



# Stanton & Castleton, Inc.

An independent firm

## *2<sup>nd</sup> Quarter 2009 Capital Markets Outlook*

Towards the end of each quarter we meet several times to discuss any changes in our outlook for the current year. We both will have reviewed several Capital Market Outlook publications from a number of respected investment houses including Raymond James. This along with our research of the global markets from both an economic and geo-political perspective helps us establish our expectations for the coming quarter / year.

Our objective is to establish an outline for how we believe the markets may behave and identify what we see as the major risks to investments across all market segments. We do not pretend to be able to predict what will happen in the future, rather we want to establish confidence that the portfolios we recommend are positioned to benefit from positive market environments and are helping to reduce risk exposure through diverse asset allocation and manager selection during negative market periods.

The following is our 2<sup>nd</sup> Quarter 2009 Capital Markets Outlook:

### *Interest Rates, Inflation, Liquidity & the Federal Reserve:*

U.S. Treasuries 04-21-2009			
	COUPON	MATURITY DATE	CURRENT PRICE/YIELD
3-Month	0.000	07/23/2009	0.14 / .14
6-Month	0.000	10/22/2009	0.32 / .32
12-Month	0.000	04/08/2010	0.5 / .51
2-Year	0.875	03/31/2011	99-29½ / .92
3-Year	1.375	04/15/2012	100-09+ / 1.27
5-Year	1.750	03/31/2014	99-22 / 1.82
10-Year	2.750	02/15/2019	99-01+ / 2.86
30-Year	3.500	02/15/2039	96-07 / 3.71

Source: [www.Bloomberg.com](http://www.Bloomberg.com)

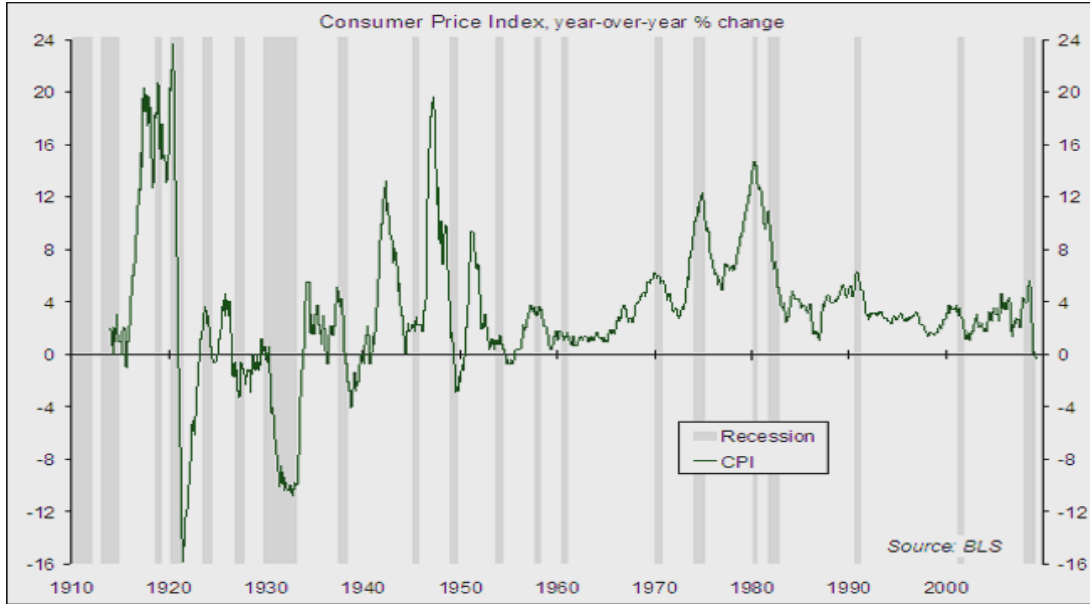
To know ones surprise interest rates are still at all time lows. Above is the current yields on US treasuries from 3/month – 30/year maturities. If you

were to look at this without knowledge of the past year you would likely be optimistic about the economy. In these times however we are still wrestling with a weakened bank lending environment and an overall lack of liquidity. We can all see how most everyone **could** benefit from these low interest rates. The problem is that the average person and company can not get access to money on these terms. Lending is still very restrictive. While our money market returns have fallen to below 1% (saving the banks billions) the rates we can borrow at are still relatively high, if you can get a bank to loan. That is the issue. In making the banking system healthy by widening the spread between a banks cost of funds (rates they pay on money market and CD's) and their return on investment (rates banks lend funds at or invest funds at) we did not require the banks to lend.

