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Quarterly Investment Commentary

4th Quarter, 2009

When the dust settled on one of the most eventful and upended years in memory, investors had generous gains in stocks and certain segments of the bond market to salve the wounds of a disastrous 2008 and first quarter of 2009. Stocks finished the year strongly, continuing their powerful run that began in early March. Large-cap stocks, based on the Vanguard 500 Index Fund, gained about 6% in the final quarter, and finished 2009 with a 26.5% gain. In both the quarter and the full year, growth sharply outpaced value, but between larger-caps and smaller-caps, returns were pretty similar.

On the domestic fixed-income side, returns varied widely in 2009. The Vanguard Total Bond Market Index Fund gained 5.9% for the year, but the iShares Barclays 7-10 Year Treasury ETF was (6.4%). My point is that the lower the risk of the bonds (U.S. Treasuries) the lower the return, and in the case of the treasuries, an actual negative return. The higher the risk of the bonds, the higher the return is, i.e. Loomis Sayles Bond Fund, which was up 37%.

Heading overseas, the Vanguard Total International Stock Index of returned an impressive 37% for the year.

I spent the better part of 2009 saying that if I was going to be wrong in positioning your investments, I would rather be wrong by being too conservative, than be wrong being too aggressive. That being said, there were times I took some risks and the markets reversed on me. Overall, my clients earned money on their investments – some more than others. My SEC mandated Form ADV discloses that I manage for downside protection, not upside gains, so in a year when the S&P 500 was up a very surprising 26.5%, there was no way I was going to be able to keep up.

I feel like I just did my confession to Fr. O'Keefe, just like when I was a kid at St. Bede's Catholic School, so that being said, what about 2010? As Clint Eastwood said, "are you feeling lucky?"

I am sorry to report that I still have a negative attitude about equities and frankly, about bonds, too. In January, as I reported to you, there were signs that perhaps that the bear market was finally going to end. I rated the odds at less than 50%, but just in case I did make buys in your retirement accounts, but not the non-retirement ones. On the bond side in the retirement plans, I am emphasizing high quality bonds for the largest allocation. For those of you less risk-averse, I am using a heavier weighting in some riskier bond funds.

In the retirement plans, on the stock side, I have invested only half of your ultimate allocation in equities. The more risk-averse you are, the lower the allocation of equities and the less risk-averse the higher the allocation.

In the non-retirement accounts, I am still holding a lot of cash, again with my finger in the air trying to monitor the changing winds in both stocks and bonds. If you are in a high tax bracket, i.e. 28% federal or higher, for the most part I am keeping your bonds and cash in tax-free bond funds. The downside of that strategy is that you miss out on the run-up in value of the bonds that pay out high yielding distributions. It is definitely a trade-off. If your bracket is lower than 28% federal, I am being more flexible in buying bond funds that cover a larger type of bonds. Eventually I will invest some of your cash in more stock funds, but during this environment of up 100 points in the Dow one day and down 100 points the next, I am remaining still.

In gold and silver, your retirement accounts have been generally holding 5% in each metal, as I reduced your exposure in October. In your brokerage accounts, however, I did not reduce the weighting, mainly for tax reasons. I wanted to defer the gains (yes, gains) to 2010. Yesterday, I did reduce your gold and silver in the brokerage accounts to approximately 10% combined gold and silver, but not necessarily an even 5% in each.

I hope that this commentary helps you understand what happened in 2009, my thoughts on the stock and bond market in 2010, and what I have done so far this year with regards to my viewpoint.

Please call me with any questions or issues, but mostly, thank you for your business and your trust.