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ECONOMIC AND INVESTMENT FORECAST
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The U.S. economy remains constrained as consumers continue to pay down debt and increase their savings. Consumers are still concerned about their financial well-being as unemployment hovers in the 9-10% range nationally, and housing foreclosures continue at a prodigious rate in many areas of the country. The U.S. Gross Domestic Product (GDP) will likely remain sluggish through the middle of next year as consumers repair their balance sheets. Consumer spending makes up approximately 70% of GDP.

Although the Federal Reserve recently announced another Quantitative Easing (QE2) stimulus program, it was not as large as QE1 and it is doubtful it will be implemented fully. However, the fact that the Fed initiated this program at all indicates their continuing concern about deflation. Conversely, most economists have discounted a double dip recession and are warning that the Fed is overreacting to deflation with QE2, which will cause inflation.

The results of the recent mid-term election sent a strong message of dissatisfaction to the Obama administration and changed the U.S. House of Representatives to Republican control. As a result, President Obama has indicated that he will be more flexible on any new social initiatives that would add to the growing budget deficit. It is expected that the Bush tax cuts will remain in place for all income levels into 2011, and perhaps longer, to help stimulate the economy.

As bond yields have declined significantly during the year (10 year treasury now 2.83%), investors have migrated into riskier high yield bond funds (less than investment grade) in order to maintain necessary income levels. Chairman Bernanke has commented over the years that the Federal Reserve was responsible for the Great Depression by tightening credit too soon; therefore, we expect that he will allow inflation to grow significantly before raising interest rates in order to slow down the recovering economy. As interest rates begin to rise and bond values decline, it is likely that there will be a rapid move by investors into other income-producing asset classes, resulting in a collapse of the bond market in 2011 or early 2012. We expect that investors will then shift to dividend paying stocks, TIPs, and alternative income investments such as REITs, Master Limited Partnerships, royalty trusts, and foreign government bonds. We have been proactively adding these investments into our portfolios during this year.

The U.S. stock market has recovered most of its losses from the 2008-2009 bear market and strong forecasted corporate profits should give the market support in 2011. With the U.S. dollar weak and demand for U.S. goods and services by developing countries on the rise, the stage is set for S&P 500 corporations to continue growing their earnings and for stock prices to continue rising. Approximately 50% of S&P 500 earnings are now coming from overseas.

Every week, roughly 1 million people migrate to cities from the countryside in developing countries around the world. This migration will result in increased demand for commodities and U.S. products and services in order to provide for housing and infrastructure. Economists estimate this economic development could carry on for several decades.