

QUARTERLY REPORT

VOLUME 8, ISSUE 2 MAY 2010

BEWARE OF GREEKS BEARING GAPS (BUDGET)!

The first quarter proved to be a rewarding time for equity holders, as the U.S. economy continued with modest growth of 3.2%, down from the fourth quarter's growth rate of 5.6%. Despite the significant decline, the economy has now shown positive growth over the past nine months, which is a strong indication that the Great Recession is over. It is not surprising to see stock prices rebound strongly out of the steep recession; we consider the run up in the market since the March 2009 lows as evidence of better economic times to come.

Although economic optimism is on the rise in the U.S.A., all is not well in Euroland, as Greece's governmental debt woes appear to be spreading to its weakened euro partners, namely Spain and Portugal. Although it is often lumped in with the aforementioned countries (a.k.a., The PIIGS – Portugal, Ireland, Italy, Greece and Spain), Ireland appears to be managing its sizable debt woes. As fear migrates from Greece to Portugal and Spain, echoes of the 1997 "Asian Contagion", which began in Thailand and quickly spread throughout the Far East region, comes to the fore.

During the Asian Contagion, individual Asian countries were able to devalue their sovereign currencies and restructure their national debts. In the current Euro-Crisis, Greece, Portugal and Spain are members of the common Euro currency; their participation in this currency union precludes the

possibility of individual sovereign currency devaluations. So, the Euro is rapidly depreciating in value vis-à-vis the U.S. dollar, as investors make a relative "flight to safety". It is not that the United States has its budget and debt levels under control; far from it. As one pundit put it, "the U.S. is the best looking horse...at the glue factory."

We have identified a number of clouds on the horizon for global markets including the normal topping off after a strong recovery with historically rich valuations. It would not be unusual for the market to see a "correction" after thirteen consecutive months of gains. Europe remains a pivotal world trading partner and it remains to be seen whether the political will can be mustered to quickly contain what is both a liquidity and solvency issue for Europe's "Club Med" countries. China's incredible "growth" story now is being questioned as authorities seek to slow down what is considered to be an overheating economy. Finally, we are mindful that the Federal Reserve has ended its "quantitative easing" policies with the hope that the U.S. economy can stand on its own merits.

We appreciate the opportunity to guide your accounts through fitful times and shepherd your assets with our best efforts.

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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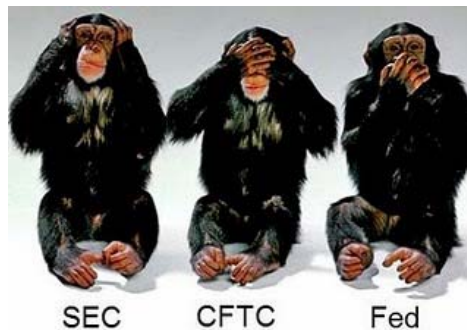
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YEAR TO DATE REVIEW

The first quarter of calendar year 2010 showed U.S. equity markets outpacing most of the developed and emerging markets as economic recovery became more convincing to investors after nine consecutive months of GDP expansion. The broad market S&P 500 index turned in a solid 4.9% rise over the first three months of the year while the Russell 2000 index of small-cap stocks realized a stellar 8.5% return over the same period. Since the stock market began recovering from its March 2009 lows, smaller, higher-leveraged and frankly, more speculative, stocks have outpaced the more conservatively managed “blue chip” stocks of Dow or S&P 500 index. The technology-laden Nasdaq Composite Index enjoyed a 5.7% return in the first quarter and benefitted greatly from an 11% booster shot from biotechnology stocks in the same period. Three other sectors which generated double-digit returns in the first quarter of 2010 were industrials, financials and consumer discretionary stocks. The surge in prices for industrials can be seen as a leading indicator that the economy

“...the financial regulatory agencies seem to be whistling past the “toxic asset” graveyard.”

is on the mend. We continued to avoid the financial sector as banks remain saddled with “toxic” assets with severe exposures to commercial and residential real estate. While there is much talk of new financial regulation on the horizon by the U.S. Congress and the Obama Administration, the financial regulatory agencies seem to be whistling past the “toxic asset” graveyard.



As for the strong performance of consumer discretionary holdings during the first quarter, we can only say auto incentives, I-pad, smart phones and Kindle. It's remarkable that the overleveraged consumer continued to spend.

The MSCI Emerging Market Index squeaked out a 1.5% gain in the first quarter of 2010 and was substantially held back by a 3.5% slide in the Shanghai Composite Index as the Chinese raised bank reserve requirements, implemented tighter lender guidelines and required higher loan rates in an effort to take air out of an expanding real estate bubble. Initial signs indicate that the Chinese

government's efforts are having the desired effect of slowing the housing market down.

Commodities remained an investor favorite as a hedge against weak currencies and as a physical store of value. Gold prices fluctuated in a narrow band in the first quarter of 2010 and ended up 2% for the period, settling at \$1,113 an ounce. Crude oil continued to benefit from a rebound in demand and strategic stockpiling over the first three months of the year as a barrel of oil rose 6% to \$83.76 as of March 31, 2010. China, with its red-hot economic growth rate of 11% per annum, is considered a key driver in sustaining commodity prices at their present level.

