



Mendham Capital Management, LLC

Independent Firm

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SECOND QUARTER 2009 NEWSLETTER

Chrysler and General Motors bankrupt. Swine flu hysteria. North Korean and Iranian nukes. A powerful stock market rally off the early March panic lows?! The old saying that the market climbs a wall of worry proved true once again!

U. S. Financial markets actually posted their best quarter in the past decade during Q2, 2009. The recent market figures are quite impressive. The Dow gained 11% for the quarter, the S&P 500 gained 15% and the tech heavy NASDAQ rocketed ahead by 20%.

The NASDAQ is ahead by a hefty 16.36% year-to-date while the S&P 500 has crept into positive territory at +1.78%. The Dow has lagged behind and is down 3.75% for the year.

Review of Previous Quarters:

	<u>12/31/08</u>	<u>03/31/09</u>	<u>06/30/2009</u>	<u>YTD Change as of</u> <u>6/30/2009</u>
S&P 500	903.25	797.87	919.32	+1.78%
Dow	8,776.39	7,608.92	8,447.00	-3.75%
NASDAQ Composite	1,577.03	1,528.59	1835.04	+16.36%
MSCI EAFE	1,237.420	1,056.233	1,307.161	+5.64%
10-Year Treasury Note	2.25%	2.67%	3.54%	+129 basis points
3-Month T-Bill Rate	.11%	.21%	.18%	+7 basis points
Price of Gold (COMEX)	878.20	920.70	927.10	+5.57%
Crude Oil (NYMEX)	39.22	48.82	69.89	+78.20%

Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results.

- **Treasury Bills** are certificates reflecting short-term (under one year) obligations of the U.S. government.
- The **S&P 500** is an unmanaged index of 500 widely held stocks that's generally considered representative of the U.S. stock market.
- The **NASDAQ** composite is an unmanaged index of securities traded on the NASDAQ system.

- *The Dow Jones Industrial Average (DJIA) commonly known as “the dow” is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.*
- *The MSCI Europe, Australasia and Far East Index is a market capitalization weighted selection of stocks from 21 developed nations excluding the US and Canada.*

Interestingly, stock market leadership has been dominated by sectors sensitive to economic recovery. This includes technology, materials, consumer discretionary, mid caps and emerging markets.

Emerging markets and investments related to a specific sector are subject to specific risks, including limited diversification.

Bank profits have begun to rise as the spread between low yielding deposit balances and higher lending rates has created an ideal operating environment. While banks still face the ongoing challenges of questionable consumer debt and troubled commercial property loans, investors have begun to consider the opportunity presented by the attractive spreads available to banks.

Most economists anticipate a lethargic economic recovery characterized by GDP growth of about 2% in 2010. This is well below the growth rate experienced after other deep recessions going back to World War II. Unemployment is likely to peak at well over 10% and won't start coming down until the second half of 2010.

There has been much discussion concerning the potential inflationary effects of massive government stimulus and deficit spending. While we certainly face the risk of inflation over the long haul, the near term risks are likely to be muted by our tremendous excess labor supply and excess industrial capacity.

Income tax rates will likely head north over the next several years as government seeks to ease our deficit problem. The campaign promise of increased taxes only on those Americans earning more than \$250,000 per year will likely go by the wayside within the next few years.

There are simply not enough \$250,000⁺ households to produce the desired amount of revenue.

The top 1% of wage earners already pay more than 25% of the nation's taxes, and the top 5% contribute more than 40% of all taxes paid. The bottom 50%, pay effectively nothing to the Federal Government. – The Gartman Letter, L. C. June 29, 2009

The ways of Washington are such that meaningful deficit reduction is next to impossible. While there has been tremendous outrage over the flood of red ink resulting from war spending and bailouts, most of these items are temporary. Entitlement programs, from Social Security to farm subsidies to veteran's benefits, are a far bigger issue long-term. These programs have powerful friends in Congress and huge constituencies that won't budge when cost cutters approach.

Government continues to find it more palatable to run deficits and increase taxes than to address rapidly rising entitlement spending. Until this changes, there is little hope of any real progress.

