# 'Tis Only My Opinion!

### January 2010 - Volume 30, Number 1

### Outlook 2010

## The World from 80,000 feet.

It is important to keep a global perspective to understand the forces that will shape the economic and political pressures in the coming months and years. There are major shifts developing that suggest that the current economic system may not survive.

According to the International Monetary Fund (IMF), the following table suggests the extent of the world economy and the U.S. portion of it.

| 2008 | 2009 |
|---|---|
| World GDP $60.9T | World GDP 59.4T |
| World Savings $1.4T | World Savings $800B |
| US GDP $14T | US GDP $13.8T |
| US Stated Debt $380B | US Stated Debt $1.4T |
| US Trade Deficit $680B | US Trade Deficit $360B |

In 2008, the U.S. required about 70% of world savings to finance its federal and trade deficits. In the first year of the Obama Administration, the new financing needs of the U.S. Treasury exceeded world savings by a factor of at least two times. To finance the deficit, the U.S. printed more fiat currency.

## Factors that might impact events in 2010

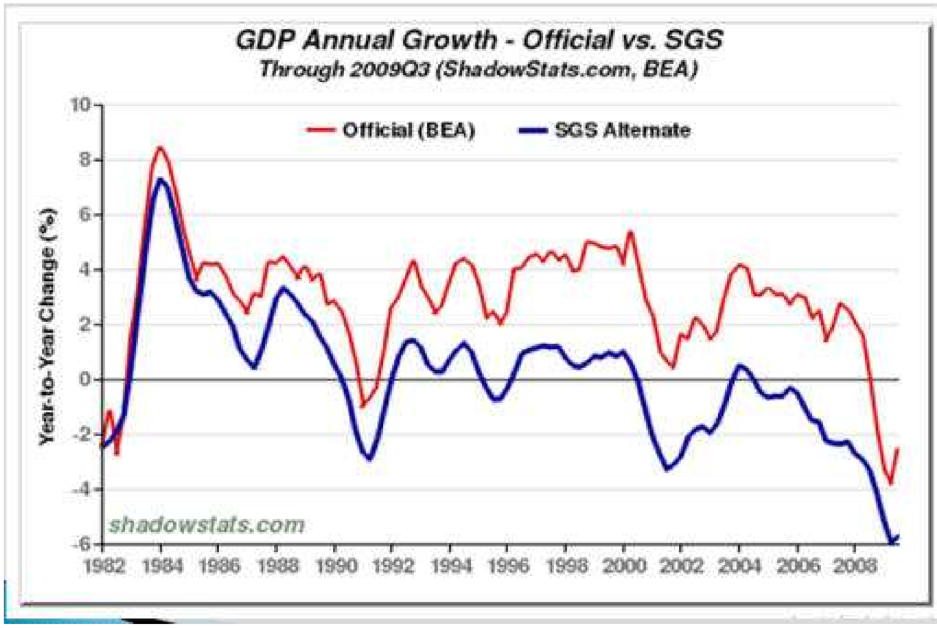
There are several factors that will play an important part in the economic events in 2010 and beyond. In no particular order, they are:

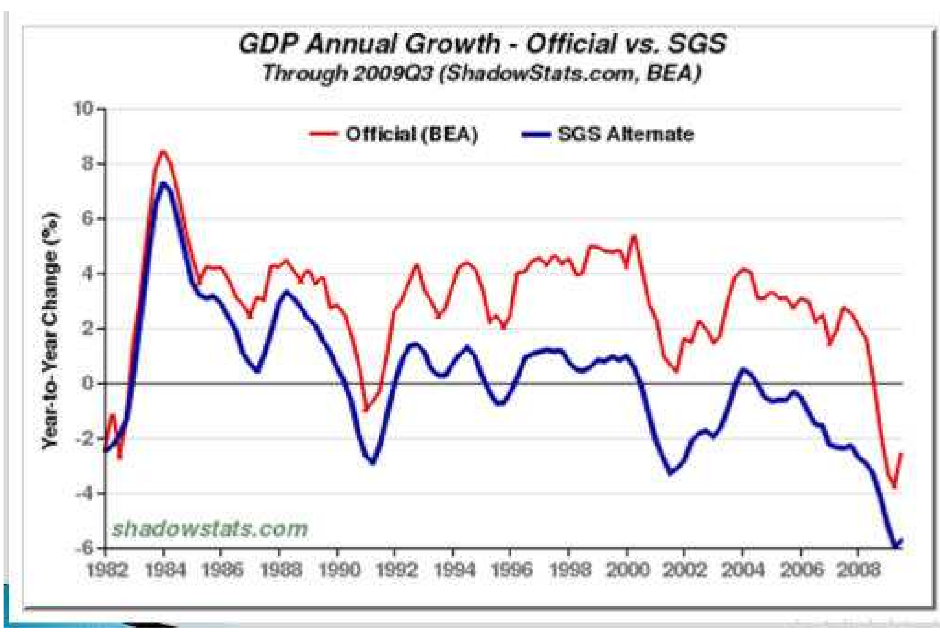
- ☐ Competition for the world resources
- ☐ The world's largest debtor nation trying to lead world opinion based upon its military superiority.
- ☐ The continued diminishment of the dollar as the world's reserve currency.
- ☐ The growing impact of Russian/Chinese and Middle East economic and military alliances.
- ☐ A civil war in Iran disrupting the region or an Israeli strike against Iran triggering a wider conflict in the region.
- ☐ The growing role of Islam in Africa and Europe.
- ☐ Increasing political and economic turmoil in South America
- ☐ The impact of environmental regulation upon food production
- ☐ Campaigning for mid-term elections in the U.S.

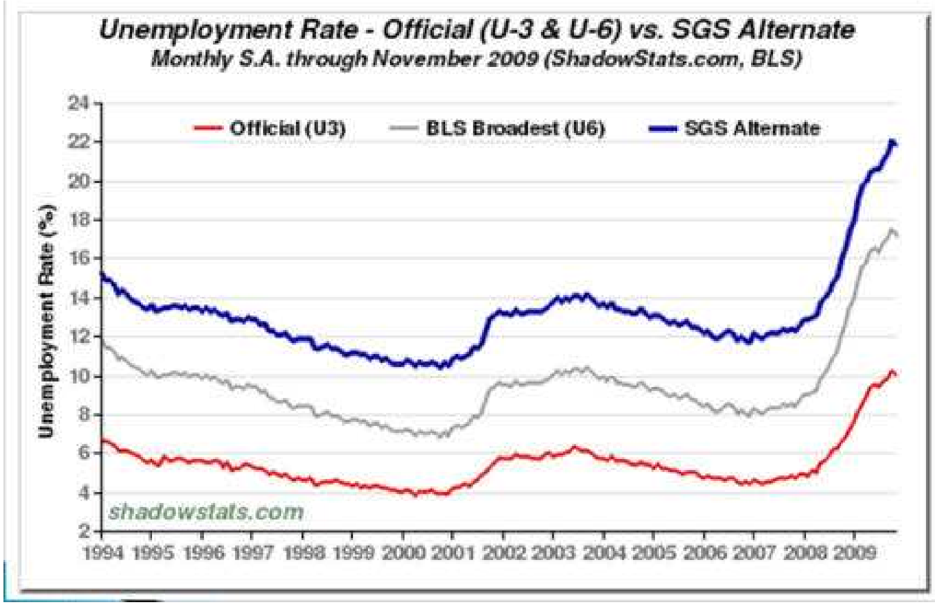
## Evaluating the U.S. Economy today.

During the past three decades, there have been many changes to the methodology of preparing economic statistics in the U.S. Today, there is a difference between the official statistics coming from the administration (know as the Ministry of Truth, or MOT) and those from a group of economists of which John Williams of Shadow Government Statistics is the best known.

The following three charts of gross domestics product (GDP), the consumer price index (CPI) and the unemployment rate show the differences as of the latest data available.






As these three charts clearly illustrate, there is a significant difference in the official record and the real world. The real problem is that many decisions are made based upon the official record and not the real world data. The result is bad decisions are made.

If GDP growth is really less than reported, CPI higher than reported and the unemployment rate over twice what is reported in the major news media, do you think our policy making bodies would have made the same decisions if they really understood the facts.

## Obama's 1st Year Record

Barack Hussein Obama became President of the U.S. on January 20th, 2009. He was elected with 54% of the popular vote and the Congress was solidly Democratic. During his first year in office, Obama was facing a major recession resulting from the collapse in the housing market. The collapse was largely the result of a Democratic Party initiative to increase home-ownership by reducing credit standards and the greed of Wall Street in selling certain financial instruments to investors who relied upon financial ratings without doing their own due diligence. The explosion of derivative instruments and the misunderstanding of the concept of counter-party risk created a financial meltdown which began on Bush's watch but continued under Obama.

Rather than allowing capitalism to function and bring down those institutions which had made bad investment decisions, both the Bush and Obama administrations were complicit in bailing out those institutions because of their fear of systemic financial risk.

As a result, Obama's first year record was largely one of reacting to crises. Rather than living up to the "change and transparency" platforms of the campaign, much of the legislative agenda was done in secret and rammed through on straight party line votes resulting in a country further polarized.

Here are the major "accomplishments" of the Obama first year:

- ☐ Passed a $780 billion stimulus package
- ☐ Nationalized two major automobile companies
- ☐ Unemployment rate rose above 10% according to the MOT.
- ☐ The U.S. dollar index fell by 8.5%

- ☐ Passed a health care reform package that will be challenged on constitutional grounds
- ☐ Increased the military exposure in Afghanistan
- ☐ Presided over the largest federal deficit in history - $1.4 trillion
- ☐ Raised debt ceiling to over $12.1 trillion and needs to increase it again

## Concerns for 2010

As the nation moves into 2010, there are many concerns that I have that will create further problems for the country. The major one is that many of our politicians are lawyers that believe that they can just legislate problems away. Most important there does not appear to be any political will to reduce spending at any level.

As a result of their willingness to spend fiat dollars with the complicity of the Federal Reserve System (FED), the result could be a major erosion of the dollar's purchasing power coupled with an economy suffering either stagflation or hopefully not, hyper-inflation.

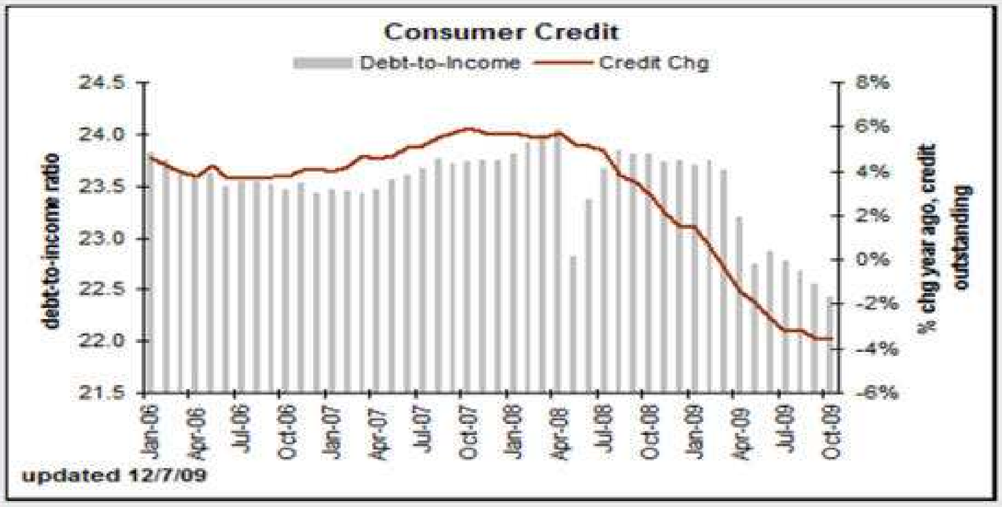
Low interest rates are just a transfer mechanism from savers to debtors. In effect, continued low interest rates hurt the savers and senior citizens of this country. For example, if capital normally receives a 5% long-term interest rate, a 3% rate is a hidden 2% tax that is being taxed at 100%. But like withholding, the person receiving the interest does not actually realize it. As foreign interests reduce their purchases of U.S. financial instruments, the spread between short-term rates which are dictated largely by the FED and longer-term rates should continue to increase.

As the TARP program shows as well as the Health Reform package, the current administration has embarked upon a program that will increase government oversight of the economy and raise taxes. Both of those measures will decrease the ability of U.S. business to compete world-wide.

As both the Bush and Obama administration failed to take advantage of the lower yield curve and increase the maturity schedule of U.S. notes outstanding, the U.S. Treasury is facing a huge refinancing requirement in 2010 as well as the financing requirement for the FY 2010 deficit. It might be as high as $3.5 to $4 trillion.

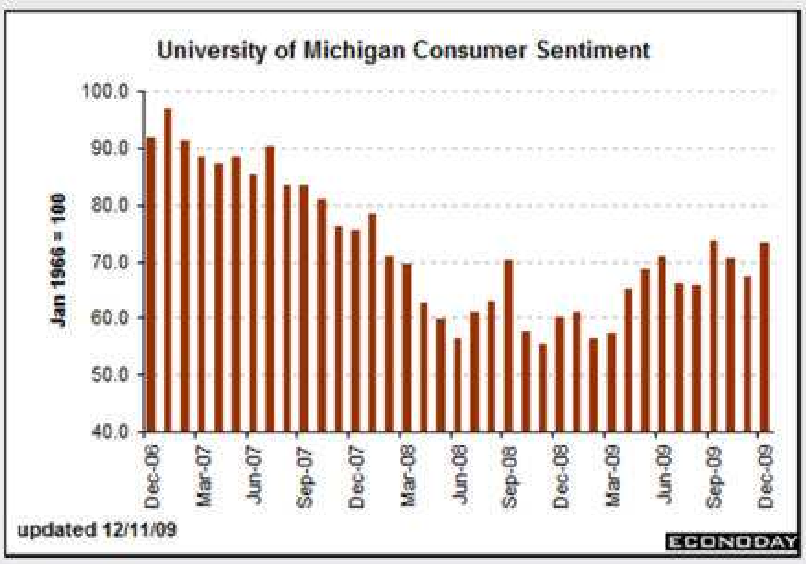
## The Consumer

The financial meltdown and the demise of the housing ATM machine may have changed the relationship of the consumer to the overall level of the economy. For most of the last 30 years, consumer spending was over 70% of GDP. As unemployment rose during this economic recession, the consumer has not only reduced credit card usage but has begun to increase savings. As a result, consumer spending is falling as a percentage of GDP and could result in a paradigm shift.



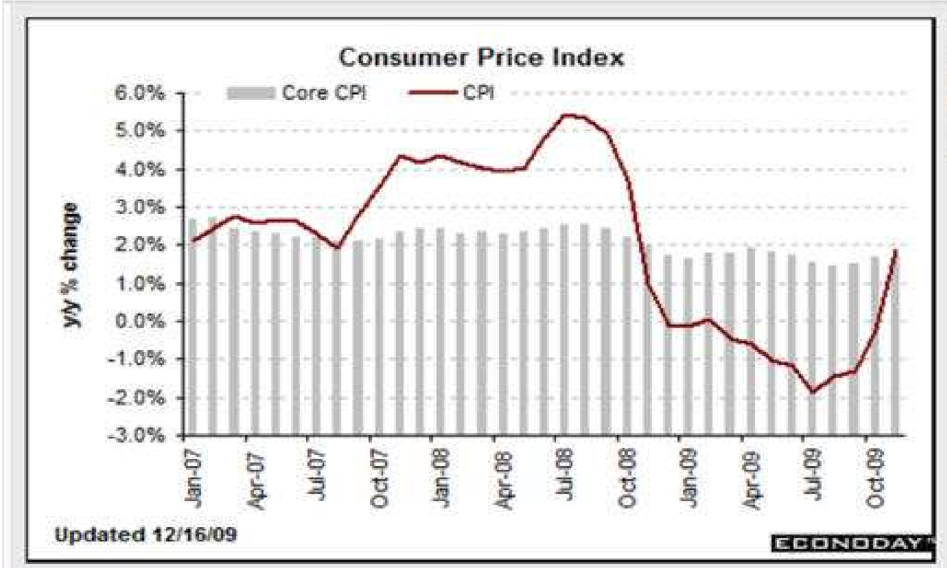
Data Source: Haver Analytics

Since the beginning of the financial meltdown, consumer confidence fell by almost 45% and since the middle of 2009 has failed to make any significant movement higher as shown in the following chart.