The Congress, Treasury, President and Federal Reserve were in such a rush given the extreme conditions that we did not try and pair lenders and borrowers together as a condition for receiving TARP funds. The result was that banks were able to honor their obligations to one and other (the credit default swap mess) and keep the systems functioning, however little effort was given to helping "Main Street" to honor their commitments to the banks. As a result consumers and business are strained to the point of breaking. The good news is we have seen this flaw in our approach and have been working on reopening access to capital to the "masses". This will take time and even then we will still see a lot of families and companies be allowed to fail as in every recession.

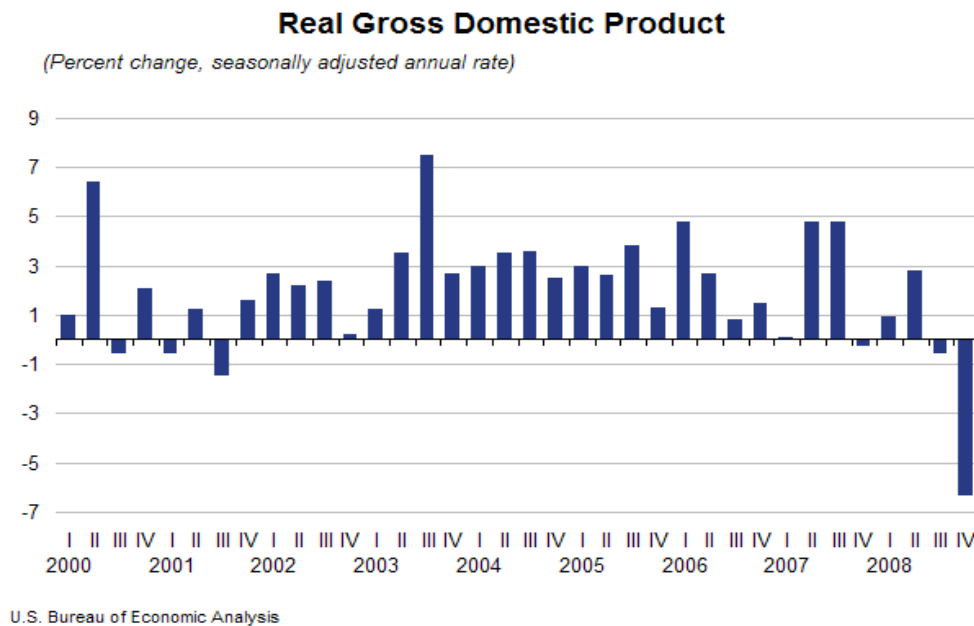
The old Steve Martin line: You can be a millionaire....First you get a million dollars. This is how most people feel about getting a loan from the banks today. If you do not have a 800+ FICO score and do not really need the loan good luck getting one. The dilemma is how do we open access to the credit market for the average person/company and still keep from re-leveraging our system with questionable loans?

With these difficult issues at hand we see little risk to the Federal Reserve rising interest rates in the near future. We hear a lot of discussion about inflation becoming a problem; however for the first time since 1950 we have a year over year negative inflation rate. The last 12 months (03-2008 thru 03-2009) inflation is at a -0.38% annual rate:



In fact under the current conditions we need to consider deflation and if it is likely to continue. Our short answer is not for long but that is not a sign that hyper inflation is on the horizon.

