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SULLIVAN  ASSOCIATES

January 2009

A REGISTERED INVESTMENT ADVISOR

Special Market Update

New year, new president and administration, same recession and economy. As bad as all the news seems to be, we see a few bright spots such as the government actions that are starting to take hold, President Obama's upcoming stimulus package, and we may have reached a bottom with the November low. As a result, we believe there is a probability we may see a significant "bear market rally" over the next couple months. Earlier in January it looked as though we might be seeing the start of a rally, but then additional bad news came out in the banking sector, and the new president and administration continue to talk about how bad it is and it may take a substantial period of time to turn around. Accordingly, what looked to be the start of a rally fizzled out and whether we will see another rally in the near term remains unknown. In the mean time, the only things that seem to be overbought are treasuries, as people and institutions line up to take advantage of the perceived safety in these government instruments. At these valuation levels, we feel patient investors who remain with the markets may be well rewarded over time. The question, of course, is how much time will it take?

After a potential bear market rally, we think the worst may be yet to come, as consumer spending may not return for many years to the levels we saw in the 90's and first years of this decade. The demographics are

leaning more towards retirement and savings mode rather than the spending trends we have seen. The consumer is very highly leveraged with about \$813 billion in consumer debt. The Baby Boomer Generation, or the "Grey Wave" as it has been called, is bearing down rapidly. Additionally, although the cost of energy has come down substantially, the future cost of energy should rise due to "peak oil" or the "greening" of the world, which will also have an impact on the economy. The decrease in consumer spending is reverberating through the economy as manufacturing and transportation are down, and unemployment is up. Furthermore, banks are failing with accelerated speed, and weak companies are being taken over, merging or in some cases going into bankruptcy. This process, while painful, is a necessary part of the business cycle.

As bad as it sounds, we do feel we will get through the current crisis. As the Federal actions continue to take effect, we will see stabilization in the banking system, which will be a major step in the right direction, and the stimulus package that President Obama is trying to put in place will certainly help in the short term. We have periodically experienced financial crisis in the past, and although this one may be severe, we will eventually work our way through it.

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