Data Source: Haver Analytics

The consumer is concerned with real increases in the cost of living. The MOT's methodology changes which have reduced reported inflation with the real cost of living is seeping into the public's consciousness. The difference in core versus total inflation as reported by the MOT is meaningless to the consumer. Yet even the reported CPI is beginning to show the effects of the governments printing machine as shown in the following chart.




*Data Source: Haver Analytics*

Even with the rate of new jobless claims decreasing, the consumer is reluctant to spend and the old cliché that the consumer is 70% of the economy may be in trouble. The shifting priorities which are evident are:

- ☐ Increased savings rate
- ☐ Decreasing volume of credit/debit cards
- ☐ Increased numbers of personal bankruptcies
- ☐ Increasing reliance upon the shadow economy and barter transactions

Those shifting priorities of the consumer will result not only in a reduction in GDP but will impact many other areas of the U.S. economy including:

- ☐ Lower retail sales taxes will impact state and local government budgets
- ☐ A reduction in GDP will increase unemployment benefits
- ☐ To compensate for rising unemployment benefit costs, states will raise unemployment taxes
- ☐ Lower sales taxes will further pressure state and local governments to raise property taxes which will further reduce the ability of consumers to meet be able to pay mortgages.

## The Housing Market

When Congress mandated the affordable housing program known as Community Reinvestment Act of 1994 (CRA), it merely expanded policies that began under Franklin Delano Roosevelt in the 1930 which saw Fannie Mae, Freddie Mac and Sallie Mae added to the mortgage financing arena. However, the 1994 CRA passed under the Clinton administration also set into motion unsound lending practices which eventually almost brought the financial system to its knees.

One of the main contributors to the financial meltdown was the securitization of mortgages and the "mark-to-make-believe" valuation techniques which allowed both sides to a derivative transaction report a profit. Now elementary accounting suggests that in the long run that is simply not possible. The rating agencies, of course, also had a conflict of interest as some of their major shareholders were the very investment institutions that were selling investors those "AAA" rated derivatives.

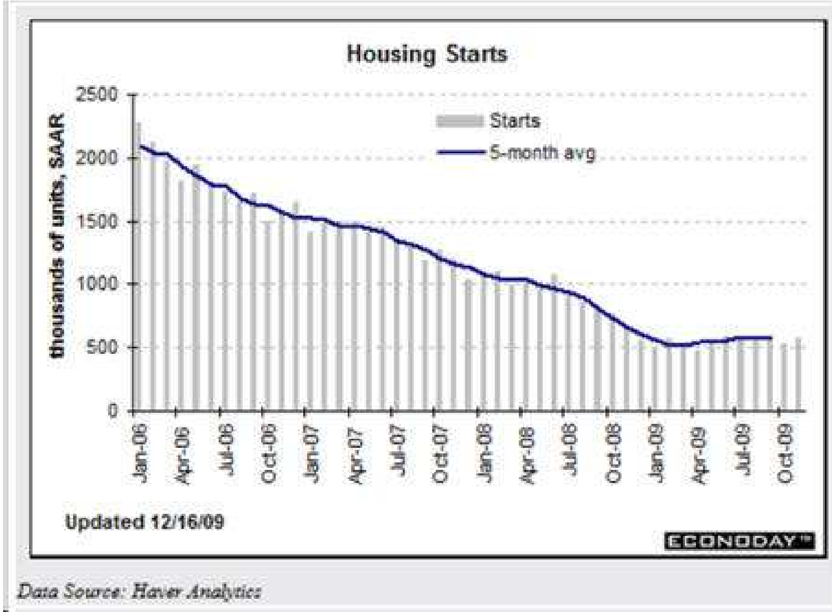
Investors were mesmerized by the "AAA" rating and failed to perform their own due-diligence. In fact, many of them were unable to even unravel the concept of counter-party risk.

So that brings us to a housing market today that some would have you believe has bottomed. However, I am not in that camp. Certainly, the first-time tax credit up to $8,500 helped moved some houses at the low end of the market. However, the following factors lead me to conclude that the housing market will be in the doldrums for some time.

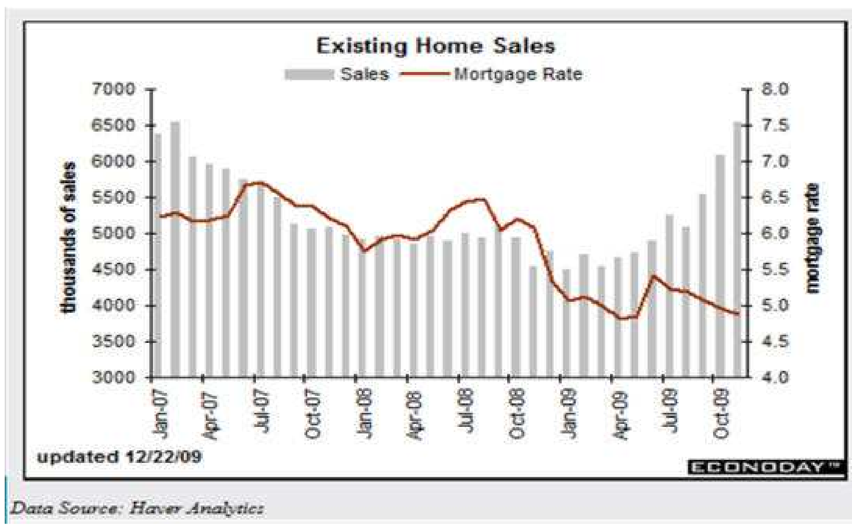
- ☐ Loan modifications unable to reduce foreclosure rates significantly as unemployment remains high
- ☐ Many foreclosures have been held in abatement because of state requirements
- ☐ Shadow home inventories held by banks continue to rise
- ☐ Home prices continue under pressure
- ☐ GSE's provide the majority of new mortgage issuance
- ☐ Many mortgages face interest rate resets in 2010

Despite the extension of the home tax buyer credit, the National Association of Home Builders Housing Market index continues to be weak.

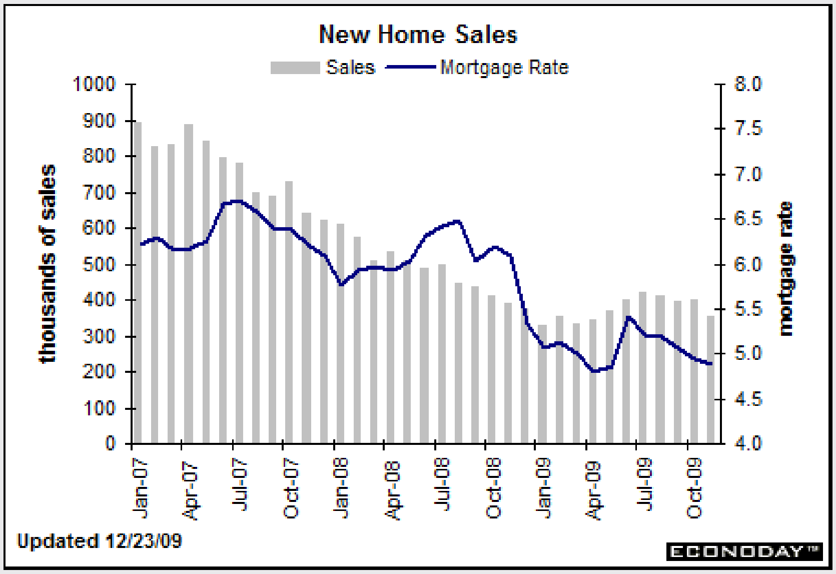

Housing starts appear to have leveled off at an annual rate of about 500,000 homes/year and that could very well be the new normal.




It would appear that existing home sales have benefited from both a declining interest rate and the first-time home buyer credit as November's rate reached the highest level this year. Inventory of existing homes fell to a 3-1/2 year low in November at 6.5 months.




New home sales, however, are not showing the same increases as existing home sales. Supply is about 7.9 months and rose in the latest month. It might be some time before home builders are able to increase production as credit lines remain tight.

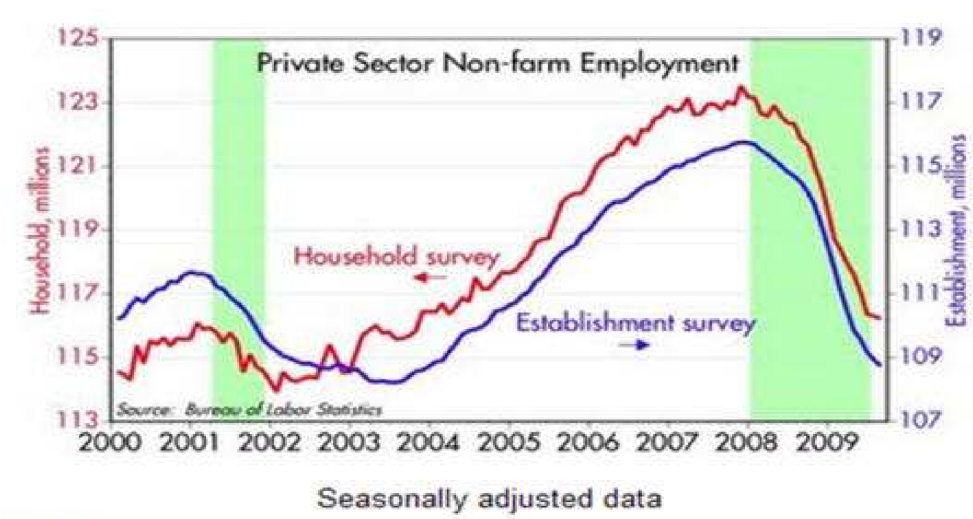



*Data Source: Haver Analytics*

It would appear that for the next few years, the new normal annual production rate for new homes will be about 500,000 to 550,000. If inventory of all homes drops to under 90 days then the market might be back to normal. The housing market is currently being helped by implied and/or real government subsidies.

## Production versus Globalization

The financial meltdown during the past two years has brought into focus the production/globalization debate again. During the last two years, non-farm employment has dropped by about 10 million jobs in the U.S. as shown in the following chart.




The cost of transferring jobs to low-wage countries has some politicians wondering about the benefits of various treaties that have enabled emerging countries to challenge the U.S. technical superiority as indicated below:

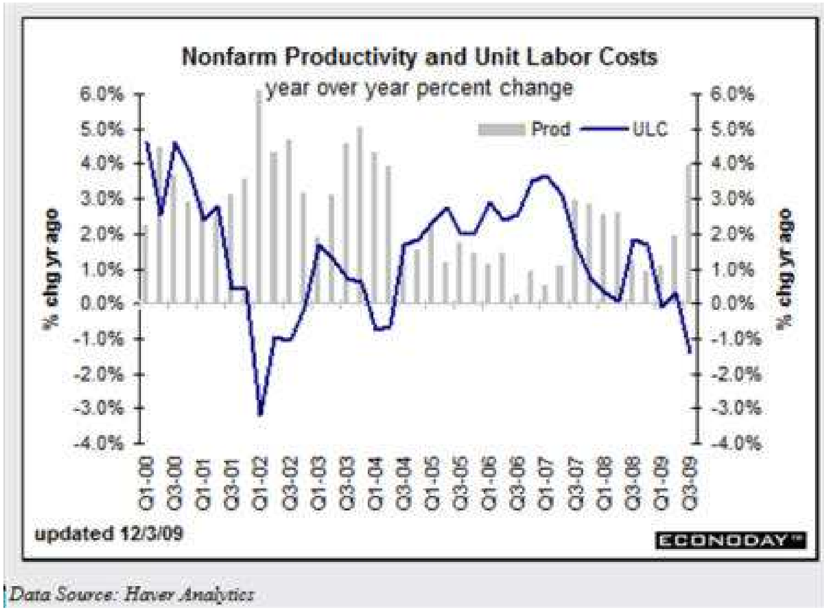
- Desire for cost savings builds foreign competition for U.S.
-

Technical knowledge interacts constantly with manufacturing skills to improve processes.

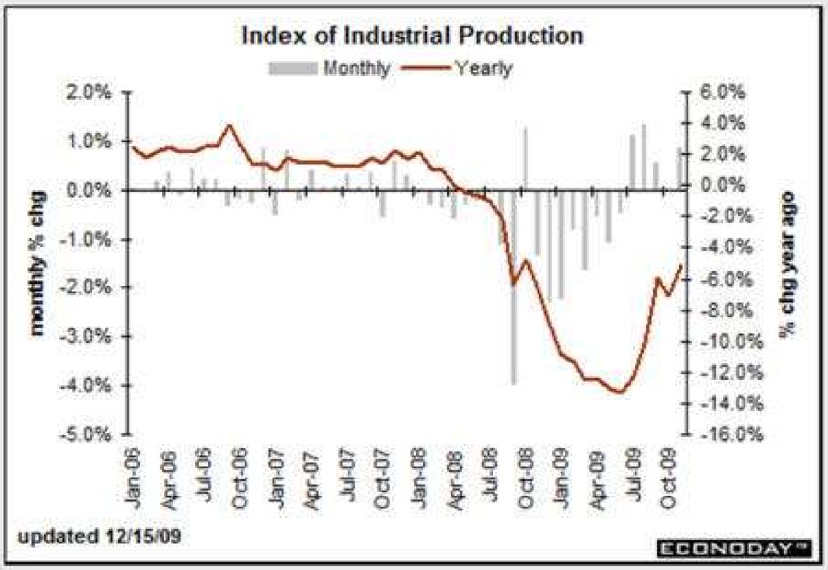
- Increases balance of payment deficits
- Countries with capital surpluses can purchase ownership interests and transfer intellectual property

The real outcome of the globalization movement has been a reduction in the technical superiority of the U.S. and a lowering of the standard of living for many of its citizens. Moreover, when there is an economic downturn, ownership tends to protect employment in the country where it is domiciled and makes layoffs in higher wage countries.

One result of the recent downturn has been an increase in non-farm productivity and a reduction in unit labor costs in the U.S. as companies have downsized and employees have become more efficient as shown in the following chart.



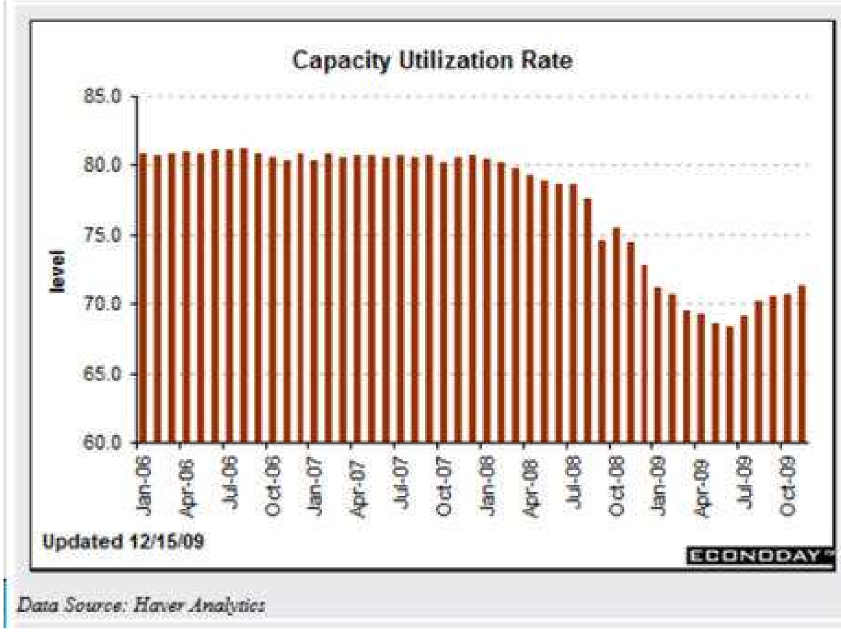

Industrial production remains about 6% below a year ago level although the capacity utilization rate is showing an increase from the bottom. Various measurements of the manufacturing economy like the Philadelphia Fed Survey and the Chicago Purchasing Managers index suggest that the depth of the downturn has been reached and the economy is now in a muddling-through phase.



