

Weekly Commentary

January 11, 2010

The Markets

So far, so good.

The S&P 500 index rose every day last week and finished with a 2.7% gain. This gain came despite a disappointing jobs report, which showed another 85,000 jobs were lost in December. A survey from MarketWatch expected a *gain* of 15,000 jobs. On the bright side, temporary-help jobs rose by 46,500. This is often a precursor to growth in full-time jobs.

The Holiday shopping season turned out a little better than expected as same store retail sales in December rose 2.8% compared with a year ago, according to the ICSC sales index. Paradoxically, consumer debt fell by a record \$17.5 billion in November and continued a streak of monthly declines that now stretches 10 months. Maybe consumers were paying cash for all their holiday goodies?

This week ushers in a new earnings season and experts project a whopper. Corporate profits are expected to rise 184% in the fourth quarter of 2009 compared to the year-earlier period, according to Thomson Reuters. Of course, numbers can be misleading as the year-ago period included massive write-offs by major banks. By comparison, these banks should show healthy profits in the quarter that just ended as they are enjoying a wide spread between their cost of money and the rate at which they can invest it. If you remove the financial stocks, profits are expected to rise a more benign 8%.

As with every new year, there will be challenges and opportunities. Through diligence and discernment, we will try to minimize the impact of the challenges and maximize the gain from the opportunities.

| Data as of 1/8/10 | 1-Week | Y-T-D | 1-Year | 3-Year | 5-Year | 10-Year |
|---|--------|-------|--------|--------|--------|---------|
| Standard & Poor's 500 (Domestic Stocks) | 2.7% | 2.7% | 28.6% | -6.8% | -0.8% | -2.4% |
| DJ Global ex US (Foreign Stocks) | 2.7 | 2.7 | 39.8 | -4.7 | 4.5 | 1.1 |
| 10-year Treasury Note (Yield Only) | 3.8 | N/A | 2.4 | 4.7 | 4.3 | 6.6 |
| Gold (per ounce) | 2.1 | 2.1 | 31.7 | 22.7 | 21.8 | 14.9 |
| DJ-UBS Commodity Index | 2.3 | 2.3 | 21.7 | -3.2 | -0.3 | 4.6 |
| DJ Equity All REIT TR Index | -0.1 | -0.1 | 35.0 | -11.8 | 1.7 | 10.5 |

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

DO THE WILD SWINGS WE'VE SEEN IN THE MARKETS over the past couple years defy explanation? How is it that the S&P 500 index can drop 56% between October 9, 2007 and March 9, 2009 and then turn on a dime and rise 69% over the next 10 months, according to data from Yahoo! Finance? How can a company like Bank of America decline 94% and then rise 380% – all

in less than the 30 months ending December 31, 2009? Or, how about Alcoa dropping 87% then more than tripling during the same period as Bank of America, according to *The Wall Street Journal*?

Aren't the markets supposed to be "efficient" and "rational?"

These massive swings seem to happen with frightening frequency and investors who are unprepared for them will likely pay a heavy price. Benjamin Graham, arguably the "father" of security analysis and author of a classic book by the same name, said the price of a stock reflects two components. The first component, investment value, represents the discounted cash flow of all the company's present and expected future earnings. The second component, speculative value, is driven by sentiment and emotions such as fear and greed.

It is not much of a stretch to suggest that an oscillation between investment value and speculative value may help explain the head-spinning volatility of the past few years. In other words, as markets rise or fall rapidly in short periods, speculative value may take prominence. Conversely, when markets are stable or moderately trending, investment value may take the lead.

Keeping this idea of investment value versus speculative value in mind can help us do a better job of maintaining a disciplined perspective on market volatility. It can help us better understand and potentially profit from the market's periodic "inefficiency" and "irrationality."

Weekly Focus – Think About It

"The individual investor should act consistently as an investor and not as a speculator."
--Benjamin Graham

Best regards,

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