

**2009 INVESTMENT COMMENTARIES:** 1st Quarter, 2009 in Review

**Recap of the Current Economic Situation**

The list of issues affecting today's investment landscape is dizzying; at the top is the dismal state of the global economy. The fundamental problem is that over the past several economic cycles U.S. households and financial services businesses took on increasing amounts of debt in order to fund consumption and investments. This trend was self-reinforcing as purchases with borrowed money drove up asset prices (such as homes and financial stocks) and profits, which supported even more borrowing. Ultimately this upward spiral was unsustainable, and its unwinding has created an adverse feedback loop of falling asset prices and lower spending and profits. As the economy deteriorates, contributing factors (such as rising unemployment, mortgage defaults, loan write-offs, reduced lending, and overall fear) all fuel one another.

In such a situation, most experts agree that the government needs to step in as a consumer and lender of last resort to try to stop or mitigate the effects of this adverse feedback loop. In effect, the public sector (the government) must take on more borrowing (selling treasuries) and spend more in order to try to plug the gap created by the private sector trying to get itself out from under its huge debt. The \$800 billion fiscal stimulus package and the monetary and credit policy actions undertaken by the Federal Reserve and the Treasury to support the financial and credit markets are the result so far. I agree that stopping a debt-deflation spiral from taking hold is very important, but there remains a lot of uncertainty as to how the government's efforts will play out. Generally speaking, I think that the policies and programs recently announced are likely to help move the economy towards recovery, but they may not alone solve the serious problems we are facing and I expect more government action in the months ahead.

In the world of economists, there is a vast array of opinions on whether Obama's plan will work or not. I expect liberals to support it and conservatives to bash it, but now I am reading about conservative economists, i.e., *The National Interest Journal*, supporting Obama's plan and bashing Bush's or, the reverse, liberal economists i.e. Woody Brock, thinking Obama has gone too far. In my opinion, no matter what policies are introduced, the impact of consumer and financial system unwinding from debt will almost certainly be a significant drag on economic growth over the next several years, as

saving and paying down debt replaces borrowing and spending. I also believe that there will likely be a price to pay down the road for the current policy actions in the form of a weaker U.S. dollar, higher inflation, higher interest rates and tax rates and, consequently, sub par economic growth and corporate profits.

Earlier this week I attended a mini-conference presented by PIMCO, arguably one of the top two or three bond companies and they are now referring to this recession as "L - Shaped," only the horizontal line of the "L" is 50% longer than the vertical line. They agree that downward spiral has slowed down, but when it hits bottom, they think it will not likely start back up for many months, if not a year or more. If this recession is technically a year old (conservatively), then an upward climb may not start for another 18 months.

Frankly, though, who knows for sure? Certainly not Margie Mullen. I am only as good as my sources for information.

**The Outlook for Equities**

I have made no secret of my outlook for stocks. Again, I believe we are still in a bear market that has considerably more downside than we have already had. I believe that presently we are experiencing a bear market rally that could go eventually up another 25% from where we are today - Dow is at 8,131 (April 17). But before we go higher from here, I believe we will go lower and lose much of what has been gained already. If it does go significantly down, I will buy more shares of the S&P 500 in the accounts that already have small positions. Eventually, though, I believe there will be a third leg of the bear market and that the Dow may go as low as 5,000. Hopefully everyone will have 20-30% of the ProShare "short" funds to ride that decline down.

But, again, who knows? I could be dead wrong. The market could continue up from here (I doubt it.), but I would rather be dead wrong on this side of the argument, then dead wrong by having your usual allocation of stocks and seeing the Dow go to 5,000.

One of the original research companies I started following years ago outlined in their recent newsletter four different economic/stock market scenarios. I guess I am a little too simple for that, because there is no way I see their "Goldilocks" scenario where we are all better by year-end. I just

envision more trouble in the markets, the stimulus package taking a long time to get traction and when this rally stops, that people will again stop shopping, dining out and otherwise spending.

### **The Outlook for Gold and Silver**

Gold and silver are in a bull market that does not appear to be in jeopardy anytime soon. Just like there are bear market rallies, there are bull market declines and that is what gold and silver has experienced in the last month or so. It is still up about 20% from last October, but has been sliding as investors take profits and those proceeds have help fueled the stock market rally. The technical analysts have both gold and silver looking for a bottom right now and soon they will resume their climb up. Remember, there are two reasons I am using them right now: 1) a flight to safety as the dollar decreases in value; and, 2) a very good hedge against inflation should the current economic policies result in higher inflation down the road.

### **The Outlook for Bonds**

What would one of my missives be without referencing the Loomis Sayles Bond Fund, a real nemesis last year and the early part of this year. As a direct result (I believe) of the bank bailouts, credit markets continue to "thaw out" from last year's "credit freeze." Loomis Sayles is a good example of the bad results of last year's credit problems and this year's vast improvements. There is more liquidity for mortgage backed securities and other more esoteric derivatives, the lower end of the bond market is finding buyers for "junk" bonds and the bonds that are not quite investment grade but not junk either are also finding buyers. PIMCO believes that mortgage backed securities may be the "sweet spot" of the bond market this year and Loomis Sayles holds mortgage backed securities, junk, bonds, better than junk bonds, investment grade bonds and everything but treasuries. Loomis

has had a 7% improvement just since early March and I do not think the continuation of the bear market will negatively affect it as much as the fund experienced last year when it was -22% for twelve months. In short, I think most of the bad for Loomis Sayles Bond Fund is behind us.

Except for California tax free bonds, the rest of the bond market looks reasonable, but when interest rates rise, and they will, bond values will decrease. As far as California and its economy is concerned, that's something I will continue to watch on a daily basis.

As I meet with you, my clients, I hear the same refrains over and over:

- "I'd rather be safe and not worry"
- "I trust you judgment"
- "I appreciate your directness and honesty"

In light of those responses, I need to remind you that cutting back in spending is a good idea, particularly if you are in retirement. And yes, if you recently had us do retirement projections for you in the past few years, we need to up date them, as they will be less rosy. And, yes, each time we do those projections, our rate of return assumptions get more conservative.

As you well know, I have made mistakes and that will likely not change. Mistakes happen. I appreciate your trust in me, I appreciate those of you who have recently transferred more accounts from previous brokers to me and you have my promise I will continue to be direct and honest and do the best I can with my God-given talents.

Thanks again for your business and your trust.

Sincerely,  
Margie Mullen, CFP

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