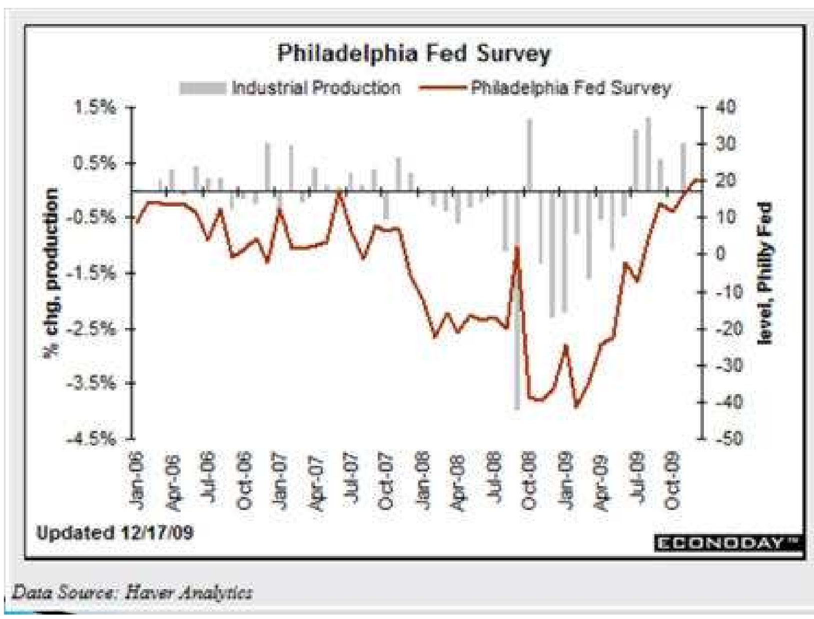

*Data Source: Haver Analytics*

| Released on | 2005 | Jun-09 | Jul-09 | Aug-09 | Sep-09 | Oct-09 | Nov-09 | Dec-09 |
|---|---|---|---|---|---|---|---|---|
| Released for | Proportions | May-09 | Jun-09 | Jul-09 | Aug-09 | Sep-09 | Oct-09 | Nov-09 |
| Industrial Production | 100.0% | -1.1% | -0.5% | 1.1% | 1.3% | 0.6% | 0.0% | 0.8% |
| Major Market Groups | | | | | | | | |
| Consumer goods | 29.7% | -1.0% | -0.6% | 1.0% | 1.4% | 1.0% | 0.1% | 0.3% |
| Business equipment | 10.2% | -2.1% | -0.4% | 1.0% | 1.3% | -0.3% | -0.3% | 0.4% |
| Construction Supplies | 4.5% | 0.2% | 0.0% | 0.5% | 0.5% | -1.3% | -1.5% | 1.6% |
| Major Industry Groups | | | | | | | | |
| Manufacturing (non-NAICS) | 76.4% | -0.9% | -0.4% | 1.6% | 1.4% | 0.8% | -0.2% | 1.1% |
| Durables (NAICS) | 42.9% | -2.1% | -0.8% | 3.4% | 1.3% | 1.1% | -0.6% | 1.0% |
| Nondurables (NAICS) | 33.5% | 0.2% | 0.0% | -0.2% | 1.5% | 0.4% | 0.2% | 1.1% |
| Mining (non-NAICS) | 9.8% | -1.1% | -1.5% | 1.2% | 1.7% | -0.1% | -0.2% | 2.1% |
| Utilities (non-NAICS) | 9.5% | -2.0% | -0.5% | -1.2% | 0.8% | 0.2% | 1.7% | -1.8% |
| Addendum | | | | | | | | |
| Selected High Tech Industries | 4.8% | -2.3% | 0.3% | 2.9% | 0.1% | -0.8% | 0.3% | 0.4% |
| Motor Vehicles and parts | 7.1% | -7.5% | -5.5% | 23.9% | 3.7% | 8.6% | -1.8% | 1.8% |
| Capacity utilization rate | NA | 68.5 | 68.3 | 69.1 | 70.1 | 70.6 | 70.6 | 71.3 |

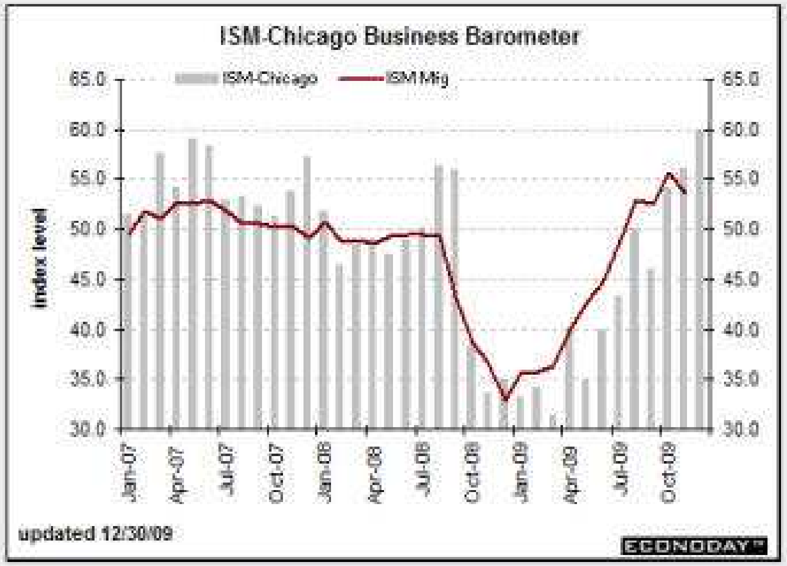
*Data Source: Haver Analytics*




Various measurements of the manufacturing economy like the Philadelphia Fed Survey and the Chicago Purchasing Managers index suggest that the depth of the downturn has been reached and the economy is now in a muddling-through phase.  The manufacturing economy continues to lose jobs and has fallen from over 40% of the economy in 1950 to under 15% today.




The latest data from the Midwest purchasing managers index, now called the ISM-Chicago Business Barometer, showed a sharp increase of nearly 4 points to 60, the highest reading in three years.

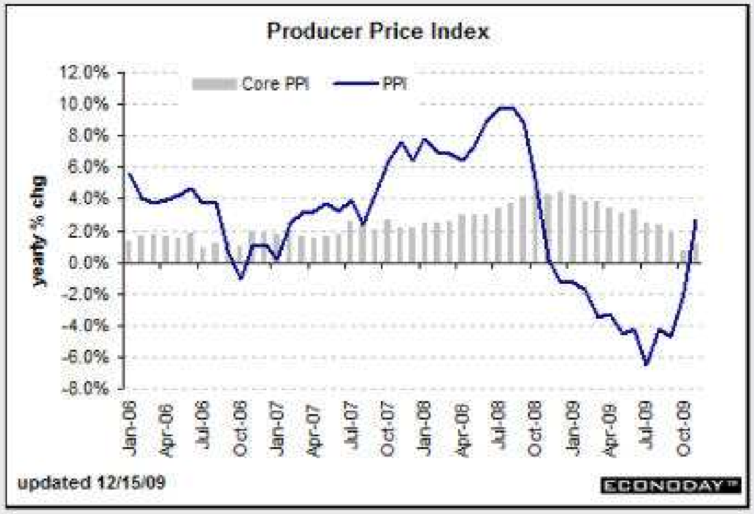



*Data Source: Haver Analytics*

The increase in business activity as seen in both the Philadelphia and Chicago surveys has raised the concerns over rising prices in the coming months. The Producer Price Index (PPI) thanks largely to rising commodity and energy prices jumped 1.8% in November 2009. However, every major category in November was higher.

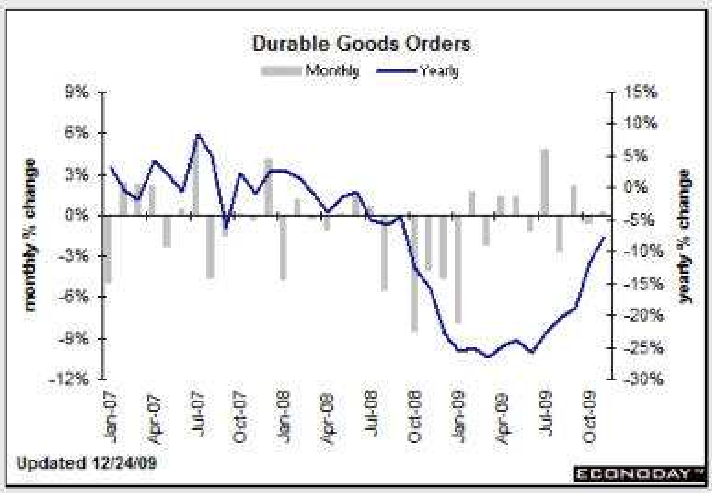
| | | data displayed as monthly percent change | | | | | |
|---|---|---|---|---|---|---|---|
| Released on | Relative | Jul-09 | Aug-09 | Sep-09 | Oct-09 | Nov-09 | Dec-09 |
| Released for | Importance | Jun-09 | Jul-09 | Aug-09 | Sep-09 | Oct-09 | Nov-09 |
| PPI, Finished Goods | 100.0 | 1.7 | -1.2 | 1.9 | -0.6 | 0.3 | 1.8 |
| Consumer goods | 75.3 | 2.2 | -1.4 | 2.5 | -0.7 | 0.6 | 2.3 |
| Food (consumer) | 20.2 | 1.1 | -1.5 | 0.3 | -0.1 | 1.6 | 0.5 |
| Energy | 20.1 | 6.6 | -3.8 | 8.6 | -2.4 | 1.6 | 6.9 |
| Nonfood, nonenergy (consumer) | 34.9 | 0.4 | -0.1 | 0.2 | -0.1 | -0.5 | 0.6 |
| Capital Equipment | 24.7 | 0.4 | -0.3 | 0.4 | -0.1 | -0.7 | 0.4 |
| PPI less food & energy | 59.7 | 0.4 | -0.2 | 0.3 | -0.1 | -0.6 | 0.5 |
| PPI, Intermediate goods | 100.0 | 1.1 | -0.4 | 1.9 | 0.2 | 0.3 | 1.4 |
| less food & energy | 75.1 | 0.2 | 0.2 | 0.5 | 0.9 | -0.2 | 0.3 |
| PPI, Crude Materials | 100.0 | 4.7 | -3.9 | 3.7 | -2.1 | 5.4 | 5.7 |
| less food & energy | 17.5 | 3.5 | 2.0 | 6.2 | 3.6 | 0.5 | -0.8 |

*Data Source: Haver Analytics*




*Data Source: Haver Analytics*

Durable goods orders have improved from the mid-year lows on a year/year basis but still remain negative for 2009. There does not appear to be a consistent improving trend in the data as shown in the table.




*Data Source: Haver Analytics*

| Released On: | Percent | Jul-09 | Aug-09 | Sep-09 | Oct-09 | Nov-09 | Dec-09 |
|---|---|---|---|---|---|---|---|
| Released For: | of Total | Jun-09 | Jul-09 | Aug-09 | Sep-09 | Oct-09 | Nov-09 |
| New Orders | 100.0% | -1.1% | 4.8% | -2.7% | 2.2% | -0.6% | 0.2% |
| less transportation | 75.5% | 2.6% | 0.9% | -0.5% | 2.1% | -0.7% | 2.0% |
| less defense | 94.2% | 0.8% | 4.3% | -2.7% | 2.0% | 0.6% | 0.0% |
| Industry Groups | | | | | | | |
| Primary metals | 7.7% | 12.2% | 3.3% | 1.2% | 2.8% | 4.0% | 1.4% |
| Fabricated Metals | 14.2% | 0.5% | 3.4% | 0.1% | 1.9% | 1.1% | 1.0% |
| Machinery | 13.5% | 4.6% | -7.7% | 1.3% | 8.5% | -7.0% | 3.5% |
| Computers & electronic prod | 15.2% | 1.5% | 1.6% | -1.6% | 0.7% | -1.9% | 3.7% |
| Electrical Equipment | 5.1% | 1.7% | 4.1% | -1.7% | -0.9% | 3.4% | 3.2% |
| Transportation | 24.5% | -11.9% | 17.8% | -8.9% | 2.7% | -0.2% | -5.5% |
| Unfilled Orders | NA | -0.8% | -0.1% | -0.4% | -0.4% | -0.6% | -0.7% |

*Data Source: Haver Analytics*

The extent of the automotive industry shrinkage has been striking despite the government takeover of GM and the cash infusions to the industry and its financing arms like GMAC. The following table from Ward's shows clearly the decline. Only Hyundai and Kia, two Korean car manufacturers, and Subaru, a Japanese manufacturer, are showing sales increases in the first eleven months of 2009 over a year ago.

**WARD'S U.S. Light Vehicle Sales by Company**

| | Month | | | | | Calendar Year-to-Date | | |
|---|---|---|---|---|---|---|---|---|
| | November | | % Share | | DSR. | January - November | | Vol. |
| | 2009 | 2008 | Current | Year-Ago | % Chg. | 2009 | 2008 | % Chg. |
| Chrysler | 62,992 | 84,850 | 8.5 | 11.4 | -19.3 | 840,909 | 1,358,409 | -38.1 |
| Ford | 121,334 | 120,333 | 16.3 | 16.2 | 9.6 | 1,475,528 | 1,806,346 | -18.3 |
| GM | 150,705 | 153,453 | 20.2 | 20.6 | 6.7 | 1,864,661 | 2,735,763 | -31.8 |
| International (Navistar) | 33 | 13 | 0.0 | 0.0 | 175.9 | 245 | 699 | -64.9 |
| **North America Total** | **335,064** | **358,649** | **45.0** | **48.2** | **1.5** | **4,181,343** | **5,901,217** | **-29.1** |
| Honda | 74,003 | 76,233 | 9.9 | 10.3 | 5.5 | 1,043,641 | 1,342,680 | -22.3 |
| Hyundai | 28,047 | 19,221 | 3.8 | 2.6 | 58.6 | 401,267 | 377,705 | 6.2 |
| Isuzu | 132 | 253 | 0.0 | 0.0 | -43.3 | 1,501 | 6,907 | -78.3 |
| Kia | 17,955 | 15,182 | 2.4 | 2.0 | 28.5 | 279,015 | 258,753 | 7.8 |
| Mazda | 14,255 | 14,134 | 1.9 | 1.9 | 9.6 | 189,512 | 245,984 | -23.0 |
| Mitsubishi | 2,925 | 5,096 | 0.4 | 0.7 | -37.6 | 49,631 | 92,687 | -46.5 |
| Nissan | 56,288 | 46,617 | 7.6 | 6.3 | 31.2 | 696,699 | 889,338 | -21.7 |
| Subaru | 16,988 | 13,706 | 2.3 | 1.8 | 34.7 | 193,578 | 170,412 | 13.6 |
| Suzuki | 1,540 | 3,216 | 0.2 | 0.4 | -48.0 | 36,810 | 81,215 | -54.7 |
| Tata | 3,319 | 2,755 | 0.4 | 0.4 | 30.9 | 33,420 | 40,910 | -18.3 |
| Toyota | 133,700 | 130,309 | 18.0 | 17.5 | 11.5 | 1,582,289 | 2,075,713 | -23.8 |
| **Asia Total** | **349,152** | **326,722** | **46.9** | **43.9** | **16.2** | **4,507,363** | **5,582,304** | **-19.3** |
| BMW | 18,272 | 19,762 | 2.5 | 2.7 | 0.5 | 218,110 | 281,564 | -22.5 |
| Daimler | 17,495 | 16,012 | 2.3 | 2.2 | 18.8 | 184,477 | 228,855 | -19.4 |
| Porsche | 1,626 | 1,378 | 0.2 | 0.2 | 28.3 | 17,578 | 23,881 | -26.4 |
| Volkswagen | 23,060 | 21,083 | 3.1 | 2.8 | 18.9 | 266,753 | 285,600 | -6.6 |
| **Europe Total** | **60,453** | **58,235** | **8.1** | **7.8** | **12.8** | **686,918** | **819,900** | **-16.2** |
| **Total Light Vehicles** | **744,669** | **743,606** | **100.0** | **100.0** | **8.9** | **9,375,624** | **12,303,421** | **-23.8** |

Light vehicles are cars and light trucks (GVW Classes 1-3, under 14,001 lbs.). DSR is daily sales rate.
Source: Ward's AutoInfoBank

As corporations sought to reduce costs, one way of evaluating the health of the economy is to measure container traffic units (TEU's). The following charts of traffic at Long Beach, California, the largest container port in the U.S. shows the extent of the decline.

