

QUARTERLY REPORT

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FROM THE SUBPRIME TO THE RIDICULOUS

2009 was a tumultuous year in the financial markets and the economy. We saw a housing market that could not defy gravity, commercial and investment banks riddled with “toxic” subprime mortgages and the breakdown of two of the Big Three automobile manufacturers. The U.S. stared into the abyss of what looked like a second Great Depression. One can criticize the Federal Reserve and Congress for creating the conditions for economic disaster by enabling millions of Americans to buy homes with mortgages they could not afford. Credit is due, however, to the central bank and Congress for stepping up with extraordinary measures to save the economy. Although Main Street is decidedly unhappy with sweetheart deals for companies that were responsible for creating their own problems, the good news is that all of the major banks that were propped up with billions of dollars of TARP funds have paid back the U.S. Treasury with interest. Better yet, the Treasury Department was granted stock warrants in TARP recipients when their stock prices were much lower. Consequently, this investment in money center banks has been a successful one for the U.S. taxpayer. The likelihood of recouping TARP funds from all of the smaller regional banks, AIG, Chrysler or GM is a different matter. Worse yet, it is becoming increasingly unlikely that the U.S. taxpayer will be repaid for bailing out Fannie Mae and Freddie Mac.

We head into the New Year on a stronger economic footing than a year ago. The “Great Recession” is thankfully over as economic growth rebounded in the third quarter and continued firmly through the fourth quarter and New Year. We attribute this rebound to inventory restocking and robust government spending in an effort to “stimulate” the economy. We are concerned that businesses are wary of hiring additional personnel given the uncertainty over health care reform and unknown costs associated with Cap and Trade (carbon or emissions control) legislation. We are, however, hopeful that future legislation and new regulations take heed of the national unemployment rate of 10.0%, as steady paychecks remain the best “stimulus” for the consumer and a strong antidote to the still ailing housing market.

Regrettably, it seems that Wall Street cannot learn from its excesses as it prepares to pay record bonuses to its employees who only have the American taxpayer to thank for their continued employment. We remain generally optimistic for an ongoing but slow recovery from the recession with more moderate gains in the broad stock market after the dramatic run-up in prices after the March lows. We wish you all the best in the New Year.

Cordially,
Kathy Wimmer, CFA, CIC
President

KEY FACTS FOR 2010

- *Annual gift exclusion*
\$13,000
- *Estate tax exemption*
“to be determined”
- *Highest marginal estate tax rate*
“to be determined”
- *IRA contribution limits*
\$5,000, plus another
\$1,000 for those over fifty
- *SIMPLE IRA and 401(k)*
contribution limits
\$11,500, plus another
\$2,500 for those over fifty
- *401(k) contribution limits*
\$16,500, plus another
\$5,500 for those over fifty
- *SEP IRA contribution limits*
25% of compensation, max of
\$49,000
- *Top Federal tax rate is 35% on*
income over \$373,650

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YEAR-END 2009 REVIEW

The fourth quarter of 2009 continued to see a favorable trend in stock prices with the broad market S&P 500 index rising 6.0% leading to a full-year return of 26.5%. The heavily technology-laden Nasdaq Composite index rose 7.2% in the fourth quarter contributing to a spectacular 45.4% return for the full year. The remarkable turnaround in stock prices from their March 2009 lows reflected investor confidence that the global financial crisis was sufficiently stabilized and that the eighteen-month long recession was over.

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While final fourth quarter results for Gross Domestic Product (GDP) will not be available until late February 2010, the Commerce Department is reporting its preliminary estimate of 5.7% GDP growth which greatly surpasses the positive 2.2% growth rate of the third quarter. The Wall Street Journal's most recent survey of 56 top economists had projected a 4.3% increase in the seasonally adjusted GDP figure last quarter.

The yield on the 30 year Treasury bond rose 15% from 4.03% at the end of the third quarter to 4.63% as of December 31st. The backup in rates reflected the economic recovery, higher commodity prices and concerns over profligate governmental spending which have led to an increase in future inflationary expectations. The Federal Reserve maintained its target of 0% to .25% for the Federal Funds Rate (the rate that banks will lend to each other on an overnight to short-term basis) throughout the fourth quarter in its ongoing effort to stimulate the economy by encouraging lending. Unfortunately, borrowers seemed to be just as leery of borrowing as lenders were afraid to lend in the fourth quarter. Consumers persisted in paying down personal debt in the quarter as the latest November data showed a pay down of \$17.5 billion in consumer debt, marking the 10th consecutive reduction.

The U.S. dollar saw a 5% decline in relative value versus a collection of sixteen major currencies in 2009. The dollar did rally, however, in December as currency speculators worried about the large real estate default in Dubai and concern over the sovereign debt of the "PIGS" (Portugal, Ireland, Greece and Spain), all of whom use the Euro currency. The U.S. dollar also benefited at year end by the realization that the U.S. economy was clearly on the mend as evidenced by two consecutive quarters of economic growth.

The flip side of the dollar's decline in 2009 was the strength of commodities. There is a clear inverse relationship between the dollar and commodities as oil, precious metals, grain etc. are commonly priced in dollars in world markets. Consequently, when the dollar declines in value, holders of commodities demand a higher price for their products in order to stay whole in purchasing power. Oil, the world's most heavily traded commodity, climbed 78% on a yearly basis to \$79.36 a barrel at year end. Clearly, the price of oil was affected more by the worldwide economic rebound and expectations of rapid demand from emerging markets such as China and India than simply the relatively modest decline in the value of the U.S. dollar.



