October 14, 2009

THIRD QUARTER 2009 NEWSLETTER

"History doesn't repeat itself, but it often rhymes." – Mark Twain

The plus 15% "Dow Wow" experienced in Q3, 2009 was the best quarter since 1998 and the third best since 1970. The S&P 500 and Nasdaq followed the lead of the Dow and advanced in similar fashion.

The equity market recovery of the last six months, and its similarity to those experienced after past market debacles, bears witness to the validity of the homespun wisdom of Mark Twain. While there are unique circumstances to every crisis, the fact that human nature remains unchanged gives rise to the old Wall Street adage that *it is never different this time*. We'll have more on this in the paragraphs that follow.

Review of Previous Quarters:

	12/31/08	06/30/09	09/30/09	YTD Change as of 9/30/2009
S&P 500	903.25	919.32	1,057.08	+17.03%
Dow	8,776.39	8,447.00	9,712.28	+10.66%
NASDAQ Composite	1,577.03	1,835.04	2,122.42	+34.58%
MSCI EAFE	1,237.420	1,307.161	1,522.843	+23.07%
10-Year Treasury Note	2.25%	3.54%	3.31%	+106 basis points
3-Month T-Bill Rate	.11%	.18%	.127%	+1.7 basis points
Price of Gold (COMEX)	878.20	927.10	1,008.00	+14.78%
Crude Oil (NYMEX)	39.22	69.89	70.02	+78.53%

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.*

After seven consecutive monthly gains, equity markets, as a whole, are in a confirmed uptrend. While it would not be surprising for the market to take a breather after such a dramatic increase, we feel that such a breather would still be within the confines of a positive, longer-term trend. It is our contention that an investor should neither be intractably bullish nor stubbornly pessimistic, but rather should be practical in assessing market expectations. Over the long run, previous markets spent two thirds of its time moving up and, at the moment, *the trend could be your friend*. Of course it's important to keep in mind that past performance is not indicative of future results.

"The market is fear, hope and greed loosely tied to the business cycle." – Jeff Saut, Chief Investment Strategist, Raymond James

It is interesting that positive equity market action commenced in March, at a time when most economic indicators were still flashing caution. Just a couple of weeks ago, Federal Reserve Chairman, Ben Bernanke, said the recession, which began in December 2007, is probably at an end. How many times did we hear that an equity market rally typically precedes economic improvement by as much as six months? Mark Twain, you are so wise!

The impact of massive government stimulus is beginning to show up in the real economy. Businesses, which had cut expenditures to the bone, are beginning to rebuild inventories. Comparisons will become easier in the quarters ahead. Sectors, such as housing and autos, will begin to cease subtracting from economic growth. A consensus of economists calls for US GDP growth to come in at 2% in 2010 and world GDP to expand at 3%.

Unemployment, which is a lagging economic indicator, has reached 9.7% and will likely continue to move higher into the middle of next year. Interest rates remain low and are likely to stay this way for some time. In fact, the Fed has never raised rates following a recession before the unemployment rate has peaked.

Chances are that recovery from this recession will be even patchier than usual. The US consumer is in the midst of a de-leveraging cycle that will likely continue for some time. It is anticipated that the savings rate will move up and debt levels will come down, albeit slowly as the sluggish employment picture impedes the ability for many families to reduce liabilities.

"Probably at no time since the Great Depression has there been so much skepticism about investing in stocks. The stock market debacle of 1973-1974, a much larger and more destructive replay of the 1969-1970 drop, resulted in huge losses for both professional and amateur investors alike. It is scarcely 24 months now since major corporations were unable to raise barely needed equity capital, since the brokerage industry tottered one step away from collapse, since the small investor had been driven disillusioned from the market, and the trained money manager stood dazed and bewildered. Stocks traded at ridiculously low prices, seemingly anticipating the total disintegration of the economic system – or that our industry was about to be carried away on the backs of new mongrel hordes.

Although the market has recovered sharply, the chorus of contradictory opinion bewilders many investors, both professional and amateur alike." – David Dreman, 1977

As recently as six months ago, many investors had no interest in equities, expressing only the desire not to lose money. The world had been turned upside down. There was such demand for "safe" investments that they became overpriced. Risky investments were priced so low that the risk was greatly diminished. For example, you would have lost money in long treasuries so far this year but you would have made a killing by loading up on junk bonds at bargain basement prices.

At the time David Dreman made this remark, the 1973-1974 crisis had destroyed the "buy-and-hold" mantra of the 1960's and 1970's. In spite of positive total returns for the Dow in 1975 and 1976 (+35.4% and +29.6% respectively), "market-timing" was all the rage. From 1977 forward, the Dow rose in 22 of the next 23 years as part of the greatest bull market in history. How ironic that the markets take off on a long winning streak just as most individuals have concluded that "buy-and-hold" is a bad idea.

Interestingly, the market of the mid 1970's was strikingly similar to that of the mid 1940's. At the end of World War II, following 15 years of malaise in the US stock market, very few investors even wanted to touch stocks. It was at this point the equities embarked on the great bull run of the 1950's and 1960's.

"I hear the refrain that the market is ahead of itself. In reality, the market is always ahead of itself. That is, after all, its job. In recoveries, the negative case is always more compelling, articulate and reasonable than the positive one, because we can see and focus on the bad news. The market, meanwhile, is looking forward over the horizon." – Laszlo Birinyi, Jr., *Forbes*, 9/21/09

At MCM, we are constructive on the return potential of the US equity market in the years ahead. An abundance of bad news and pessimistic expectations are baked in to current equity valuations. The very fact that we are coming off such a poor decade for stocks has created an environment where reversion to the mean has become our friend. This is a 180 degree difference from where the market stood after the go-go 1990's. With one last tip of the hat to Mark Twain, we suspect that the results over the next decade may well rhyme with other similar periods in our history.