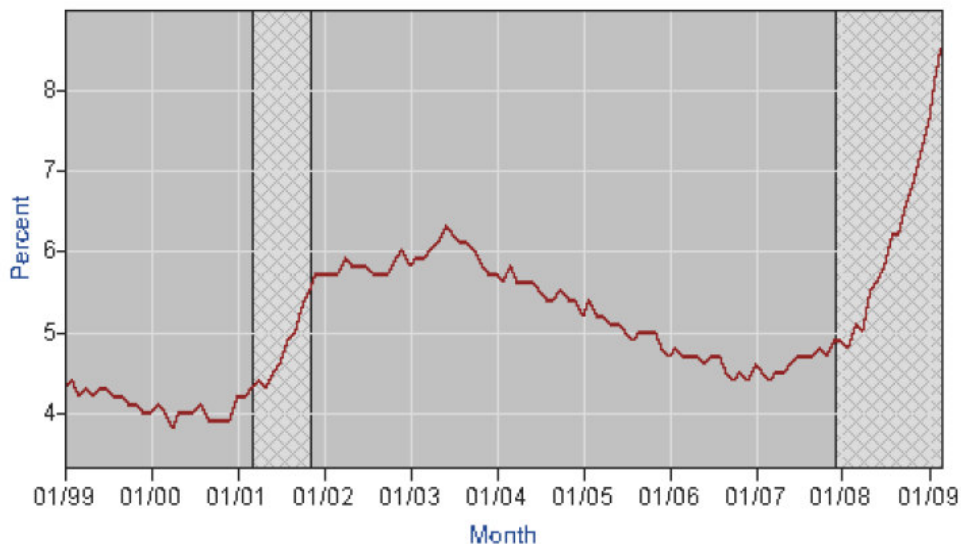
***The Economy:***



As the chart above shows the US Real GDP has slipped into negative territory. This decline is the worst decline since 1982 resulting in our worst recession since that same period.

It is clear that the consumer spending (70% of US GDP), credit and unemployment are all very connected. They feed off each other in a very positive way during economic expansion; however this same relationship can be destructive during a contraction. As credit markets close off, companies are forced to lay off more employees and in turn people spend less....causing more layoffs etc. This natural cycle came close to spiraling out of control during the 4<sup>th</sup> quarter of 2008. While 2009 has started with more of the same we are beginning to see some positive signs. The rate on rising unemployment is decelerating and we have seen the first signs that our major banks will survive and begin earning money again. This is very significant in the easing of credit access to people and business.

### Unemployment rate (seasonally adjusted)



Note: Cross-hatched area represents recession.

### Equity Valuations:

One current 2009 estimate of the S&P Index EPS average is \$47.45 (the average forecast of \$47.45 a share compiled from a Bloomberg survey of Wall Street strategists). If we use the 50 year historical average PE for the S&P 500 (S&P 50 year historical, 1955 – 2005, median P/E of 17. Source: Mark Panzner, Rabo Securities) the S&P fair value would be 806.65. With the S&P value of 832.39 on 04/20/2009 it could be argued the market is currently slightly overvalued. However, if we look at Thomson Reuters 4/20/2009 mean S&P earnings estimate of \$61.53 in 2009 a fair value for the index would be 1046! We see S&P earnings

reaching into the mid to upper \$50 range and therefore expect to see a modest gain buy year end. This may turn out to be to optimistic, however we feel the street is crossed over to overly pessimistic and optimistic at the same time. Given how varied estimates are and how quickly the analyses change their tune we believe this only supports our argument to look towards long term trends and an eventual regression to the mean.

### ***Bond Markets:***

Since September of 2007 the Federal Reserve has been lowering the Federal Funds Rate from 5.25% to our current level of .25%. With the current financial rescue plan and the current 8.5% national unemployment rate we feel the FED has little room to cut rates further and would not risk increasing rates until we have clear evidence the recession is behind us. We have also been anticipating Europe to continue lowering their rates and just saw the Bank of England cut their key rate to .5% and the ECB lowered the eurozone rate to 1.5%. We continue to see value in intermediate and long range corporate and municipal bonds along with US Tip's.

### ***Currency Markets:***

The dollar rally has stalled recently as things around the world begin to stabilize. With the overall world interest rate market continuing to fall we are beginning to see things quite down. The long debated question of the US dollar losing its status as a world reserve currency is an open issue. We feel that it will continue this position; however it will be shared with the Euro and perhaps one other currency in the future.

### ***Oil:***

We see more of the same...a range bound price of \$40 - \$60 dollars per barrel in oil for the rest of 2009. Until a recovery is well under way the current supply of oil above ground is at a surplus. If we stay committed to developing new hybrid cars and alternative energy sources we may see these prices continue for a while even when demand improves.

**“In the end, how your investments behave is much less important than how you behave.”**

**Benjamin Graham  
The Intelligent Investor**

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**(Referral Hotline: 877-975-0955)**

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**Manage.....Monitor.....Maintain**

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**[www.stantoncastleton.com](http://www.stantoncastleton.com)**