Overview

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Observations

- There is a **disconnect between Wall Street and Main Street**. Remember the stock market is a leading indictor. Stock prices are based on expected future earnings. Since March lows, the market has bet on higher corporate earnings. In order to sustain stock market gains, earnings targets must be met. The stage for profit growth is usually set by a healthy economy. Until unemployment is lower and the private sector is functioning normally, it is difficult to see equity markets continue to make large gains, even with many investors still on the sidelines.
- **Core inflation should remain tame in the short-term**. Politics and economics are entwined more than ever. If even more government spending (think health care reform and cap and trade legislation) is enacted expect to see the dollar weaken further and interest rates start to rise setting-up an environment ripe for stagflation.
- **Bad advice is being peddled** from those looking to drum-up business in a soft economy. Beware of year-end tax saving tips or new investment products. It is important to do the math, read the fine print, and know the risks.

Facts & Figures of Importance

Economic

Beyond the headline of the GDP increasing in the third quarter, is the rest of the story. Chained prices reflect the 2005 level in order to obtain a better understanding of real changes in GDP.

(billions)	2009 Current-Chained	2008 Current – Chained
1st Quarter	14,178 – 12,925	14,374 – 13,366
2nd Quarter	14,151 – 12,902	14,498 – 13,415
3rd Quarter	14,302 – 13,014	14,547 – 13,325
4th Quarter		14,347 – 13,142

What is revealing about these figures (and looking even further back at GDP results) is the scope of the decline in the US economy. A few nuggets to take away from the third quarter economic data include:

- Motor vehicle output contributed 1.7% of the total GDP increase of 3.5%. Per Edmunds, Cash for Clunkers cost taxpayers $24,000 for every incremental vehicle sold. Let's see what next quarter brings.
- Personal income fell by ½%, household real disposable income fell by 3.4%, yet consumer spending rose by 3.4%.
- Real state and local government consumption decreased by 1.1%. This is a trend that must continue to avoid bigger future problems.

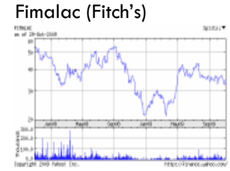
Financial

	Treasury Yields 5 Year	Treasury Yields 10 Year	Equity Markets S&P 500	Equity Markets DJWilshire 5000
2005	4.35%	4.39%	1,248	12,518
2006	4.70%	4.71%	1,336	14,257
2007	3.45%	4.04%	1,468	14,819
2008	1.94%	2.96%	896	8,945
10/31/09	2.31%	3.41%	1,036	10,655
YTD Return			17.05%	17.26%

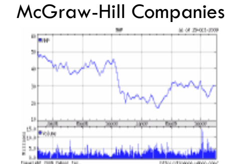
Who Can You Trust?

Moody's Corp

Fimalac (Fitch's)



McGraw-Hill Companies



No wonder the stocks of the three leading bond rating agencies fell so much over the past two years. Let's see how Congress and the SEC address the conflict of interest issues going forward. Without reliable ratings agencies, the bond markets would be less efficient.

Economic Outlook

- Early returns on the massive stimulus spending of the past year have yet to produce the expected return on investment. Don't expect this to change anytime soon.
- Economically and politically, the US needs to reduce the unemployment rate. Healthy expansion will be muted until this rate is reduced to the 5%-6% range.
- Early next year, pressure will mount on the Fed to start detailing a planned exit strategy. Their communication must encourage investment and show how the health of the financial system is not in any peril.

Investment Outlook

- Stocks, bonds, commodities, and gold all have risen this year. It is unusual when all asset classes move in tandem. Expect this to change sooner rather than later.
- It is not a question of "if", but when the correction in the market will take place. The bar is being set higher for corporate earnings. Keep an eye on the revenue line also.
- Look for interest rates to rise modestly as the dollar weakens and the Fed ceases to purchase mortgages later this year. Long-term Treasuries will feel the squeeze most.

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Insightful Thoughts of Others

Investors must recognize that if assets appreciate with nominal GDP, a 4-5% return is about all they can expect even with abnormally low policy rates. – *Bill Gross*

Stocks also swamp the returns on fixed-assets over the long run. Even with the recent bear market factored in, stocks have always done better than Treasury bonds over every 30-year period since 1871. And over 20-year periods, stocks bested Treasuries in all but about 5 per cent of the cases. – *Jeremy Siegel*

All and all we are likely to have learned little, or rather to act, through lack of character, as if we have learned nothing. In doing so we are probably condemning ourselves to another serious financial crisis in the not-too-distant future. – *Jeremy Grantham*

A Few More Things

- **Predictive portfolio software more often than not gets it wrong,** especially in the short-term. How does one predict the unexpected? There are both known unknowns and unknown unknowns. The programmers of the software cannot include outcomes they do not know or understand in software programs. Software is usually modeled based on prior events. While history repeats itself, it does not do so in predictable patterns. Output and conclusions from forecasting software should be taken in moderation in the short-term. Forecasting the behavior of many participants with different motivations in complicated markets can be likened to trying to tack jell-o to the wall.

- History has shown that **government action often makes economic problems worse**. Both Democrats and Republicans are guilty and are failing the American public. This is due to the timing of the action and the inability of government and politicians to see the unintended consequences of their actions. Short-term fixes often cause bigger longer-term problems. The inconsistency in the responses to the Bear Stearns and Lehman made a bad situation worse by confusing markets. The first fix to the economic "crises" proposed by Secretary Paulson was a simple three page plan to keep banks from failing. One year, thousands of pages of legislation, and trillions of dollars to be spent later have done more harm than good as reflected in the economic figures of the past year. Yes a catastrophe may have been prevented. If instead problems had been allowed to work themselves through the system, we very well could have been on a path to a real recovery. Do you really believe $250 for senior citizens, Cash for Clunkers, Home Buyer credits, or any other program is the real solution?

- In tough economic times, **charitable giving remains important**. However, keep an eye out for crooks and do not be shamed or arm-twisted into donating. The stories of a certain airline whose flight attendants have been badgering passengers in-flight for cash donations is unprofessional and certainly reflects poorly on the charitable organization. Please **give by check or credit card only** so that you have a receipt for your gift in order to deduct it on your tax return.

- **It is difficult not to want to buy an asset or sell an asset that is rising,** even when it appears the asset is overpriced. That is how bubbles happen. A scenario where US interest rates remain very low and there is minimal if any inflation is highly unlikely. That makes the purchase of long-term Treasury bonds risky. If and when, inflation returns along with higher interest rates, are precious metals, especially gold the most suitable hedge? Just why is gold considered so valuable? Read about the Dutch Tulip mania in the 17th century. You cannot eat gold or grow it. It pays no income. How would you use it as a medium of exchange in an economic collapse where there is no credit and paper money is worthless? If a loaf of bread were to cost $1,000, think about how expensive your trip to the grocery store will be. And just how will you carry your gold to pay for your purchases? And where will the gold be safely stored? Invest on fundamentals and not fear.

- **Have a Happy Thanksgiving** and let's hope that Large Hadron Collider works when they hit the re-start button.