## 5-Year Comparison

| Five-Year Cargo Statistics | | | | | |
|---|---|---|---|---|---|
| | **2004** | **2005** | **2006** | **2007** | **2008** |
| **Volume in Metric Tons** | 73.6 million | 80.7 million | 85 million | 87 million | 80 million |
| **Value in U.S. Dollars** | $92 billion | $105.4 billion | $140 billion | N/A | N/A |
| **Containers in TEUs*** | 5,779,852 | 6,709,818 | 7,290,365 | 7,312,465 | 6,487,816 |

*TEUs: Twenty-foot-equivalent units
*Calendar year (Jan. thru Dec.)

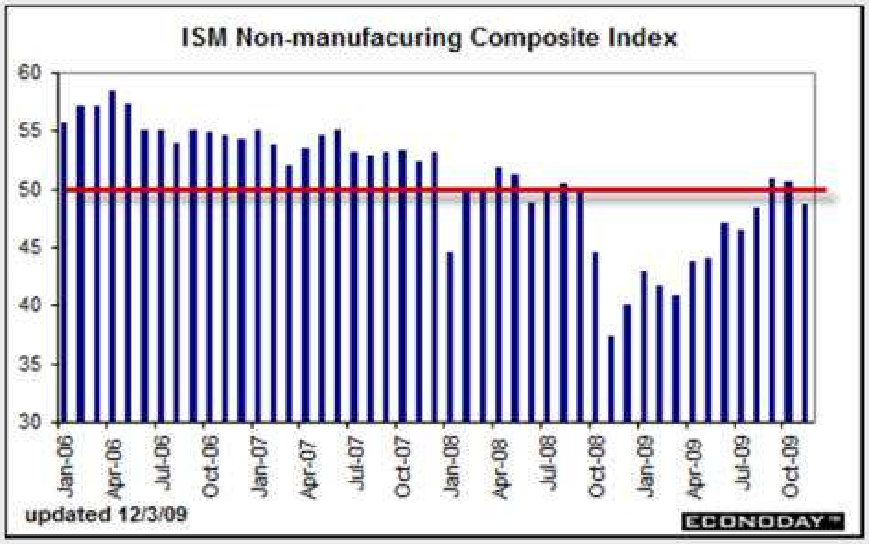
*(Source: POLB & US Dept. of Commerce)*

### Port of Long Beach
**Latest Month**
**Container Trade in TEUs***

| | November | | | Fiscal Year to Date*** | | |
|---|---|---|---|---|---|---|
| | **2009*** ** | **2008** | **%Change** | **2009*** ** | **2008** | **%Change** |
| **Loaded Inbound** | 228,347 | 267,840 | -14.7% | 455,411 | 560,296 | -18.7% |
| **Loaded Outbound** | 114,283 | 109,850 | 4.0% | 233,477 | 242,371 | -3.7% |
| **Empties** | 105,521 | 179,769 | -41.3% | 211,681 | 349,981 | -39.5% |
| **TOTAL (T.E.U.)** | 448,151 | 557,459 | -19.6% | 900,569 | 1,152,648 | -21.9% |

*TEUs: 20-foot equivalent units or 20-foot-long cargo container
**Preliminary estimate
The size of cargo containers range from 20 feet long to more than 50 feet long.
The international measure is the smallest box, the 20-footer or 20-foot-equivalent unit (TEU).
*** Fiscal Year = Oct. 1 through Sep. 30.

As manufacturing moved off-shore, the U.S. has moved to a service-oriented and technology based economy. The financial meltdown affected jobs there also and as the chart shows, the service sector is still struggling although it has moved off the bottom.



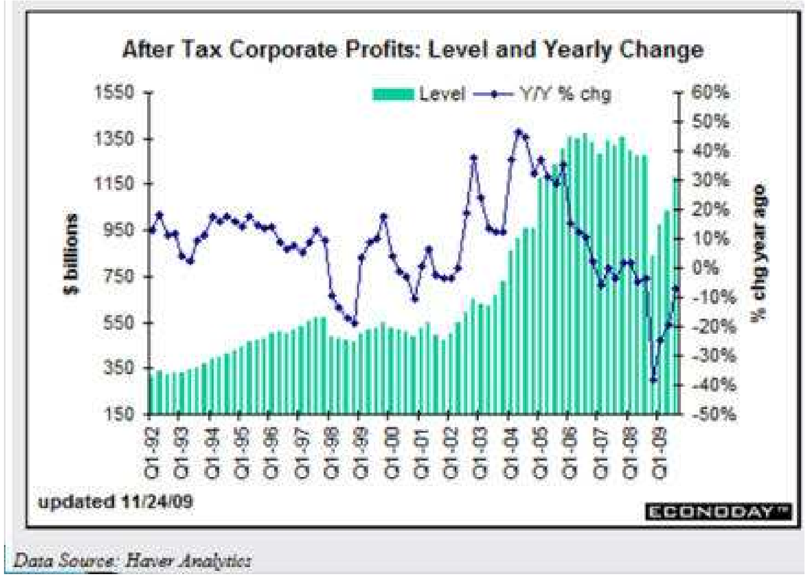
Data Source: Haver Analytics

## When will the downturn end?

The economy appears to have bottomed but the question remains about the type of recovery that will develop. However, most of the upturn has occurred through the massive infusion of funds via the Federal Reserve System and its quantitative easing policy that has poured trillions into the banking system. The FED is now in the process of winding down its quantitative easing policy and the result will be a draining of liquidity in the system.

Some analysts point to a rebound in corporate profits as proof that the economy is doing better. However, they fail to mention that changes in accounting practices account for much of the improvement. For most companies, top line revenue growth remains limited or below levels of previous years when adjusted for inflation. In fact, almost all of the increase in reported profits by financial institutions in 2009 will occur as a result of changes in accounting practices.

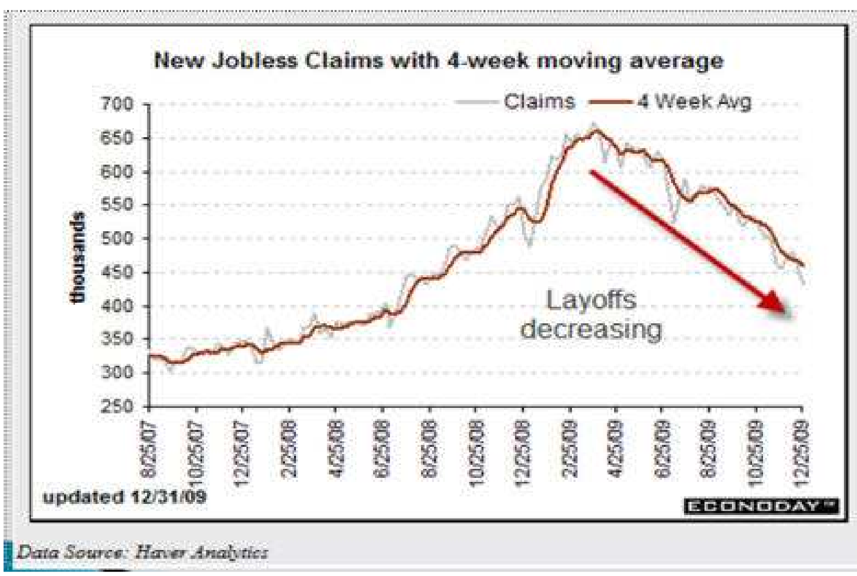
Nevertheless, corporate profits as reported by the MOT have shown an increase in each of the last three quarters as shown in the following chart although the preliminary estimates have been reduced with each revision.




FASB changes, cost cutting measures are only short-term fixes. The economy will not be on the mend until employment increases significantly and real revenue growth occurs.

## The Employment Situation

The new jobless claims rate has fallen from about 650,000 per week in the 1st quarter of 2009 to about 450,000 per week in December. The question is whether this is a sign of an improving job market or that corporations have cut staff as far as economically feasible. The current level is still about 50% higher than the average level in the 2000-2007 period. The productivity data shown above would suggest that many workers have improved their efficiency as they have become fearful of being laid off.



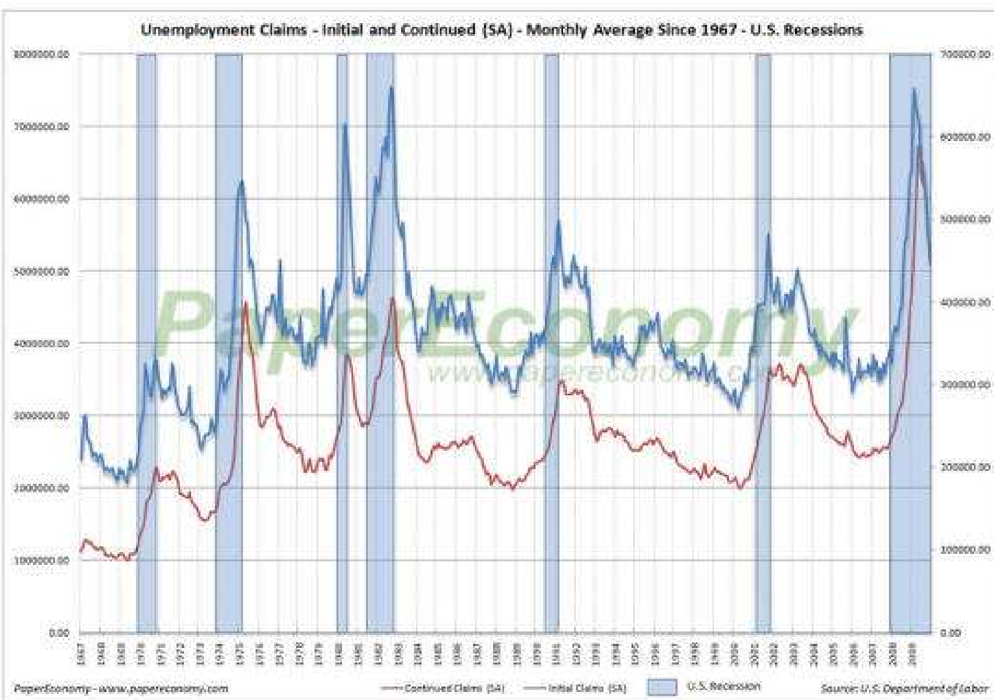

Through November 2009, the Bureau of Labor Statistics has reported that on a seasonally-adjusted basis, the household data survey indicated that about 4.836 million jobs were lost in the U.S. However, the birth/death adjustment added over 823,000 jobs through as a "fudge" factor. An analysis of those added jobs would suggest that most were pure fiction.

| 2009 Household Data | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Employment, S.A. | 142099 | 141748 | 140887 | 141007 | 140570 | 140196 | 140041 | 139649 | 138864 | 138275 | 138502 | | |
| Change from Previous Month | -1239 | -351 | -861 | 120 | -437 | -374 | -155 | -392 | -785 | -589 | 227 | | -4836 |
| YTD Change | -1239 | -1590 | -2451 | -2331 | -2768 | -3142 | -3297 | -3689 | -4474 | -5063 | -4836 | | |
| Birth/Death Adjustment | -356 | 134 | 114 | 226 | 220 | 185 | 32 | 118 | 34 | 86 | 30 | | 823 |
| YTD Change | -356 | -222 | -108 | 118 | 338 | 523 | 555 | 673 | 707 | 793 | 823 | | -17% |

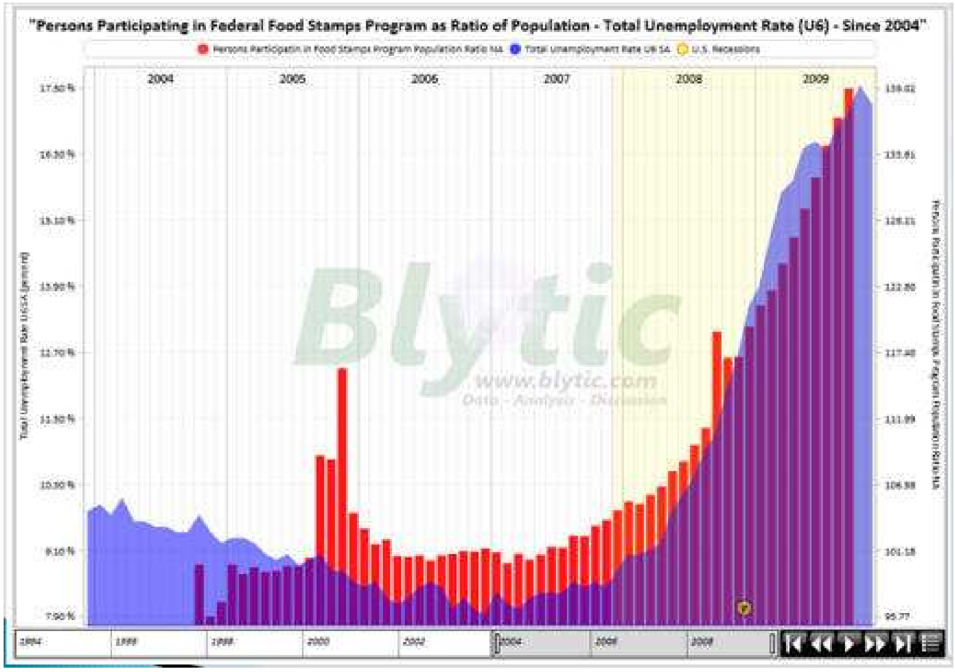
Source: BLS Employment Reports
Table A-1. Employment status of the civilian population by sex and age.

The Obama $780 billion stimulus package was rushed through Congress to prevent the official U3 unemployment rate from exceeding 8%. The FED's stress tests were also based upon the premise that U3 unemployment would not exceed 8%. With the U3 unemployment level now at 10%, one has to wonder about the credibility of those that were so eager to pass the $780 billion package.

Since the middle of 2008, the number of individuals receiving continuing unemployment benefits, federal extended benefits and federal EUC 2008 payments is now about 10 million. The following chart shows a comparison of the relationship between initial and continuing jobless claims from the Ministry of Truth. The recent downturn does not show the number of people receiving extended benefits which brings the total to over 10 million as of December 2009.