Another interesting investment idea is emerging markets. On the whole, the emerging market economies have weathered the downturn better than the developed markets. They are benefitting from a younger population and low levels of inflation. In many cases, these are countries rich in natural resources. Per capita income levels have been on the rise and have now reached the point where there is an emerging middle class of new consumers. Unlike American consumers, they are not burdened by high levels of indebtedness. Many economists foresee a disproportionate share of world economic growth in emerging markets in the next several years.

The broad selloff over the last year impacted fixed income as well as equities, resulting in some attractive opportunities in bonds. This is particularly true in credit sensitive (riskier) issues where a high risk premium is reflected in current prices. Said another way, prices on such bonds have declined on a relative basis versus low risk bonds. Lower bond prices translate into higher yields for bond buyers.

On the tax-exempt side, we like the potential opportunity in credit sensitive, high yield municipals. Due to the credit risk, we suggest playing this theme in a well diversified mutual fund. Yields can be found in excess of 6%, federally tax-free. We have come across portfolios where the average purchase price of the bonds is less than eighty cents on the dollar. This implies upside price potential in addition to an attractive current yield.

On the taxable side, we like the adjustable–rate senior loan sector. This paper represents the most senior part of the capital structure of companies whose unsecured debt is of the "high yield" variety. Senior debt is backed by specific collateral and has a lower default rate than high yield debt. Even in default, the historical rate of recovery on senior debt is close to seventy cents on the dollar. Of course, past performance cannot be guaranteed. In recent times, this paper has traded at, or even below, expected recovery levels. Current yields can be found in the 5 ½ % range. Perhaps the best news is that this is adjustable-rate paper where the yield will actually ratchet up if we experience inflation and higher interest rates. Once again, we recommend playing this theme in the form of a mutual fund.

A prospectus can be obtained from your investment professional. Investors should consider the investment objectives, risks, charges and expenses of an investment company carefully before investing. The prospectus contains this and other information and should be read carefully before investing.

"Risk not thy whole wad." - Anonymous

What if we are wrong and the market turns out another decade of decidedly sub-par results? Are there strategies available that offer the upside potential of equities with downside protection in bear markets? The answer is "yes." A "lesson from the downturn" for us has been the idea of hedging a portfolio by transferring some risk to an insurance company through the use of a variable annuity with a guaranteed minimum withdrawal benefit. We have developed several methods for the inclusion of this concept for a portion of a client's portfolio. The following observation by economist, Ben Stein, echoes our sentiments on this strategy:

"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."

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. Withdrawals from annuities will affect both the account value and the death benefit. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

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.

Before investing, investors should carefully consider the investment objectives, risks, charges and expenses of the variable annuity and its underlying investment options. The current contract prospectus and underlying fund prospectuses, which are contained in the same document, provide this and other important information. Please contact your representative or the Company to obtain the prospectuses. Please read the prospectuses carefully before investing or sending money. Variable annuities are generally considered long term investments.

MCM News

In early September, we learned that our young associate, **Kerry Carr**, would be leaving us to join an institutional fixed income firm. Kerry will be missed and we wish her well as she moves on to the next phase of her career.

Please join us in welcoming **Claire Preston** as the newest member of our organization! Claire will take on the role of Branch Assistant and you will soon get to meet her in person or over the telephone. Claire has lived in Mendham and environs for more than 20 years. She is a graduate of Cornell University and worked in the securities industry before devoting herself to raising her children. Claire and her husband, Gene, reside in Chester with their two children, Jeffrey and Haley. Jeffrey is a freshman at Villanova and Haley is a junior at Mendham High School. Claire's many talents and outgoing personality make her a great addition to the MCM team.

We enjoyed an active summer at MCM. In August, both **Bob** and **Maureen** participated in the Raymond James Regional Practice Intelligence Conference in Philadelphia. They returned with several practice management initiatives we have implemented to strengthen our client service and asset management procedures. The opportunity to interact with top Raymond James advisors from around the country is always a most rewarding experience.

Hilary became active in raising money for the Susan G. Komen Breast Cancer Foundation. MCM sponsored a court, and Hilary played in the tennis event at the *Rally for the Cure* held at our home club, Mendham Golf & Tennis. It was a most successful day in support of a cause that is very special to us. In addition, Hilary also participated in two 5k fund raising events.

We are proud to share a wonderful honor bestowed upon **Bill** in the August 2009 issue of *Registered Rep* magazine, the premier publication serving the financial advisor community. Bill was ranked among the top 100 independent financial advisors in the nation in its annual survey published in this issue. The advisors were ranked by assets under management using a database on the registered representative universe which was then validated via direct survey.

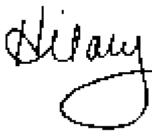
Bill was also honored to be asked to serve on the Board of Trustees of his alma mater, Oratory Prep School, located in Summit, NJ. Oratory Prep is a small school that has continued to thrive in a challenging environment.

Finally, we have a quick reminder to all of our clients and friends who participate on our **Ladies Only Luncheon** series. Our next gathering is on Tuesday, October 27 at 12 noon at the Black Horse Tavern in Mendham. Our topic for the day is "Investor Behavior." Please RSVP to Claire or Maureen.

Thank you for your continued trust and support.

Sincerely,

William F. Burke, Jr.
Registered Principal/Investment Consultant
Raymond James Financial Services, Inc.



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