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**Quarterly Investment Commentary**  
**3<sup>th</sup> Quarter**

Stocks continued to climb in September, bringing the third-quarter gain for the large-cap SPDR 500 Index Fund (SPY) (which replicates the S&P 500) to 14.79%. The small-cap Laudus Rosenberg Discovery (RDISX) was up 16.46%. Foreign stocks continued to outpace their U.S. counterparts, with Oakmark Global (OAKGX) up 20.95%.

Turning to fixed income, the intermediate-term, investment-grade PIMCO Total Return was up 6.04% for the 3<sup>rd</sup> quarter and Loomis Sayles Bond Fund was up 12.35%. Vanguard CA Tax-Free was up 7.14%, their Intermediate Tax Exempt was up 6.14%, iShares CA Tax Free up 7.16% and iShares National Tax Exempt was (.87%).

Gold and silver continue to shine (pardon the pun). iShares Comex Gold (IAU) returned 8.42% and iShares Silver (SLV) returned 22.42%

In my effort to communicate candidly with clients, I am honest about when I make mistakes and don't try to sugar coat them. The dismal first quarter is behind us and performance since then has been positive. Those of you with higher returns than others have been those of you who were willing to let me take more risk. Now I have been cutting back on stocks and the largest positions are 20% of entire portfolios, with the exception of some 401(k)s that still have 30%.

My mother-in-law is staying with us this week and since she also is a client (talk about pressure). I frequently ask for feedback on my communications. Yesterday she said I should give you more information about what I intend to do with your investments and why, in the near term, so that's what I am going to do.

**Future Stock Market**

I continue to believe that there is more downside to this bear market – the rally of the last six months is doomed to fail. Here is why I think that, what I think will be important to watch to see if this unfolds **and most importantly, what I plan on doing to protect you.**

1. There will come a time and I think it is within a month, that this market will “peeter out” and start declining and like a rolling stone, it will gather speed until it has gone down several hundred points or more. Before that decline goes very far,

- I fully expect to have everyone out of all funds that invest in equities, except gold and silver.
2. I will keep a vigilant eye on the metals because whether the dollar is going up or down, the metals will be affected. Generally speaking, dollar up, metals down – dollar down, metals up.
  3. Interest rates are at zero, so I will be parking some of your cash in Vanguard's Short-Term Bond fund. It will have taxable income, but where I have tax-free investments already, I want to diversify some. Hopefully this defensive position will not last long.

Why do I believe the decline is at hand? As many of you already know and understand, I analyze the market data and read many articles on market data. I wish I had started two years ago. Anyway, many patterns are repeating themselves, similar to October, 2007. For instance, in the last few months, the data shows that the volume of trading has greatly decreased, yet prices have risen. This would indicate that the recent rise in the market is due to relatively few people or institutions buying into the market. They are waiting for the next step. They do not believe this rally of the past six months is real, so they sit and watch, as I have been doing for the most part. The higher the prices go and the lower the volume of trades, the closer we are to a market top, I believe and then the decline will start. At the ultimate end of the decline, the bear market will be over and you will be fully invested again, according to your risk revealed in the questionnaires you are completing and sending me. I am sure there will be a few bumps on the road, but that's my plan.

### **Current Outlook in the Economy**

While we will see more bank failures, as real estate-related loan losses (residential and commercial) continue, I am fairly confident that the government has taken the financial-system meltdown risk off the table. The economy is probably already growing again. But there remains the important question of how strong the recovery will be, and whether it will be sustained or whether there will be another leg down for the economy and the markets (which is commonly described as a W-shaped recession).

With drops in household net worth erasing years of gains; debt levels far too high; access to credit more limited than it has been in years; and labor markets feeble, the consumer is in a weakened state. I continue to believe it is highly probable that households will want and need to rebuild their assets, especially the 78 million baby boomers depending on their net worth to help fund retirement. The end of the home equity ATM, and generally less available credit as financial institutions repair their balance sheets, will reinforce this trend. The consumer is 70% of the economy, so clearly consumption growth is of critical importance to economic growth. It is the expectation of slow consumer spending growth coupled with increasing regulation and likely reduced risk taking on the part of businesses and investors (relative to much of the past 20 years) that suggests that any near-term burst of economic activity is unlikely to be sustained at a robust level.

Thank you for your business and your trust. Please or write with your questions or comments.