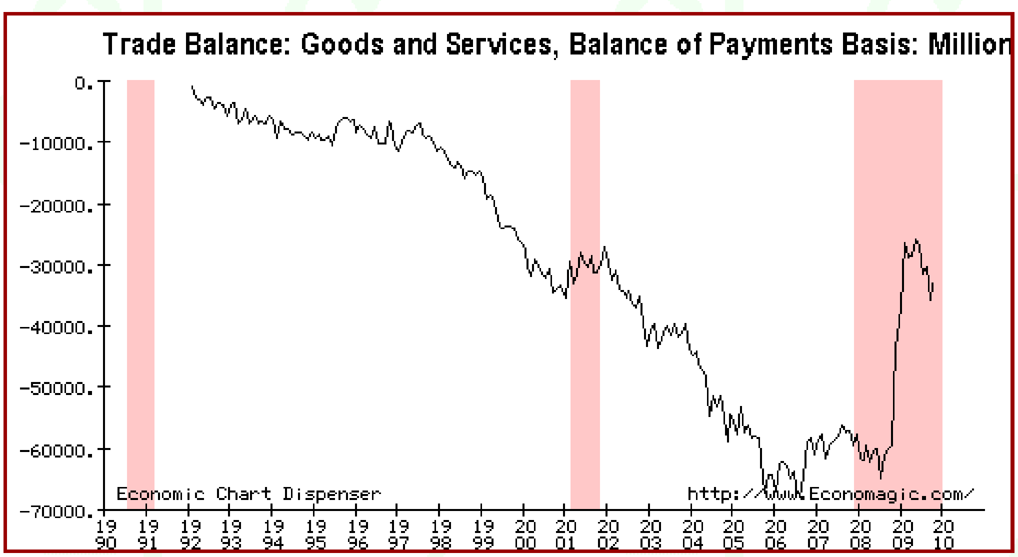

Unfortunately, the real unemployment rate is about 22% and not 10% as was shown in the ShadowStats.com example at the beginning of this Outlook 2010. Another way of looking at the real unemployment and/or under employment rate is to look at the accelerating number of individuals receiving food stamps in the U.S. as shown in the following chart. It is amazing how close is the correlation between the SGS alternate rate and the number receiving food stamps.




With a loss of over 10 million jobs in the U.S. during the past two years and a population that adds about 235,000 people to the work-force each month, it would appear that the economy will have a difficult time of absorbing all that excess labor in the near future.

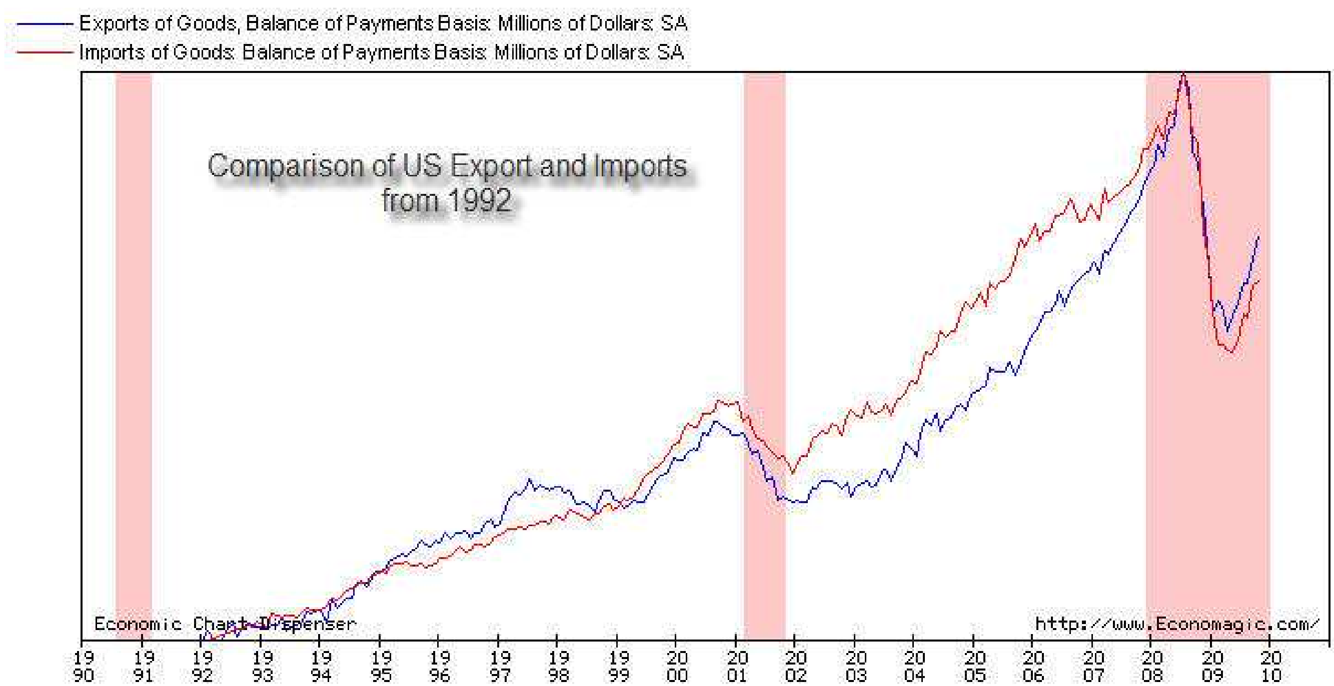
## International Trade

During 2009, the international trade deficit shows an improvement as the meltdown continued largely as a result of declining imports and crude oil prices falling from $140/barrel to the $40 level. As crude oil moved higher into the $70-$80 range, the trade deficit grew as shown in the following chart.




The following chart compares the export and import of goods on a balance of payments basis since

1992.




With the U.S. dollar index falling from a high of $122 in January 2001 to a low of $70 in 2008 and back to $80 at the end of 2009, it should be apparent that the lack of manufacturing probably has a significant role in the trade deficit than most economists believe.

## Lifting the Rug

The Clinton, GW Bush and Obama Administrations have been unable to solve the systemic risk problem which arose from the housing sector melt-down caused by politicians demanding that credit standards be reduced and that the Glass Steagall Act be repealed. As a result, the crisis was handled by changing accounting standards, throwing massive taxpayer funding at failed institutions via either the FED and/or Treasury. By helping out their major political contributors, the politicians were able to keep the money flowing into their election campaigns.

Unfortunately, the concept of moral hazard to the nation was thrown to the wolves and the sub-prime fallout began to increase in intensity. Since late 2006, the ml-implode.com website chronicled the demise of 374 major U.S. lending operations. In 2009, the Federal Deposit Insurance Corporation (FDIC) closed 140 financial institutions and wiped out all of its capital reserves.

By the end of 2009, the financial meltdown had moved beyond just the housing sector. A partial list of sectors showing signs of strain are:

- ☐ CDO's
- ☐ ABCP
- ☐ ALT-A
- ☐ Hedge Funds
- ☐ Money Funds
- ☐ Auction-Rate Securities
- ☐ Commercial Paper

- ☐ Corporate Bonds/Junk Bonds
- ☐ Municipal Repo's
- ☐ Local, Quasi-Government (Special Taxing Districts) and State bonds
- ☐ Treasury obligations/GSE financing
- ☐ Sovereign Financial Instruments

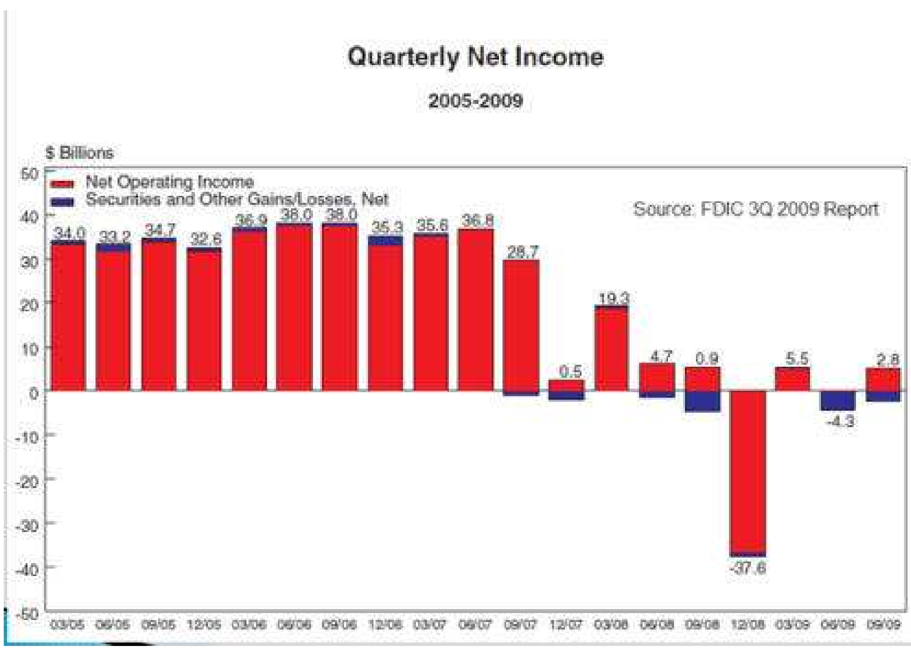
The question has now become where will the carnage stop?

## The FDIC problem

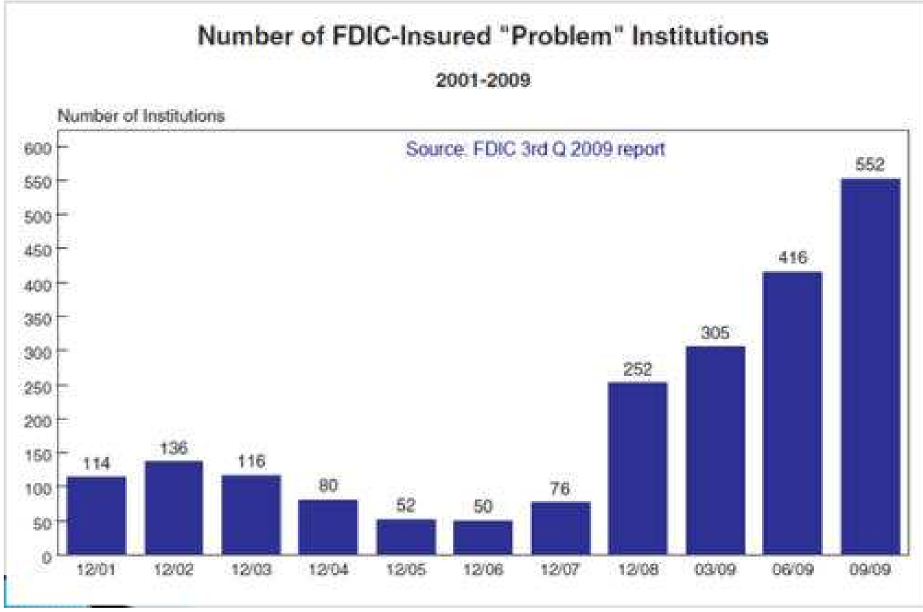
To calm the financial market as money funds "broke a buck", in 2007, the FDIC temporarily raised its deposit guarantee limit from $100,000 per account to $250,000. Many bank depositors were lulled into a state of complacency about the safety of their deposits. One little noted aspect of the act was a loan guarantee program that backed another $304 billion in promissory notes, commercial paper and other debt instruments of financial institutions.

In effect, the temporary guarantee of the FDIC added another $5 trillion to the $9.8 trillion in stated cash debt to the U.S. taxpayers obligations. Thanks to the temporary status of the raised guarantee, the FDIC did not have to increase its capital base. It was another case of the federal government using accounting techniques that got Enron executives jail terms.

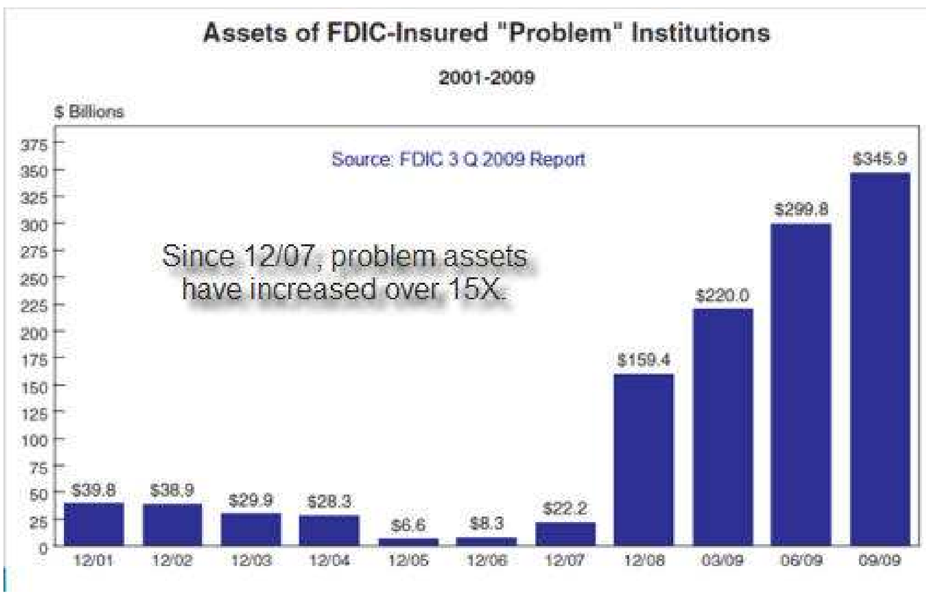
The FDIC was able to obtain from the U.S. Treasury a commitment for $500 billion in 2009 to backstop its guarantee to depositors. If you can believe the FDIC 3rd Quarter report, the strain to the financial system has been enormous. The following chart of profit and loss clearly shows the situation but remember that the data is really worse thanks to the beneficial FASB changes in the first quarter of 2009.



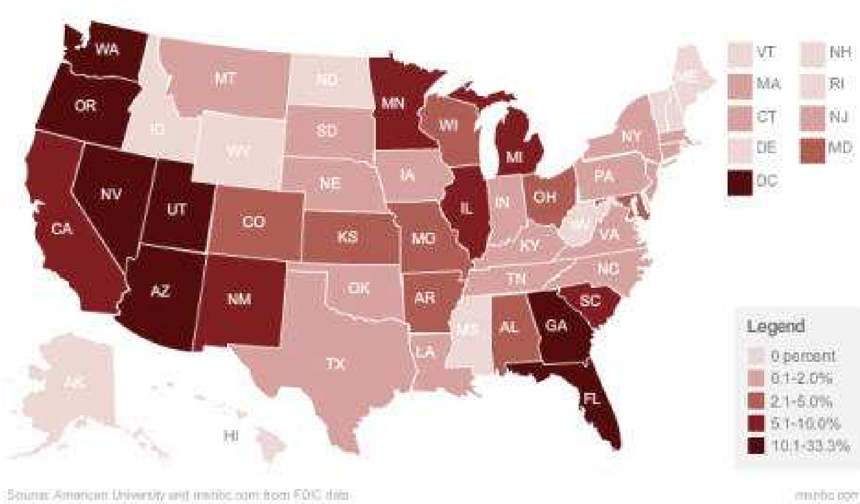

The number of problem institutions as defined by the FDIC has increased from 76 at the end of 2007 to 552 as of September 2009.



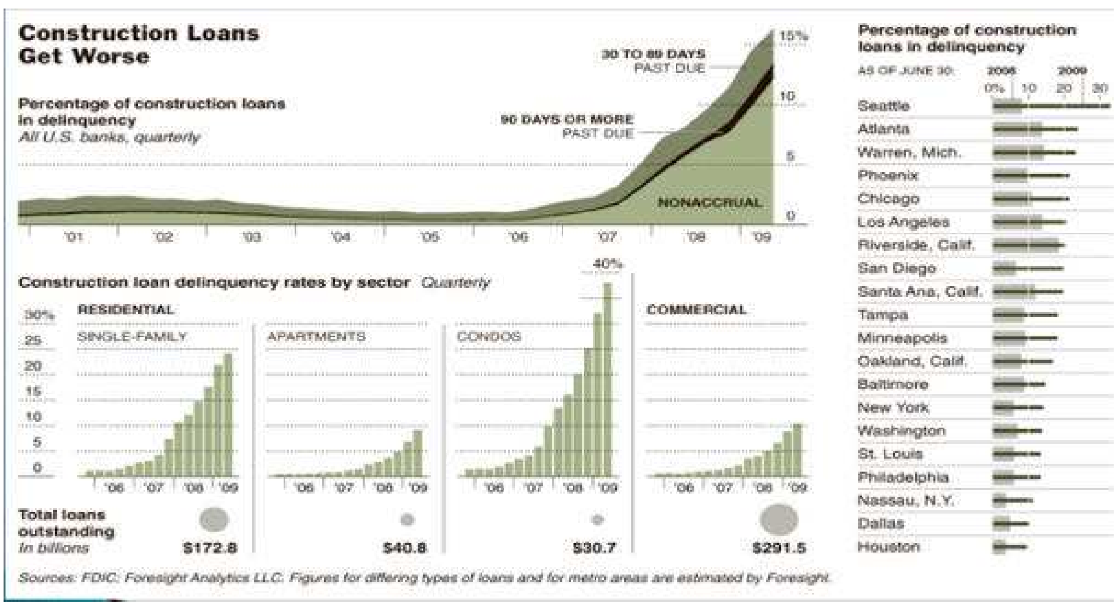

While the almost 8-fold increase is frightening, it is not as bad as the increase in assets of those problem institutions as shown in the following chart.



