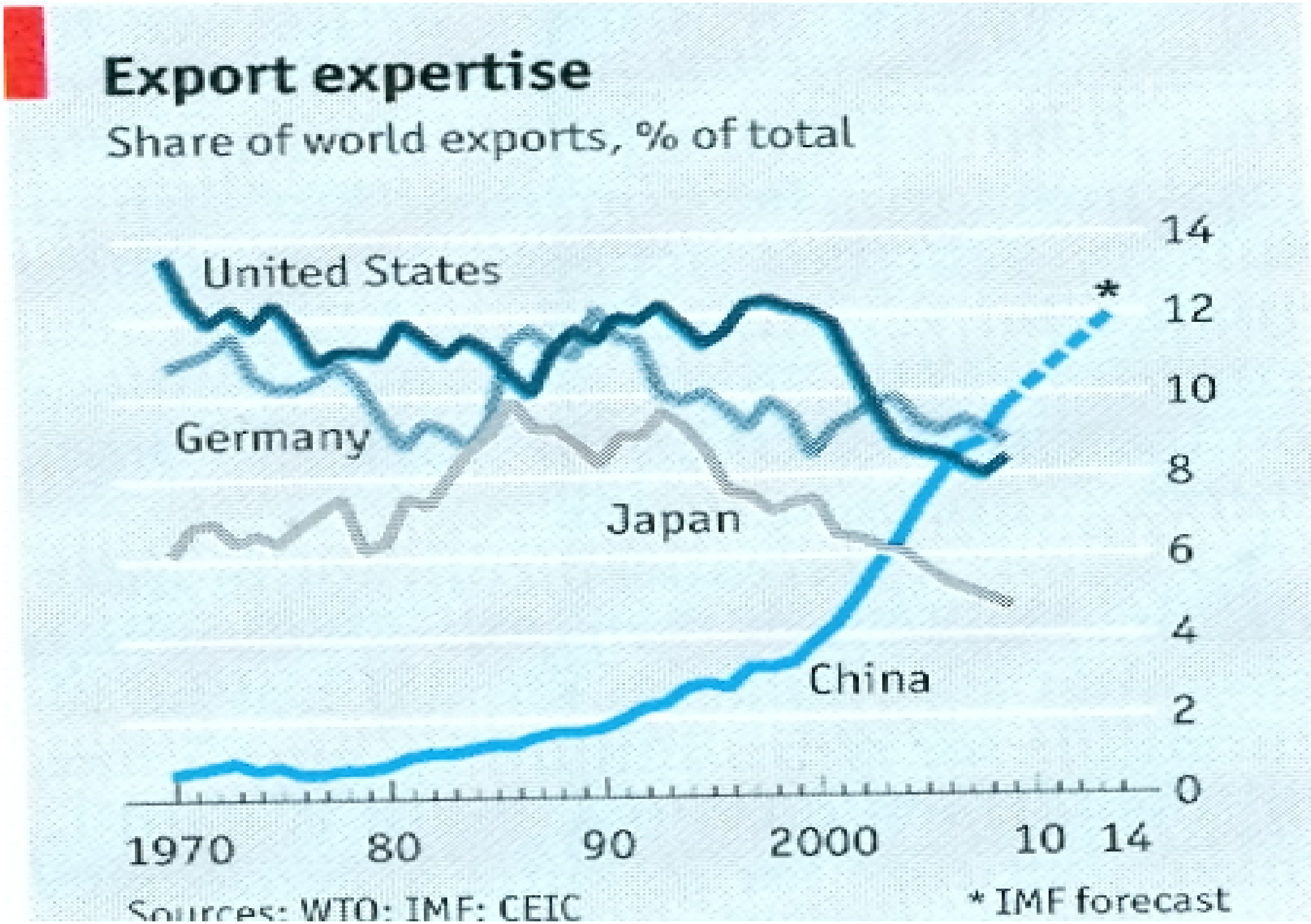
* Price/Book, Dividend Yield, and Return on Equity are based on 12-months trailing data.

** Price/Earnings is based on 12-months projected earnings. Data based on MSCI indices for these regions.

Sources: MSCI and FactSet.