**“All panics, manias and crises of a financial nature, have their roots in an abuse of credit.”
Hy Minsky, Noted Economist**

How did we get here? Minsky’s *Financial Instability Hypothesis*, developed in 1992, provides some insight. The essence of the hypothesis is that stability itself is destabilizing because capitalists have a herding tendency to extrapolate stability into infinity. Seeing only clear skies ahead, market participants proceed to put in place ever-more risky debt structures.

The longer people make money by taking risk, the more imprudent they become in risk-taking. This process is self-fulfilling on the way up. Minsky describes this as a forward journey that takes place over a period of many years.

It is likely that today, we are on a reverse of the journey described by Minsky. The reverse journey is painful, but often quick, and can be characterized as a giant margin call. Weak and highly leveraged participants are severely disciplined, if not destroyed, in fairly short order. As the weak players exit the field, the very instability that caused the purge sows the seeds for a restoration of stability.

Does buy-and-hold investing still make sense?

Dividend yields represent a substantial component of equity market returns, and this has significant application as far as the validity of a buy and hold investment strategy.

While it took 25 years for the stock market to make a new high following the crash of 1929, it took only about 5 years for buy and hold investors to be ahead of the game given the fat dividend yields of that era. A five year break even in the worst case outcome of the past century suggests that long term investing is, in fact, a sensible strategy.

No strategy is perfect and works 100% of the time. It is not correct to conclude that you have a bad strategy based on a batting average of less than one thousand!

We don’t know the future. This is the reason we diversify and strongly advocate balanced portfolios for our clients.

Dividends are not guaranteed and must be authorized by the company’s board of directors.

“Tactically, we are currently cautious, but not bearish, as we await opportunistic points to enhance our capital. Overall, we are optimistic, believing the worst is in the rearview mirror as we anticipate a better future.” - Jeff Saut, Chief Investment Strategist at Raymond James from Investment Strategy Comments of July 6, 2009.

Given the dramatic market upswing from March into the early part of June, it would not be surprising to see equity markets tread water over the summer. Some have suggested that market indicators that are “less bad” will no longer be enough to propel the market to higher levels. It may take genuine signs of improvement to bring about the next leg up for stocks. We believe that periods of market weakness in the third quarter may well provide attractive tactical opportunities for long-term investors who are currently underweighted in equities.

“The intelligent investor realizes that stocks become more risky, not less, as their prices rise – and less risky, not more, as their prices fall.” – Benjamin Graham

The US household sector has a poor track record of financial asset allocation decisions. Traditionally, when stocks are near the high end of historical valuation ranges, individuals have the highest allocation to the stock market and the lowest allocation to cash and bonds. Conversely, when stocks are cheap, individuals have minimal exposure, favoring overweights in low yielding cash and bonds.

The highest household portfolio weighting to stocks in the postwar era came as stocks rose to a record-high valuation level in 2000. Today, as stocks trade near postwar valuation lows, household allocations to the stock market are also near postwar lows! Perhaps it is time to consider the novel idea of buying low.

“Ibbotson Associates data suggest that, over the long haul, the markets have an average annual rate of return of something like 9 ½% since 1926. But average investors don’t make anything like 9 ½% because they tend to get in at the top and out at the bottom.” – Burton Malkiel, Author of the 1973 classic book “A Random Walk Down Wall Street.”

Aside from the radical idea of buying low, we continue to emphasize the importance of asset allocation in accordance with Modern Portfolio Theory. The 2008 market disaster demonstrated that even a sound asset allocation strategy will not allow you to have a perfect batting average as an investor. It is unreasonable to expect a hit every time one steps to the plate. We do believe, however, that an intelligent asset allocation strategy will put you in the investment hall of fame if practiced diligently over a number of years.

As Burton Malkiel points out, the market delivers excellent returns over time but most investors fail to participate. Human nature leads us to buy when we should sell and sell when we should buy. Asset allocation is an approach that can enable the individual investor to get invested and stay invested. We know of no other reliable way to access the substantial rewards offered by the market over time.

Please be aware that asset allocation strategies do not assure a profit and may not protect against losses in declining markets.

Lessons from the Crisis

As discussed, we continue to adhere to Modern Portfolio Theory as the basis of our investment management philosophy. We focus on strategic asset allocation designed to achieve financial goals while managing risk.