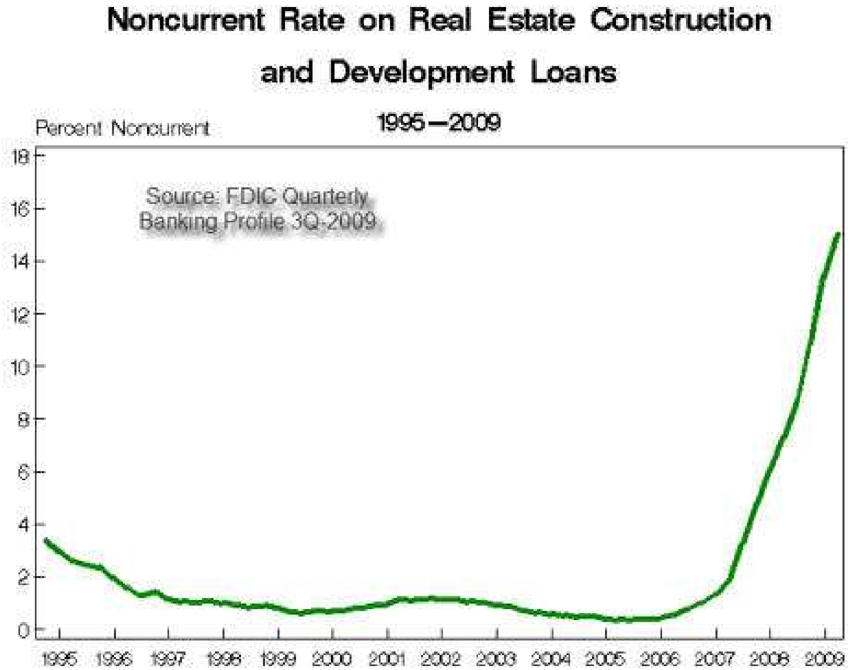

The distribution of trouble banks at the end of the 3Q 2009 is shown in the following chart.




The problems facing most of the non-money center banks at the end of 2009 are the delinquent construction and commercial real estate loans. Delinquency rates on construction loans are increasing as shown in the following chart.



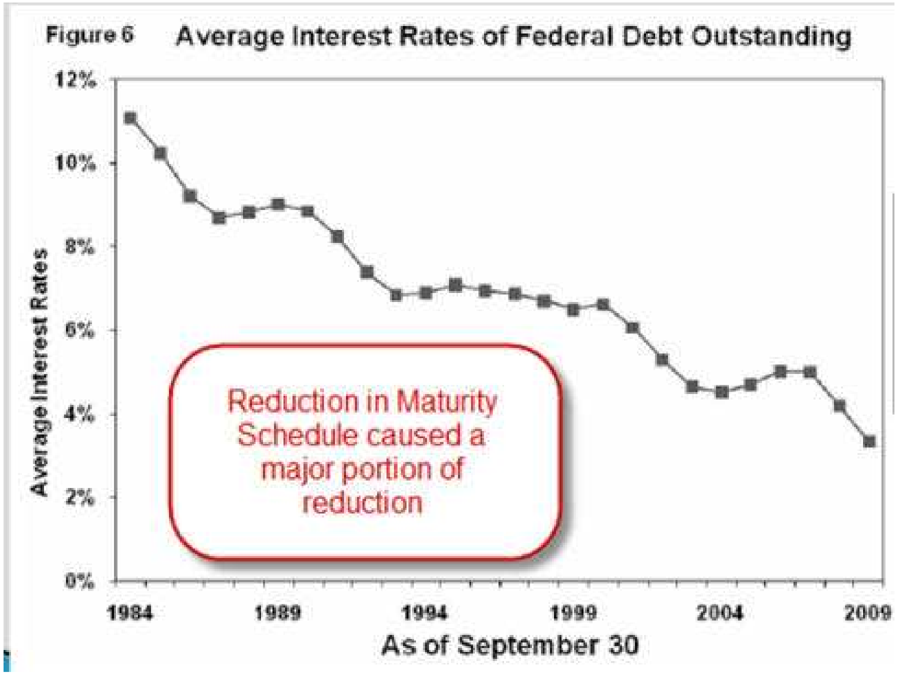

Two weeks ago, at a financial conference in San Francisco, an Assistant Secretary of the Treasury acknowledged that "extend and pretend" loans existed and were needed to prevent recognition of the real problems facing many small and regional banks. The following chart illustrates the explosive growth of non-current loans in the real estate construction and development loan portfolio. In the fourth quarter and going forward, it should be expected that the delinquency rate will increase as credit standards have tightened and prices have tumbled.



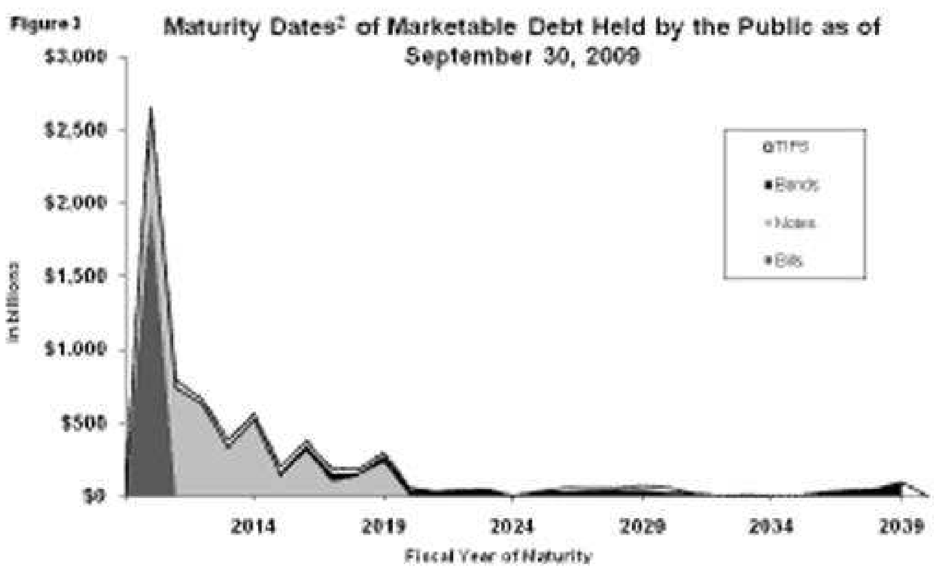

Despite all the strain on the system, the FDIC required its banking institutions to pay special assessments to keep the system afloat including paying 3 years forward in December 2009. The three card Monte game at the end of the year was just another attempt to reduce the financing requirements of the U.S. Treasury in 2010.

## The U.S. Treasury nightmare

Over the last fifteen years, the U.S. Treasury has made a series of miscalculations that have now returned to create a major problem. It has taken advantage of the FED's reduction in the discount rate to shorten the maturity curve of its outstanding debt. The following chart shows the reduction in the Treasury average interest rate from 1984 to the present. Rather than taking advantage of low long-term rates during the past few years, the U.S. opted to continue a policy of borrowing short to reduce immediate budget deficits as the maturity schedule dropped.

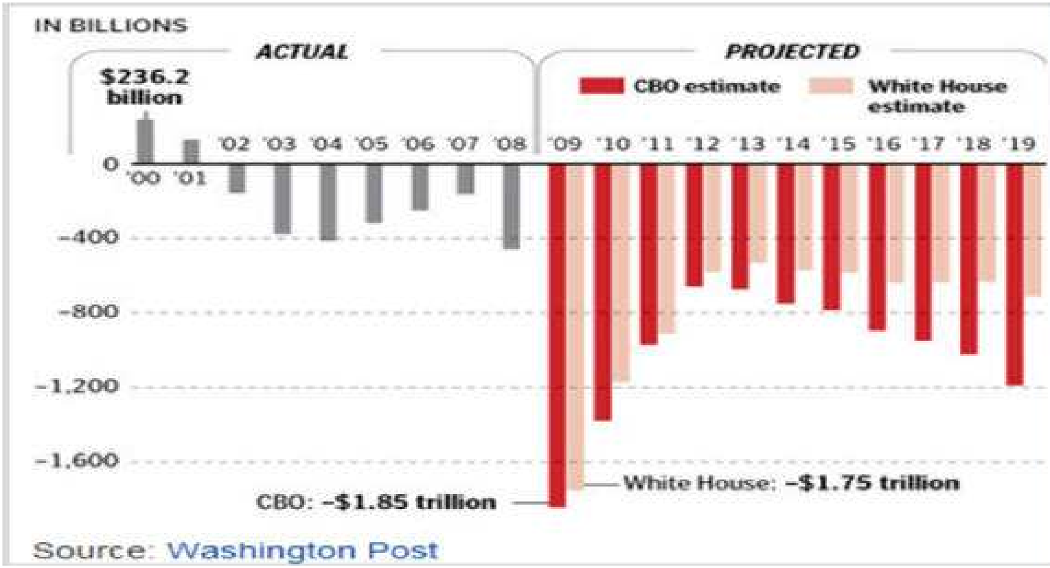



As a result the maturity schedule has now caused a major problem for the Treasury as shown in the following chart.

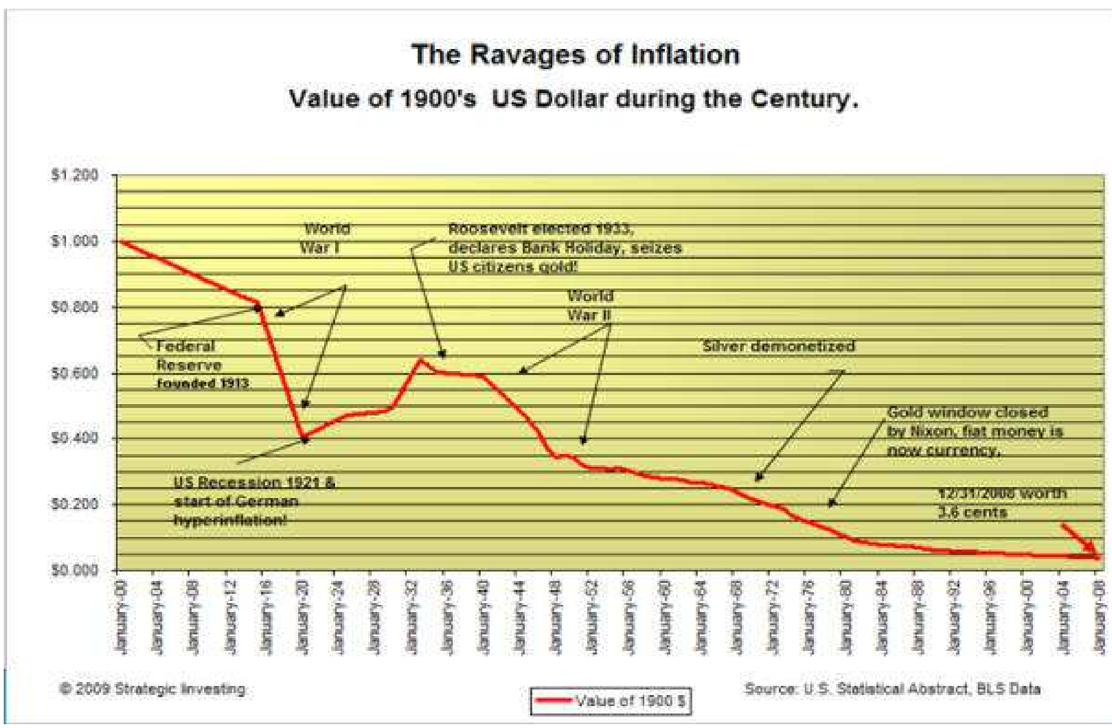



In 2010, it is facing the difficult task of not only refinancing about $2.5 trillion of maturing debt but also another record deficit. In total, the U.S. Treasury could be looking at raising from $3 to $4 trillion in Fiscal 2010.

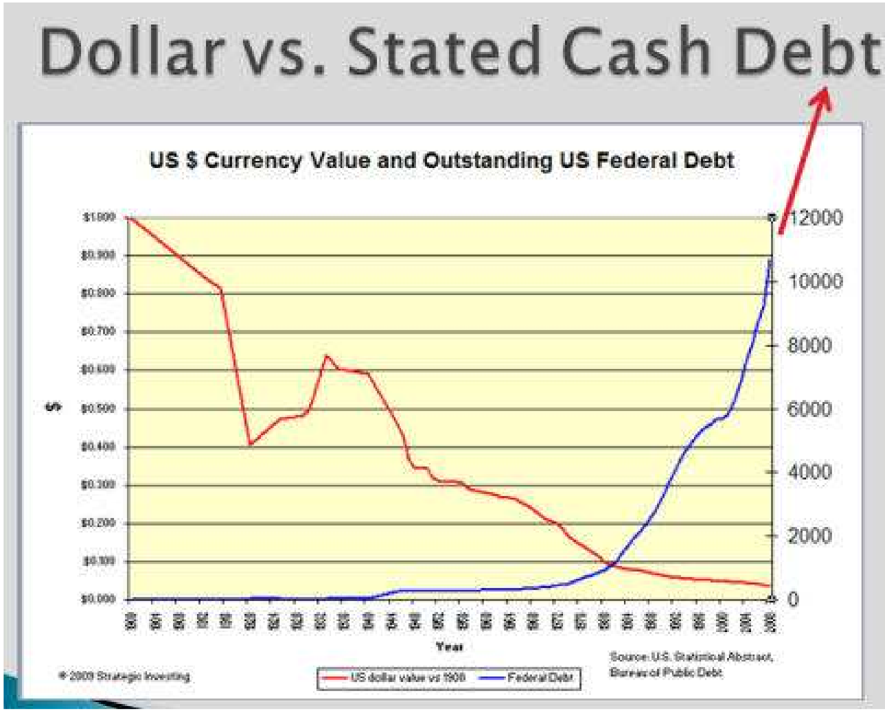
If the health care reform bill passes, the following estimates of U.S. Treasury deficits as of September 2009 is sure to be understated despite all assurances that health care reform will save money.




Rather than repudiating the debt, the policies of both parties continues to pay lip-service to fiscal restraint and continue an unrestrained spending spree aimed at staying in power. As a result, the decisions of the U.S. Treasury and the FED based upon Keynesian economics has eroded the purchasing power of the U.S. currency and is now threatening to significantly reduce, if not destroy, the purchasing power of the U.S. dollar. The following chart tracks purchasing power since 1900.




It is interesting to look at the inverse relationship between the U.S. dollar and the growth of the stated cash debt of the U.S. as shown below:




The inability to reduce spending to meet revenue has now brought the U.S. sovereign debt position to a critical point where the tremendous financing requirement coupled with a burgeoning deficit could well create a failure of a Treasury auction in the near future.

The U.S. Treasury prepares the following schedule augmented by information supplied by Shadow Government Statistics which clearly shows that any rationale analysis of the data would indicate that the U.S. has gone beyond the point of no-return unless draconian measures are taken. As a result, the federal government is essentially bankrupt and the "full faith and credit" of the U.S. is worthless.