China overtook Germany as the biggest Exporter in 2009

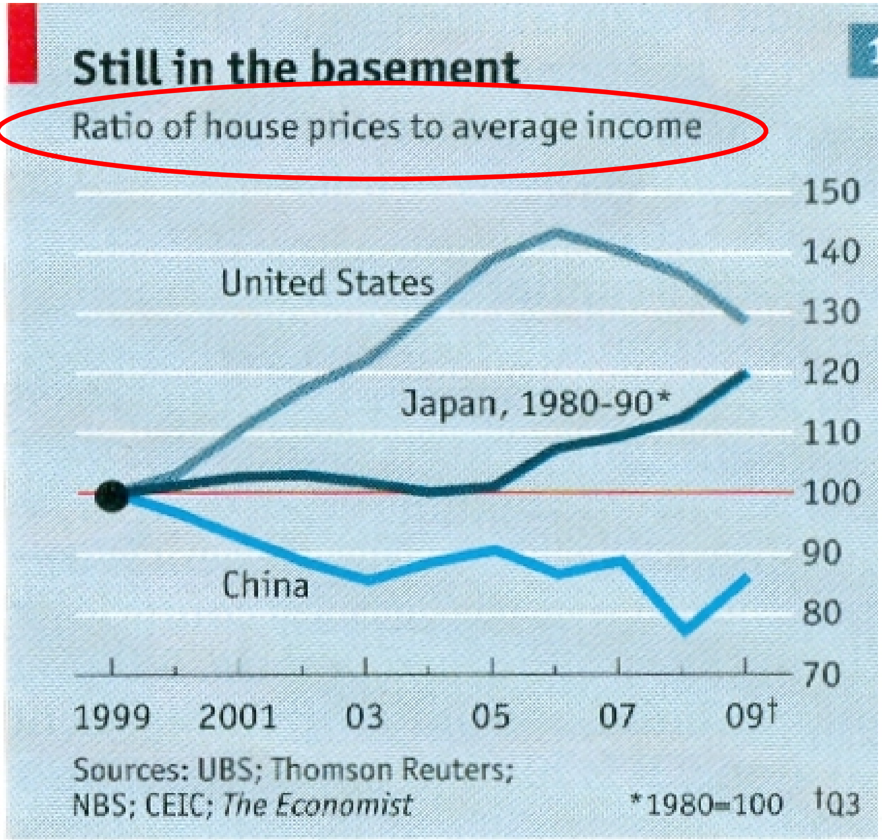
The Economist, Jan. 9-15, 2010

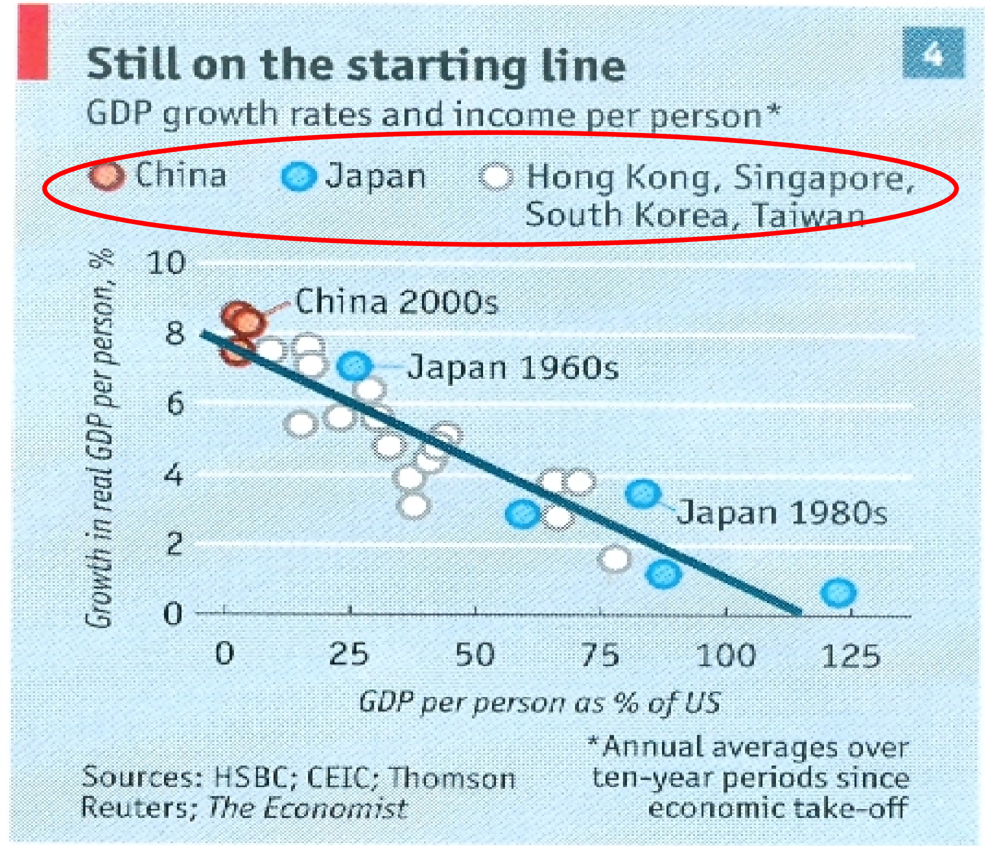


China's Economy May Overheat in 2010

- M2 money supply grew ~ 30% year on year.
- High food prices (severe weather in northern regions)
- There is a big pressure on wage growth
- China will begin to raise interest rates before 2Q
- Over-owned (ripe to fall) (Alexander Young, Market Watch, Feb. ‘10)

China: A Japanese Style Bubble? *The Economist, Jan. 16, 2010*





Per capita GDP: Singapore $50,300; US $46,900; Japan $32,600; Taiwan $30,200; S. Korea $27,700; China $6,500

"The Chinese authorities have a lot of power that democratic nations don't have."

"They showed great skills in navigating China through the recession and the credit-market collapse."

Emerging Markets (I)

- **"I believe China is likely to manage its growth successfully, at least over the next 2-3 years, and avoid, for example, a real-estate crash." (Roger Altman, Barron's, Feb. 8, '10)**
- **Auto sales and oil consumption are larger today in emerging economies. India added over a hundred million mobile phones in 2009.**
- **Emerging economies, in fact, are larger than the developed world.**
- **In the past 10 years, the BRICs contributed far more to global GDP growth than the U.S. did. (Cohen, Barron's, 02/08/10).**

Emerging Markets (II)

- Today Emerging Countries don't have current-account deficits, rather, current-account surpluses. **(Faber, Barron’s, 02/08/10)**
- **The typical international portfolio manager has 60-70% of his client’s money in America and 30-40% overseas. Maybe 10- 20% is in emerging markets**
- **“ I see the emerging markets as a longer-term story with GDP growth surpassing the developed markets and that's been true for decades. Some of the key emerging markets today are relatively developed countries, e.g., Korea.”**