The U.S. dollar rose 6% against the Euro in the first quarter 2010 as the U.S. Federal Reserve was seen as being more accommodative than the European Central Bank in ensuring an economic rebound from the recession. Fears of greater relative weakness in the European banking sector than in America further acted to support the strength of the dollar. Greece's financial ailments did not clearly come to light during the first quarter of the year and did not have a significant drag on the Euro. Despite continued threats of trade retaliation by Secretary of Treasury and the U.S. Congress, China maintained its peg to the greenback, which undervalued the Chinese Yuan and made it easier for China to maintain a favorable surplus trade account with the United States.

YEAR TO DATE REVIEW (CONTINUED FROM PREVIOUS PAGE)

The short end of the bond market did not move or change in the first quarter of the year as the U.S. Federal Reserve reiterated its existing policy stating:

“The Committee will maintain the target range for the federal funds rate at zero to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.”

Similarly, the yield on the 10-year Treasury bond remained flat at 3.837% at first quarter end in 2010, although it fluctuated in a range of nearly 1/3 percent. The 10-year Treasury bond is especially important as it serves as the benchmark for standardized 30-year mortgages. The Federal Reserve notably ended its \$1.25 billion program to purchase mortgage backed securities as of March 31, 2010, which could lead to higher mortgage rates if bond investors

fail to fill in the void in demand left by the Federal Reserve’s withdrawal from the market.

According to the Zillow Home Value Index, national home prices fell 3.8% on a year-over-year basis as of March 31, 2010. The drop in home prices was especially disappointing as Congress extended an \$8,000 home buyer tax credit throughout the period in an effort to spur purchases.

According to Zillow Chief Economist, Stan Humphries,

“We suspect that the homebuyer tax credits are, for the most part, stealing demand from later this summer, rather than creating new demand (emphasis ours). Even with the tax credits in place during the first quarter, inventory levels were rising, and home values continued to decline at a steady clip, rather than steadying. Because of these factors, we believe national home values are more likely to reach bottom in the third quarter of 2010, rather than in the second quarter, as we had hoped.”

On a happier note for our California clients, the residential real estate market appeared to stabilize in the first quarter of the year, with home prices rising 3.3%, 3.4% and 3.7% in the Los Angeles, San Francisco and San Diego metropolitan areas, respectively on a year-over-year basis.

“The Committee will maintain the target range for the federal funds rate at zero to ¼ percentfor an extended period.”

LOOKING FORWARD

World markets were rocked in early May as the Dow Industrials fell nearly 1000 points in the span of an hour and then settled down a mere 348 points. Over \$1 trillion of market capitalization vanished in twenty minutes only to rebound over six hundred points on the Dow. Rumors abounded of a “fat finger” whereby an errant trader reportedly submitted a sale for a billion dollars, instead of a million dollars, of Procter & Gamble. A more likely explanation for the

market’s decline was the NYSE’s decision to stop trading in some specific stocks for two minutes which forced “program” or “algorithmic” orders to seek out like trades but on smaller and sometimes illiquid electronic trading platforms. The SEC has announced a formal investigation into the trading anomaly which should pinpoint what we consider to be the “spark” that ignited three days of frenzied trading.

Whereas we remain sanguine as to the likelihood for a continuing recovery for the U.S. economy and moderated returns for the stock market over the next nine months, we are concerned that recent developments in Europe may have an unhelpful influence over U.S. prospects. Although the European Central Bank has reversed itself and now has embraced the concept of “quantitative easing” or printing money on the order of one trillion



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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.

LOOKING FORWARD (CONTINUED FROM PREVIOUS PAGE)

dollars to provide emergency liquidity for Portugal, Ireland, Italy, Greece and Spain (ignobly, the PIIGS), we are not convinced the aforementioned countries will embrace the tough economic restructuring necessitated by their runaway budget deficits. Referring to the European loan package, IMF European Chief, Marek Belka stated, "I obviously don't treat it as a long-term solution, don't treat it as a panacea for European problems. This is some kind of morphine that stabilizes the patient -- and the real medication and the real treatment has to come."

Moreover, it is not certain that "rich" European countries such as Germany, France and the Netherlands will receive the domestic backing required to

provide bailout loans to the profligate "PIIGS". The Euro currency nations are a disparate bunch with the wealthy located in the North and the relatively poorer members located in the South. We are skeptical that the grand "Euro" currency experiment will prove to be successful as there does not seem to be a coherent policy response to impose financial order on individual member states. Newsreels of Greek workers rioting in Athens indicated little movement towards fundamental financial restructuring and moving away from current policies which allow hairdressers, musicians, media workers and others to retire at age fifty with full pensions.

While consumers and states still face unwelcome debt levels, companies have strong balance sheets and are poised to restock inventories which

have dropped to untenable levels over the course of the *past* recession. Notwithstanding a "wall of worry" regarding Europe's odds to tidy its house, North Korean military provocations, an overheating Chinese real estate market, etc., we are cautiously optimistic for an ongoing rebound in the U.S. economy with moderating returns in the stock market. We see interest rates remaining at present levels in the U.S. and Europe for at least the next nine to twelve months as the respective central banks are committed to providing affordable liquidity to business and consumers with the unstated intent to keep their currencies from appreciating and, thus, encouraging an export-led recovery.

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.