U.S. Government - Alternate Fiscal Deficit and Debt
Reported by U.S. Treasury

Dollars are in either billions or trillions, as indicated.
Sources: U.S. Treasury, Shadow Government Statistics.

| Fiscal Year(1) | Formal Cash-Based Deficit ($Bil) | GAAP Ex-SS Etc. Deficit ($Bil) | GAAP With SS Etc. Deficit ($Tril) | GAAP Federal Negative Net Worth ($Tril) | Gross Federal Debt ($Tril) | Total(2) Federal Obligations (GAAP) ($Tril) |
|---|---|---|---|---|---|---|
| 2009(3) | $1,409.0 | $2,800.0 | $8.8 | $68.1 | $11.9 | $74.6 |
| 2008 | 454.8 | 1,009.1 | 5.1 | 59.3 | 1c0.0 | 65.5 |
| 2007 | 162.8 | 275.5 | 1.2(4) | 54.3 | 9.0 | 59.8 |
| 2006 | 248.2 | 449.5 | 4.6 | 53.1 | 8.5 | 58.2 |
| 2005 | 318.5 | 760.2 | 3.5 | 48.5 | 7.9 | 53.3 |
| 2004 | 412.3 | 615.6 | 11.0(5) | 45.0 | 7.4 | 49.5 |
| 2003 | 374.8 | 667.6 | 3.0 | 34.0 | 6.8 | 39.1 |
| 2002 | 157.8 | 364.5 | 1.5 | 31.0 | 6.2 | 35.4 |

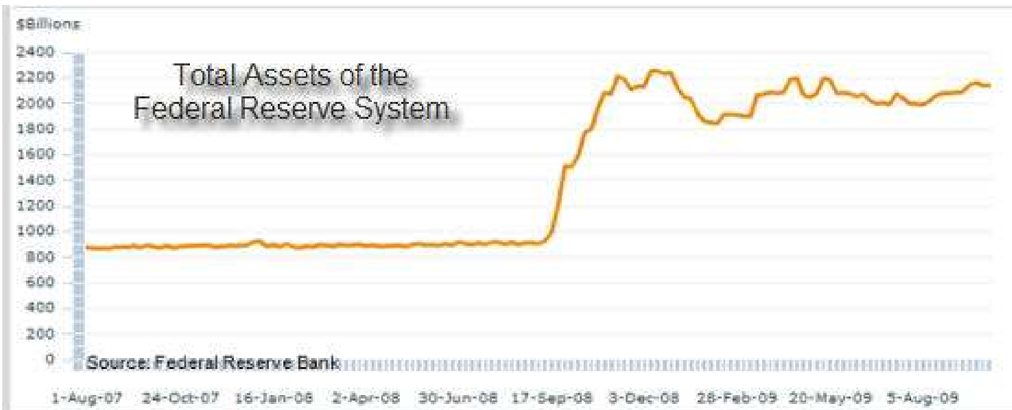
In January 2009, Jason Saving of the Dallas Federal Reserve concluded that the stated cash debt plus unfunded liabilities of the U.S. government were actually in excess of $105 trillion. The interest on that amount would require almost the entire income of corporations and individuals each year.

Further, Mr. Saving's study did not include the costs that were associated with any health care reform package, any cap & trade package and assumed no further military adventures. It also assumed that the federal budget would be balanced in 2020 and thereafter.

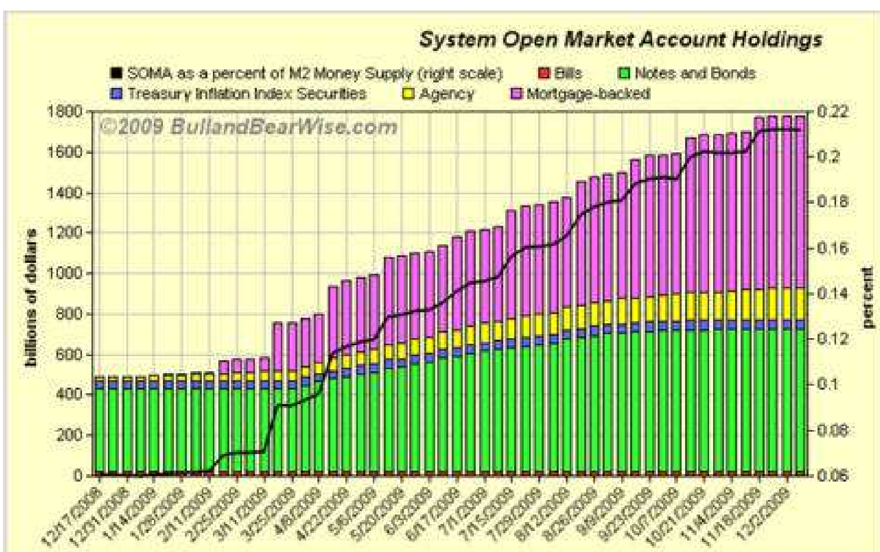
The day of reckoning is nearly here. By any measure, the United States is bankrupt. The only question is when will our creditors pull the plug?

**The Federal Reserve System**

Since the beginning of the financial crisis in August 2007, the FED's balance sheet has grown in size and changed composition. Total assets of the FED have increased from $869 billion on August 8, 2007 to over $2 trillion today.



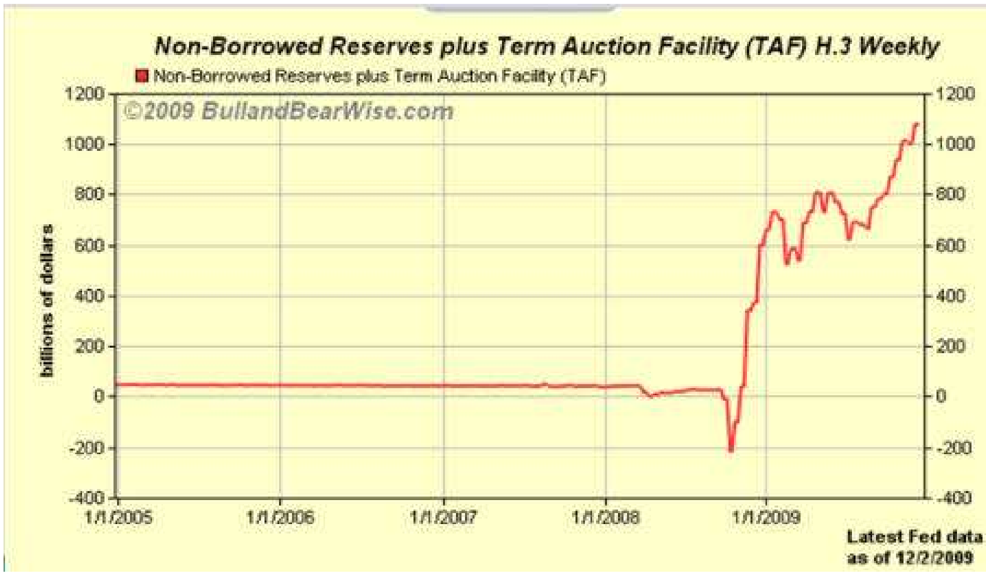

In August 2007, the FED held over $800 billion of U.S. Treasury instruments. As it engaged the financial crisis in various ways, the balance sheet grew and the quality of its assets diminished. The following chart of its system open market account holding shows the growth. The amount of mortgage-back securities shown in the chart are carried at par value whereas the market value is significantly less.




The growth of the FED's balance is based upon nothing but hot air. In actuality, the FED simply adds figures to a computer register and suddenly, there appears more "fiat currency" which it can now use.

The biggest casualty world-wide of the financial meltdown is the lack of confidence and trust in the U.S. financial system. As that trust continues to erode, the ability of the FED to issue paper that is worth more than tissue paper is also impacted.

The TARP program was supposed to fix the financial system. However, the decision of the FED to pay interest on non-borrowed reserves provided bankers with free money and a no-risk 2% return at a time when credit standards were being tightened and Tier 1 capital was needed to avoid being placed on a "troubled bank report."




The over-reaching of the Obama Administration into controlling not only the lending practices but also the compensation practices of those receiving TARP funds has moved many to repay the TARP loans rather than increase customer lending.

Reducing TARP funds coupled with the forward assessments by the FDIC has reduced many financial institutions from having funds to loan to their customers.

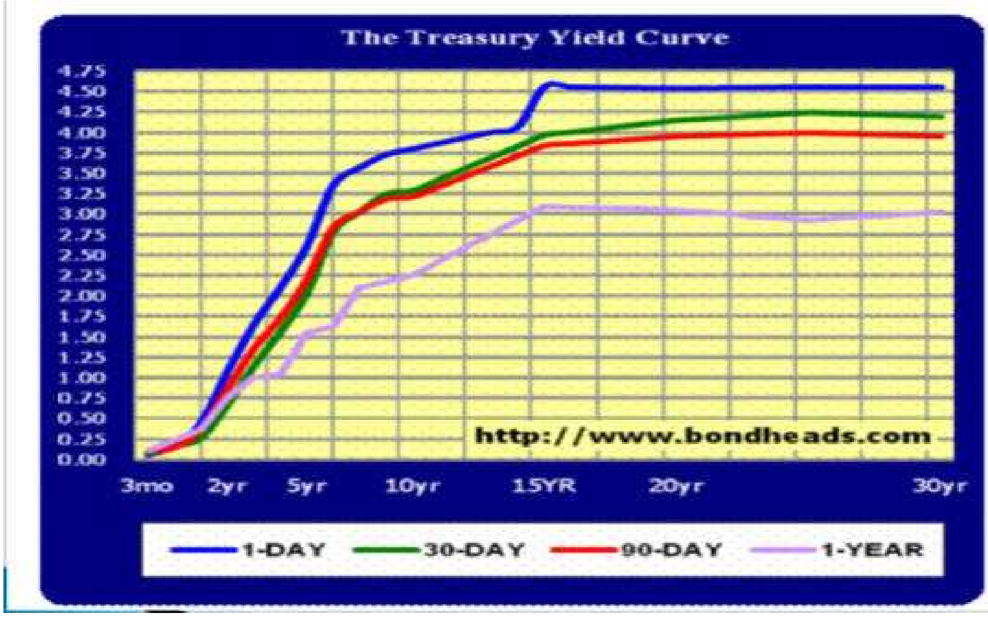
Now that the FED has announced a reduction in its Qualitative Easing policy, the risk of further credit problems should be apparent.

**There is one fundamental law that the politicians have not learned. You can not borrow your way out of debt!**

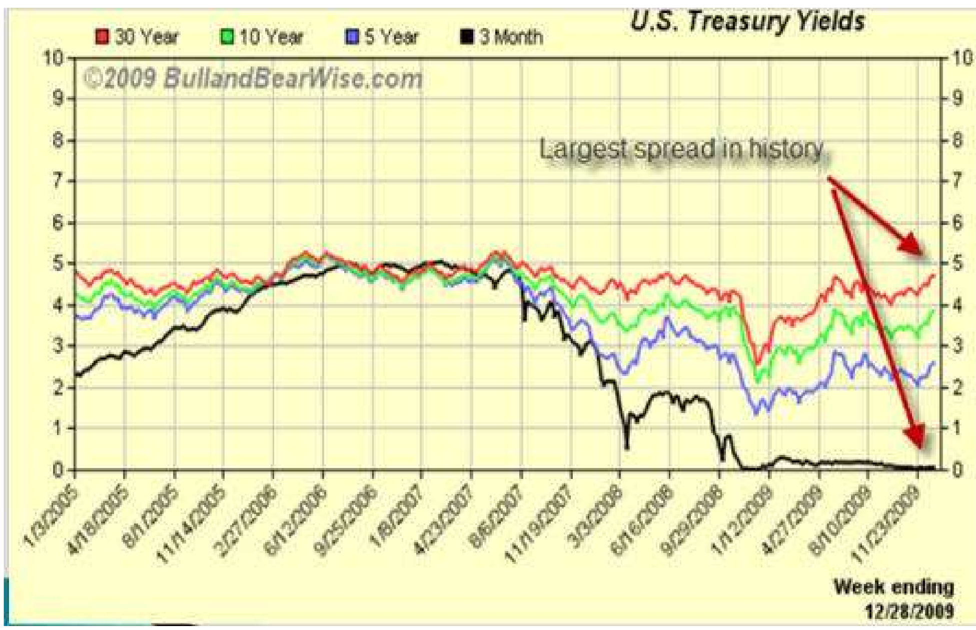
## The Bond Market

The bond market dwarfs the stock market and as the demand for U.S. debt wanes world-wide, it will be important to watch the bond market and interest rates closely.

Over recent weeks, the rate spread on U.S. Treasuries has widened as shown in the following chart from bondheads.com.




The risk premium on U.S. Treasuries is now at the largest spread in recent memory.




The following three charts show the recent trend of the 90 day, 10 and 30 year Treasury offerings. The volatility in the 90 day bill since November 15th is striking. Note that the increases in the rates for the 10 and 30 year notes are particularly ominous. During 2009, the interest rate on the 90 day bill changed from 1.15% to 0.5%. The 10 year note went from 2.24% to 3.84%. The 30 year note increased from 2.69% to 4.64%. The FED has some control over short-term rates but its ability to control long-term interest rates is significantly less.


$IRX (3-Month T-Bill Discount Rate) INDX
31-Dec-2009 4:00pm
Open 0.6000 High 0.7000 Low 0.3500 Last 0.5000 Chg +0.1000 (+25.00%)
$IRX (Daily) 0.5000
@StockCharts.com
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec


$TNX (10 Year Treasury Note Yield) INDX
31-Dec-2009 3:00pm
Open 38.09 High 39.18 Low 38.09 Last 38.43 Chg +0.59 (+1.56%)
$TNX (Daily) 38.43
MA(50) 34.86
MA(200) 33.82
@StockCharts.com
75 bps Emergency cut
75 bps cut
50>200
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec

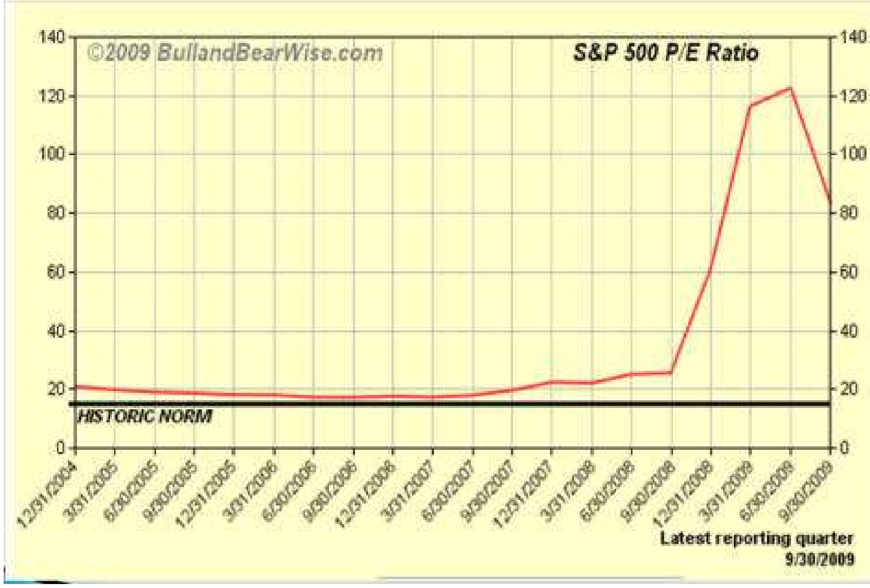

As the U.S. Treasury goes to market during 2009 for its massive requirements, you might expect that interest rates will continue to raise on the long-end.

## The Stock Market

At the close of 2009, the market was running out of steam from the Santa Claus rally. From a historical perspective, the following charts show the markets movement since 1980.