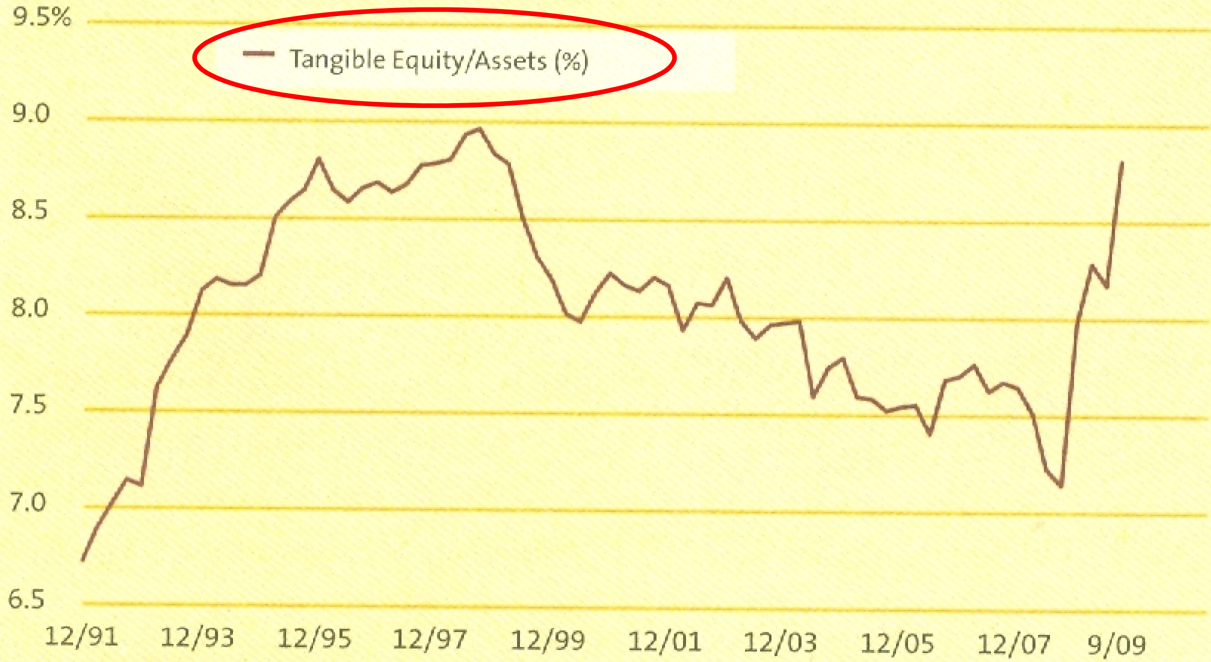
Other Troubled Spots

- Eastern Europe
  - Saw its markets soar 120% over 12 months (High Valuation)
- Southern Europe
  - Greece, Portugal, Spain, Ireland and Italy (Public Debt),
- Brazil
  - Skyrocketing stock valuations and the presidential election
- Consumer discretionary --- U.S., Japan, Europe
  - Retail, luxury goods/appliance makers

US Financials are getting Healthier everyday, but are not helping the Economy Yet!

Banks' Financial Stability on the Mend

This chart shows the recent sharp rise in tangible equity capital as a percentage of tangible assets for all publicly traded banks and thrifts. In other words, the banks have substantially increased their equity capital as a buffer against potential losses on bad loans on their balance sheets. This influx of capital into the banking system and a more defensive balance sheet profile bodes well for the financial health of the industry.



Data include capital raised as of December 15, 2009; reflects banking industry median values.
Sources: KBW Research and company filings.

Equity: Domestic stocks (20%) & Developed International (MSCI EAFE) stocks (15%)

- Selected High Quality Stocks/ETFs
  - Telecom, Pharmaceutical (T, FTE, VZ, LLY, PFE, MRK, JNJ)
  - Natural Resources (EWA, XLE, XOM, CVX)
  - Utilities (EXC, XLU, JXI)
  - High-Dividend (DD, GE, MCD)
  - Financial & Construction (IXG, ITB, FNF, TRV)
  - Technology (LLTC, NOK)
- Broadly Based Index Funds
  - Diversified (SPY, EZU, EFA)

Disclaimer

Equity: Selected High-Growth-Region ETFs

- **Emerging Markets (30%)**
  - Vanguard Emerging Markets (VWO)
  - iShares Asia Except Japan (AAXJ)
  - Fidelity Southeast Asia (FSEAX)
  - FTSE/Xinhua China 25 Index (FXI)
  - iShares Taiwan Weighted Index (EWT)

Disclaimer

World Economic Growth

	2007	2008	2009	2010
World Economies	5.2	3.2	-1.3	4
Advanced Economies	2.7	0.9	-3.8	2
US	**2.0**	**1.1**	**-2.8**	**2.7**
Euroland	2.7	0.9	-4.2	1
Japan	2.4	-0.6	-6.2	1.7
Emerging countries	**8.3**	**6.1**	**1.6**	**5.0**
Africa	6.2	5.2	2.0	3.9
Central and Eastern Europe	5.4	2.1	-3.7	0.8
CIS	8.6	5.5	-5.1	1.2
Developing Asia	**10.6**	**7.7**	**4.8**	**7.1**
Middle East	6.3	5.9	2.5	3.5
Latin America	5.7	4.2	-1.5	1.6
Middle East	6.3	5.9	2.5	3.5
China	**12**	**9.1**	**8.7**	**10**

Table 1 Source : IMF, ‘10

Alternative Investments as a hedge against inflation

- **Commodity (Energy, Metals, Agricultural Products): Attractive at the later part of the expansion (GSG)(5%).**
- **Real Estate: Now is time for US REIT??? (VNQ)**

Disclaimer

Be a Millionaire