



Adams Hall

Asset Management

Was 2009 an aberration or a progenitor of better times?

While there is no certainty in any market we do believe better economic times are ahead, but don't think the markets will rise at the same pace they did last year. Here are a few of the questions that are first and foremost on our minds as we head into the new decade.

How much longer will the recovery last?

The average bull market has lasted 68 months and has generated 176% in growth from its low point. The current bull market has lasted 10 months and has recovered 65% from the March 9th low. By both average measures, the recovery is still in its infancy.

Will there be a correction?

Yes, there always is, and there will no doubt be ups and downs in this recovery. The key is what you do when they come (for a perfect example of what not to do see the article on the CGM Focus fund on our website). If there is a correction in the near term, will it be a wholesale decline in the market or could it be the latest bubble bursting? Many areas have performed extremely well in 2009. If it is a bubble, a few possible culprits could be gold (more on that later), China, and bonds. Through November, almost \$350 billion poured into bond funds in 2009, pushing the total assets in bond funds over \$2.2 trillion. Real yields on the 10 year Treasury have been significantly below the 20 year average since 2008. When looking at the Obama Administration's 2010 budget, it is hard to see the Treasury being able to continue financing the administration's deficits at such low rates. If Treasury rates rise, it should filter through the rest of the fixed income universe causing bond prices to fall as the rates increase. As bond prices fall, it would not be surprising to see some of that hot 2009 money pour out of the bond funds.

If there is a sell-off in equities, look for some of the \$9.6 trillion in cash that has been waiting on the sidelines to come back into the market.

What do we think about inflation & gold?

Pimco, a very influential investment company recently released their views on the 2010 economy. They believe that US inflation rates will likely be below 1% in the short term. We agree with Pimco. Though there has been massive fiscal stimulus and the Fed's balance sheet has grown significantly, we feel like there are just too many opposing factors keeping inflation down for it to be much of a worry now. The Federal Reserve has yet to even hint about raising short term rates, and with unemployment currently around 10%, wage pressure is not a factor on inflation. Even though we think rates will stay low for now, we are very mindful of the negative effect rising interest rates have on fixed income.

Gold has had an impressive run the last few years and was up 24.8% for 2009. We consider gold to be less of an inflation barometer and more of a hard currency. When the dollar goes down, gold goes up. The Fed has been printing money as fast as the presses will go (we call this quantitative easing) in order to keep the economy out of deflation. At some point in the future, when the economy is again operating normally, it will be important for the Fed to start withdrawing some of the stimulus. Gold and the dollar have been on the move because some investors are wondering whether or not the Fed has the willingness or ability to reverse the quantitative easing at just the right time and by the right amount. It's not so much an issue of inflation but an issue of confidence in our policy makers. In a way, gold is providing a hedge against mismanagement in Washington. If the Fed is able to thread that needle when the time comes, then the run up in gold and corresponding decline in the dollar could reverse very quickly. If that happens, the dramatic rally in gold will be seen as nothing more than an irrational bubble. But if the Fed itself is unable or unwilling to exit when the time comes, especially if at the same time Congress continues to run massive deficits, then the current market trends in gold and the dollar could have a long way to go still.

What's the deal with the foreign markets?

Everywhere we turn we are reminded of how quickly the foreign equity and fixed income markets recovered in 2009. Many of the economies in the developing world were on relatively stable footing when all this economic worry began. Their economies were not as levered as ours, but they were initially painted with the same broad brush. Once investors realized the error in this perception, they were quick to take advantage of the growth opportunities available in these markets. A steadily falling dollar also helped. We look for emerging markets to continue to grow at a much faster pace than the US and Europe, but don't expect 2010 to bring the same degree of performance as 2009. We continue to believe in diversification throughout the globe.

If the above isn't enough to worry about we've highlighted a few more topics that are just as important and looming just around the bend. As each becomes clearer, we will expand on them further.

- Taxes - they are going up. When and how - we don't know yet.
- The falling dollar - the dollar has been on a downward trajectory, but could this be good for manufacturing and our exports?
- Corporate profits - how much more cost cutting can companies do? When will sales growth contribute to the bottom line again?
- Housing - the worst seems to be behind us. Housing affordability is as promising as it has been since the Nixon Administration.
- Commercial real estate - there have been rumblings about commercial real estate for a while. Some refinancing will need to happen. How much of this is already priced into the market?
- Healthcare reform - we should know more on this soon.
- Geopolitical threats - a sudden spike in oil prices could put the breaks on the economy quickly.
- State deficits- state budget deficits will continue to make headlines in 2010.

Now that we've shared our vision of the future, we would be remiss if we didn't tell you what we learned from the past. Too many people were willing to go with the flow and follow the crowd. They invested in things they didn't understand and put their faith in people who made promises that were too good to be true. At Adams Hall we continue to believe that "Independence of thought" is paramount, there is no substitute for transparency and that "boring is good".

Thanks for your continued trust and support.

Happy New Year!

Adams Hall Asset Management LLC