ECONOMIC AND INVESTMENT FORECAST
November 10, 2009

The U.S. economy continues to struggle, even as the housing market appears to have bottomed out. Credit conditions are improving, interest rates are low, and 30 year fixed rate mortgages are below 5.0%. Although most economists and Fed Chairman Bernanke believe the recession has ended and a double dip is unlikely, the recent Commerce Department 3rd quarter Gross Domestic Product (GDP) of 3.5% was not as encouraging as first perceived. Personal consumption expenditures rose 2.36%, but 1.66% of this was due to the one-time Cash for Clunkers stimulus program. Other positive contributors to GDP included inventory replenishment and government spending. Surprisingly, net exports were a slight detractor despite the weak dollar, which makes our goods and services less expensive overseas. Consumer spending, which accounts for approximately two-thirds of GDP, was weak, and we believe will remain so until the consumer feels more financially secure. Unemployment, now 10.2%, is not predicted to decline significantly until the 2nd quarter of 2010. Although consumers will gradually return to spending, an increasing amount of their purchases will be through the Internet, from which neither the Federal government nor most states currently collect taxes. Recently, there has been some talk in Congress about a Value Added Tax (VAT) to replace the existing cumbersome income tax system, although implementation in the near future is highly unlikely. With or without a health care plan, tax increases are expected at the federal, state, and local levels.

Fed Chairman Bernanke believes that Fed policy in 1932 played a significant role in causing the Great Depression. He has repeatedly expressed his determination not to make the same mistakes of raising interest rates or reducing liquidity too soon. We expect 2010 U.S. GDP to fluctuate between 2.5% and 3.5%, and about the same for developed European countries. This is well below the International Monetary Fund (IMF) forecast of 9% GDP growth for China and India. Inflation represents a potentially serious long-term problem given the unprecedented monetary stimulus and the deteriorating financial situation at both the federal and state levels. Although the Federal Reserve has been downplaying inflation, the Labor Department reported that the Consumer Price Index (CPI) rose in September. Commodity prices are also rising, with oil and metals up over 50% since the beginning of the year. Import prices have risen 6 out of the past 7 months as the weak dollar has caused the price of almost everything we import to rise.

U.S. corporate profits have been higher than anticipated as a result of cost cutting and employee layoffs earlier in the year. We expect corporate revenue growth to provide positive earnings surprises next year which, coupled with a continued influx of cash from the sidelines, should continue to drive stock prices higher. Investments that benefit from inflation should produce the best returns next year, including basic materials (energy, gold), REITs, as well as equities. We especially like emerging economies due to their young demographics, rising middle classes, and robust economic growth rates. Over the next several years, emerging markets will likely dominate and drive worldwide growth.

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