The MSCI Emerging Markets Index (EEM) rocketed to a 66.2% annual return in 2009 with Brazil, India and China leading the way with returns of 82.7%, 81.0% and 79.2%, respectively. These nations benefited from weak currencies, strong exports and low debt levels.

2010 THE YEAR AHEAD

As we noted in the previous section, the U.S. equity markets delivered a tremendous return after hitting an abysmal low last March. Initially, it is common for equities to rebound strongly after coming out of a recession. Consequently, we believe it is highly unlikely for stocks to continue to perform as they have over the past nine months in the New Year. As 70% of the U.S. economy is consumer driven and the current national unemployment figure is at 10%, we do not see the economy poised for rapid growth. Moreover, with families now saving 6% of earnings in an effort to rebuild their balance sheets after the collapse of the housing market, we see future consumption to be moderate and rightfully so! We continue to believe that future equity appreciation must first arise from economic growth and an increase in productivity. We have seen a resumption of economic growth over the past six months marking the end of the recession and the first quarter of 2010 appears to maintain this trend.

In mid-January, the Administration called for reinstating the Glass-Steagall Act which previously separated deposit-insured commercial banks from the more lightly-regulated investment banks. Furthermore, the President has called for the implementation of the eponymous "Volcker rule" which would break up banks that are deemed "too big to fail". There are clearly pluses (limiting speculative trading by banks and lowering

systemic risk) and minuses (how will neutered American banks compete with foreign banking behemoths?) to both proposals. Whatever new measures are implemented on the U.S. banking industry, we are convinced that regulations will increase and that bank earnings will not revert to their pre-crash highs. Our allergic reaction to the banking industry is further aggravated by ridiculous bonus payments to "banksters", concerns over unresolved "toxic assets" hidden on balance sheets, high unemployment leading to potential credit card losses and the continued high-rate of mortgage foreclosures.

We are happy to greet the New Year as the worst of the financial crisis and recession has passed and equity markets and the global economy have begun recovery.

We continue to see opportunities in the health care industry as innovation is rampant in the biotech and medical device fields and an aging population demands additional resources. Any progress in health care reform will most likely provide a fresh infusion of demand for additional services. The fundamental underpinnings of the dollar are negative as the Federal Reserve will maintain loose monetary policy "for an extended period" while Congress takes profligacy to new heights.

It is possible, however, that the dollar could benefit from relatively worse economic conditions in the Euro denominated countries or by an unexpected strengthening in the chronically undervalued Chinese renminbi. We will look to add mining and minerals exposure to our holdings should a market correction offer a buying opportunity. We like commodities priced in U.S. dollars as a hedge against a declining "greenback" and future inflation. While a resurgence of inflation is unlikely in the short-term with weak employment and moderate economic growth, huge structural deficits at the Federal and State levels portend a future of higher price indices and ultimately higher interest rates.

We are happy to greet the New Year as the worst of the financial crisis and recession has passed and equity markets and the global economy have begun recovery. Stable companies with strong balance sheets, growth prospects and dividends will continue to be the staples in our portfolios. Our selection of low-risk, fixed income investments will continue to provide a balanced complement to equity holdings.





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We strive to optimize our clients' financial well being by coordinating investment decisions with other professionals in the fields of taxation and estate planning.

U.S. CENSUS 2010

Every ten years since 1790 the U.S. Census Bureau undertakes a national poll which involves a series of questions asked of households. The information collected is used to determine how many seats a particular state may have in the House of Representatives and how approximately \$400 billion of federal funds will be allocated to pay for hospitals, schools, senior centers, bridges, tunnels and various emergency services. Participation in the census is mandatory.



In early March, every residence in the United States and Puerto Rico will be mailed a census form with the following ten questions:

1. How many people were living or staying in this house, apartment, or mobile home on April 1, 2010?
2. Were there any additional people staying here April 1, 2010 that you did not include in Question 1?
3. Is this house, apartment, or mobile home: rented, occupied without rent, owned with mortgage, owned without mortgage?
4. What is your telephone number (for any follow-up questions)?
5. Please provide the names for each person living here.
6. What is the sex of each resident?
7. What is the age of each resident?
8. Are any residents of Hispanic, Latino or Spanish origin?
9. What is the particular race of each resident?
10. Do any of the residents ever live elsewhere on a temporary basis?

If you don't mail the form back, you may be visited by a census taker at your home, he or she will have a badge with their name, a Census Bureau canvas bag, an electronic handheld device and a confidentiality notice. Under no circumstances should you be asked any financial questions and most importantly, never give out information regarding your salary, credit cards, bank accounts or Social Security number. It is possible that the Census Bureau may contact you by phone but be sure to delete any emails purporting to contact you through the internet as they are scams! Census Bureau workers, and for that matter, no strangers, should ever enter your home. Sadly, our elderly neighbor was relieved of her life's accumulation of jewelry by con men impersonating local water utility workers. One can always ask for official identification and all local utilities can be called to verify whether work has been assigned to your place of residence.

Disclosure: "Be careful about reading health books, you may die of a misprint." Mark Twain Keep that in mind as you read these articles. We obtain data from sources we believe are reliable but they should not be relied upon for making life-changing decisions.