This period of crisis has been a learning experience and we have incorporated a couple of approaches that complement strategic asset allocation. We are making use of exchange traded funds (ETF’s) in addition to the mutual funds that have traditionally comprised the bulk of our client portfolios. ETF’s trade throughout the day and allow us to make

use of trailing stop orders to help limit potential losses or lock in profits on a portion of the portfolio. Also, we are paying particular attention to building a mix of investments that is designed to meet retirement income needs. Some thoughts on this idea are discussed by economist, Ben Stein below:

“We have to apologize to the insurance companies. For years they have been offering us spectacularly good deals on variable annuities with guaranteed floors to protect us against collapses such as the one we have had recently. They have been offering us not only floors but actual guarantees of minimum growth of the portfolio. Too many of us turned up our noses at the offers. Now the offers are not quite as good as they were, but we still know that we need - desperately need - guaranteed income in our declining years. The insurance companies can sell it to us. If we do not have it yet, we should get it.”

ETF shareholders should be aware that the general level of stock or bond prices may decline, thus affecting the value of an exchange-traded fund. Although exchange-traded funds are designed to provide investment results that generally correspond to the price and yield performance of their respective underlying indexes, the funds may not be able to exactly replicate the performance of the indexes because of fund expenses and other factors.

Investors should consider the investment objectives, risks, charges and expenses of ETFs, variable annuities and their underlying funds before investing. This and other important information about ETFs and variable annuities are contained in the prospectus, which can be obtained from your financial advisor and should be read carefully before investing.

Annuities involve market risk and should be considered as long term investments. Withdrawals are subject to income taxes and may be subject to a penalty if withdrawn before age 59 ½. Withdrawals may also be subject to surrender charges.

There are fees and charges associated with variable annuities, including mortality and expense charges, administrative fees, and annual contract fees.

Guarantees are based upon the claims paying ability of the insurer.

Tired of Low Money Market and CD Rates?

There are alternatives. Depending on the situation, short duration and limited maturity fixed income mutual funds may be suitable for your portfolio. Also, we have found that fixed annuities are an attractive choice for some investors. Let's discuss these ideas the next time a CD comes due.

Opportunity on the Horizon

Roth IRA's, which offer the benefit of tax-free distributions, have become exceedingly popular savings vehicles since their introduction in 1998. In most cases, high-income tax payers have been precluded from participation in the Roth revolution. This has been especially true as far as the ability to convert your traditional IRA to a Roth.

This is all about to change in 2010 when income limits are lifted, enabling conversion to Roth regardless of how much you earn. There are complexities to this, and converting to Roth does involve paying taxes now to get the benefit of tax-free distributions down the road. There is some additional good news. If you convert in 2010, the taxes due can be spread over two years.

It is quite possible that income tax brackets may be much higher ten or twenty years in the future. Now is the time to start planning for 2010 and beyond. We'll look forward to discussing this concept with you soon.

Personal Notes

Bill recently participated in the annual Raymond James Leaders Council conference held at Cap Cana in the Dominican Republic. This was a great opportunity to dialog with top advisors from all over the country. Thanks to the support of our clients, our branch ranks among the top 5% at RJFS which affords us this type of opportunity. It was most helpful to gain some new ideas to improve our practice and benefit our clients.

Hilary travelled to Charlotte in May and completed a two day course on Advanced Concepts in Retirement Planning sponsored by Raymond James' Planning Corporation of America unit. Following the course, she was able to visit with some of our wonderful North Carolina clients and enjoy some true southern hospitality!

Hilary's 17 year old daughter, **Kara**, just returned from a ten day mission trip to the Dominican Republic with the Foundation for Peace organization. The group of 25 adults and teens laid the foundation for a water purification facility, worked with local personnel to host a medical clinic for 150 families and conducted a week long camp for over 100 children. Despite the heat, hard work and long days, Kara hopes to return next summer.

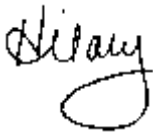
Please visit our web site at www.raymondjames.com/MendhamCapitalManagement for a link to the Raymond James Mid Year Economic Update.

Thank you for your continued trust and support.

Sincerely,



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