The S&P 500 like most major indices had a terrible 1st quarter as fear of the financial meltdown continued. However, beginning in March, the market began a rally which was largely lead by "junk-off-the bottom" stocks. The fundamentals of the economy did not improve significantly during the year. However, those stocks which had suffered major losses from the late 2007 highs were able to out-perform those few stocks which had increasing sales and increasing earnings during the last year.


At the end of the 3rd quarter, the price/earnings ratio of the S&P 500 stocks had risen to an all-time record level as shown in the following chart. Historically, the range for the P/E ratio was between 6 and 30. The current relationship suggests that either earnings must improve quickly or that the market is over-valued and will correct substantially.




During the last year, the NASDAQ index followed a similar patter as the S&P 500. However, the NASDAQ index was unable to set a new all-time high in 2007 as the S&P 500.


Many investors look to the Dow Jones Industrial Average (DJIA) as a gauge of the markets health. However, many professional investors do not. Following the runup in the late 90's, the DJIA made a new high in early 2000 and then fell to the bottom in October 2003 before starting another rally that ended in record breaking levels in late 2007. Since peaking at 14,198, the DJIA index fell about 55% before rebounding from its March 2009 lows.


At the end of 2009, using data from Investor's Business Daily, we prepared the following table of the DJIA stocks.

**DJIA Ratings from Daily Graphs Online® after close on 12/31/2009**

| Stock | Symbol | A/D | EPS | RSI | Total | C.R. | Last Price | Trailing P/E | 2010 Est EPS | Forward P/E | 12/31/2008 Price | % Change |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Hewlett-Packard Co | HPQ | A | 92 | 66 | 158 | 93 | $ 51.51 | 14 | $ 4.35 | 11.8 | $ 36.29 | 42% |
| Intl Business Machines | IBM | A | 94 | 61 | 155 | 96 | $ 130.90 | 14 | $ 10.90 | 12.0 | $ 84.16 | 56% |
| Walt Disney Company | DIS | B | 75 | 72 | 147 | 88 | $ 32.25 | 18 | $ 1.92 | 16.8 | $ 22.69 | 42% |
| Merck & Co | MRK | B | 83 | 59 | 142 | 84 | $ 36.54 | 11 | $ 3.45 | 10.6 | $ 30.40 | 20% |
| United Technologies Corp | UTX | B | 74 | 65 | 139 | 74 | $ 69.41 | 16 | $ 4.59 | 15.1 | $ 53.60 | 29% |
| Boeing Co | BA | C | 81 | 56 | 137 | 71 | $ 54.13 | 47 | $ 4.29 | 12.6 | $ 42.67 | 27% |
| Three M Company | MMM | A | 65 | 68 | 133 | 80 | $ 82.67 | 19 | $ 5.00 | 16.5 | $ 57.54 | 44% |
| Microsoft Corp | MSFT | A | 54 | 73 | 127 | 82 | $ 30.48 | 19 | $ 1.83 | 16.7 | $ 19.44 | 57% |
| Coca Cola Co | KO | B | 77 | 46 | 123 | 75 | $ 57.00 | 19 | $ 3.42 | 16.7 | $ 45.27 | 26% |
| J P Morgan Chase & Co | JPM | C | 68 | 54 | 122 | 51 | $ 41.67 | 25 | $ 3.18 | 13.1 | $ 31.53 | 32% |
| Travelers Insurance | TRV | D | 84 | 37 | 121 | 55 | $ 49.86 | 9 | $ 5.62 | 8.9 | $ 45.20 | 10% |
| Mcdonalds Corp | MCD | B | 89 | 30 | 119 | 79 | $ 62.44 | 16 | $ 4.41 | 14.2 | $ 62.19 | 0% |
| Procter & Gamble | PG | D | 82 | 35 | 117 | 74 | $ 60.63 | 17 | $ 4.15 | 14.6 | $ 61.82 | -2% |
| Kraft Foods | KFT | B | 88 | 29 | 117 | 56 | $ 27.18 | 14 | $ 2.19 | 12.4 | $ 26.85 | 1% |
| Johnson & Johnson | JNJ | C | 79 | 37 | 116 | 57 | $ 64.41 | 14 | $ 4.94 | 13.0 | $ 59.83 | 8% |
| Cisco | CSCO | B | 57 | 56 | 113 | 57 | $ 23.94 | 19 | $ 1.44 | 16.6 | $ 16.30 | 47% |
| Wal-Mart Stores | WMT | D | 83 | 26 | 109 | 46 | $ 53.45 | 15 | $ 3.61 | 14.8 | $ 56.06 | -5% |
| American Express Co | AXP | B | 17 | 91 | 108 | 67 | $ 40.52 | 33 | $ 2.39 | 17.0 | $ 18.55 | 118% |
| Caterpillar Inc | CAT | B | 17 | 78 | 95 | 64 | $ 56.99 | 30 | $ 2.72 | 21.0 | $ 44.67 | 28% |
| Verizon Communications | VZ | B | 67 | 27 | 94 | 52 | $ 33.13 | 14 | $ 2.50 | 13.3 | $ 33.90 | -2% |
| Pfizer Inc | PFE | B | 46 | 46 | 92 | 50 | $ 18.19 | 8 | $ 2.27 | 8.0 | $ 17.71 | 3% |
| Home Depot Inc | HD | B | 44 | 48 | 92 | 40 | $ 28.93 | 18 | $ 1.55 | 18.7 | $ 23.02 | 26% |
| Alcoa Inc | AA | B | 9 | 82 | 91 | 58 | $ 16.12 | NA | $ 0.65 | 24.8 | $ 11.26 | 43% |
| Dupont De Nemours & Co | DD | E | 25 | 59 | 84 | 26 | $ 33.67 | 26 | $ 2.23 | 15.1 | $ 25.30 | 33% |
| Intel Corp | INTC | D | 27 | 53 | 80 | 45 | $ 20.40 | 31 | $ 1.49 | 13.7 | $ 14.66 | 39% |
| A T & T Inc | T | C | 51 | 27 | 78 | 30 | $ 28.03 | 13 | $ 2.24 | 12.5 | $ 28.50 | -2% |
| Bank Of America Corp | BAC | D | 18 | 58 | 76 | 22 | $ 15.06 | 215 | $ 0.83 | 18.1 | $ 14.08 | 7% |
| Chevron Corp | CVX | C | 28 | 35 | 63 | 19 | $ 76.99 | 14 | $ 7.75 | 9.9 | $ 73.97 | 4% |
| General Electric Co | GE | C | 27 | 35 | 62 | 26 | $ 15.13 | 12 | $ 0.94 | 16.1 | $ 16.20 | -7% |
| Exxon Mobil Corp | XOM | E | 27 | 16 | 43 | 7 | $ 68.19 | 16 | $ 5.79 | 11.8 | $ 79.83 | -15% |

Data source: Daily Graphs Online 9/30/2009. Not for reproduction. Used with permission.

At the moment, it would appear that the new money flowing into the market from pension fund money will enable the first couple of weeks to be positive. However, the trend of the market could well change if the earnings forecasts are not realized.

## Foreign Markets

With the U.S. economy under stress in 2010, many investors have looked to foreign markets for not only diversity but also improved portfolio performance. The following charts show five major foreign indices from a historical perspective.

Despite economic growth that continues to exceed that of most other countries, the Shanghai index suffered a higher drawdown in the last two years than the U.S. The recovery from the bottom does not differ markedly from the NASDAQ. Curing the next decade, China's growth will be more dependent upon its export potential to countries other than the U.S. and the ability to handle the growing unrest of its population. Accounting standards in China are less strict than in the U.S. The Chinese government also controls the access to capital and with growing unrest in various areas, the outlook for continued growth is somewhat suspect.


In last year's election, the LDP party was defeated and the current administration has embarked on a major program of deficit financing that will cause the high debt to GDP ratio to increase further. With an aging population, Japan will be turning towards alliances with China in the future rather than the U.S. As a result, Japan's holdings of U.S. securities will continue to be reduced in the future.


Germany remains a country that is built upon its exports. Leverage in many European banking institutions was double that of the U.S. banks which resulted in greater distress, if possible, than in the

U.S. The situation is still not resolved.  With a growing Islamic population, the outlook for Europe is negative.  Germany will probably be the last one standing, however, on the continent.

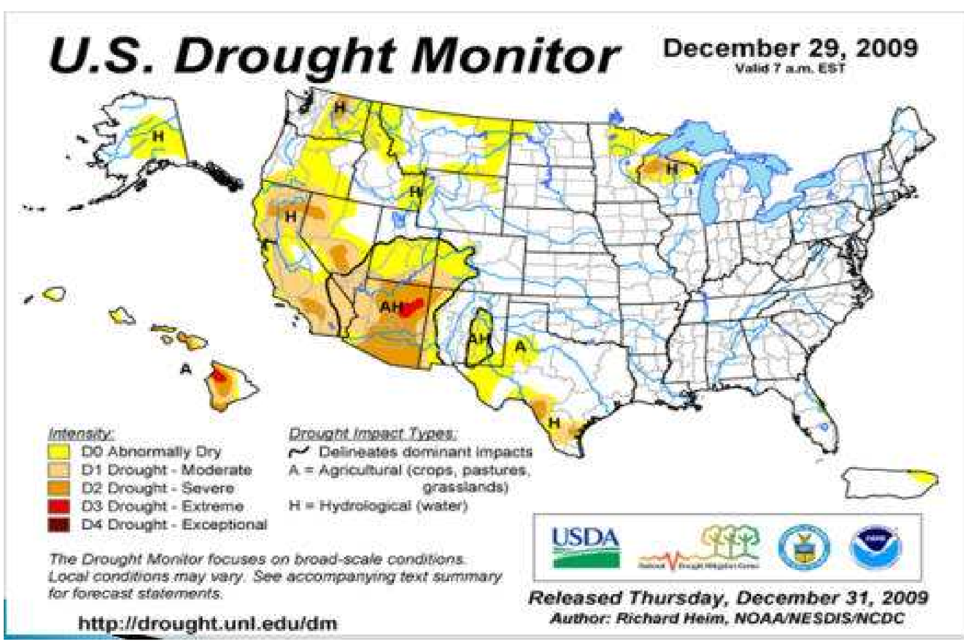

England's decline as both a free society and a world power continues.  Its immigration and taxation policies have taken its toll. It's role as a world financial center is in danger and for the most part, most of its industrial complex is inefficient and the work ethic has been lost.  The long-term outlook for the U.K. is not promising.


Brazil has been a country with a future. Blessed with a small population in a vast land with natural resources, Brazil has been the place to invest for the past decade.  However, the upcoming election this year may change the economic climate in Brazil.


The financial meltdown has obviously had a world-wide impact.  There are risks to investing in foreign countries. Prudent investors should try to restrict their investments to those companies that trade ADR's or in ETF's with significant liquidity.

## Commodities

As 2010 begins, the world's population growth and the impact of green regulations coupled with drought conditions in many areas is creating the growing fear of a food crisis.  Fall weather in the U.S. has left about 8% of the corn crop in the U.S. un-harvested.  The result is that carry-over stocks for wheat, corn and soybeans world-wide are at low levels.  Drought conditions throughout the growing areas of Argentina, China, India and the 'Stan's have combined to reduce food production in 2009. The U.S. drought monitor shown below shows the U.S. in the best shape of the past few years. However, U.S. food production in 2009 was below forecast levels.  Food production in 2010 will be critical and crop failures could mean disaster for many.



The CRB index has fluctuated dramatically in the last ten years. Some of the fluctuation was due to inflation and changes in the index weighting. The outlook for inflation suggests that the CRB index may move higher due to monetary and fiscal policy rather than an increase in demand.


The price of copper which has been moving higher should be watched closely to confirm future economic activity. If it begins to sag, world economic activity is probably going negative.


The price of crude oil in dollars will depend largely on the strength of the U.S. dollar and the production/demand equation. The movement to price oil in a currency other than U.S. dollars could obfuscate the real movement in the production/demand relationship. However, for 2010, crude oil may trade in a $60 - $90 dollar range. However, if there is a major problem in the Middle East, the price could easily make a new record.


## Currency

The U.S. dollar has recently improved and for the next month could continue to show improvement. However, unless the U.S. dollar index moves above the $80 level, the upward movement will only be temporary as the massive financing requirements of the U.S. Treasury will impact the dollar's value. During 2009, competitive devaluations will become more visible as many countries strive to gain an advantage.

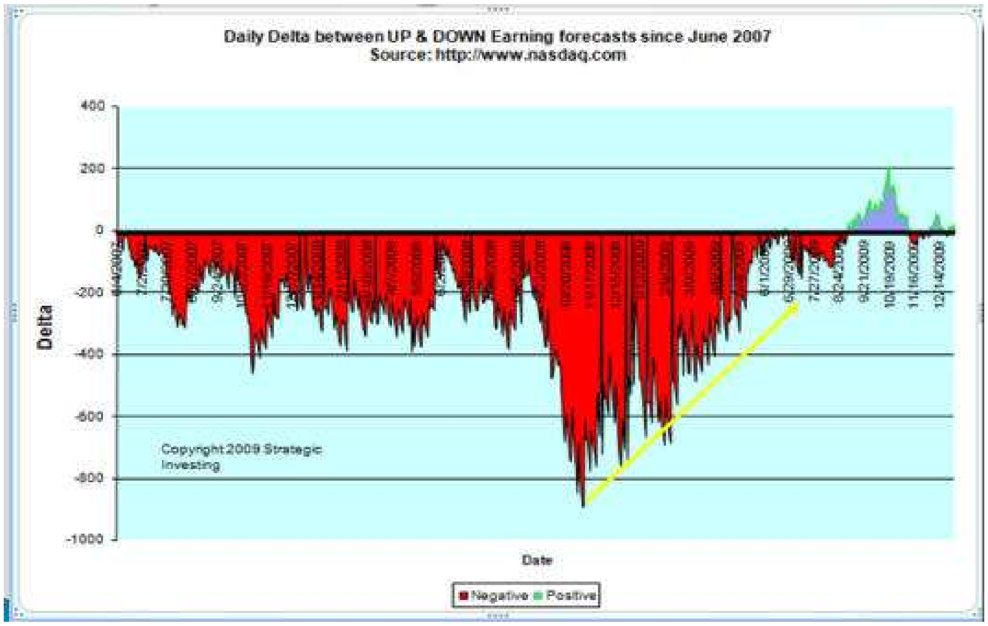

Gold's performance during the last decade has been outstanding, although, most investors have not profited from the shiny metal. As long as fiat currency remains, gold will always be a store of value. However, do not be fooled, it is subject to market manipulation by central banks.


Silver's performance during the past decade has also been good.


## 2010 Forecast

The forecast for 2010 remains difficult. On the one hand, we have the FED in the process of draining liquidity from the system and trying to move away from its Qualitative Easing policy. Likewise, we have the Obama Administration trying in a variety of ways of increasing regulations that will increase costs throughout the country. Despite declines in new jobless claims and continuing claims, unemployment remains high and the outlook for new job creation is not robust.

The following chart shows the difference between the number of companies that analysts are increasing earnings forecasts on a daily basis less those companies whose forecast are decreasing. The economic downturn which resulted in the S&P 500 P/E ratio ballooning to a record level is confirmed by the chart. However, the lack of a major turnaround in the last quarter in this ratio suggests that any economic revival might be weak. If that is the case, the equity market is probably due for a major correction.




Sectors that will probably under-perform the market consist of the following:

- Housing
  - Subprime lenders
  - Home Builders
  - Home Furnishing manufacturers
- Finance
  - Firms with derivative exposure
  - International companies that could suffer from competitive devaluation
  - Financial institutions facing a squeeze on lending spreads
  - Bond funds
  - ETF's that are discovered to be fraudulent
  - Companies with exposure to commercial real estate development
- Firms dependent upon Medicare and/or Medicaid funding
- Capital intensive sectors
- Over-extended countries in Eastern Europe, Ireland, Spain, Greece, Italy and the Middle East

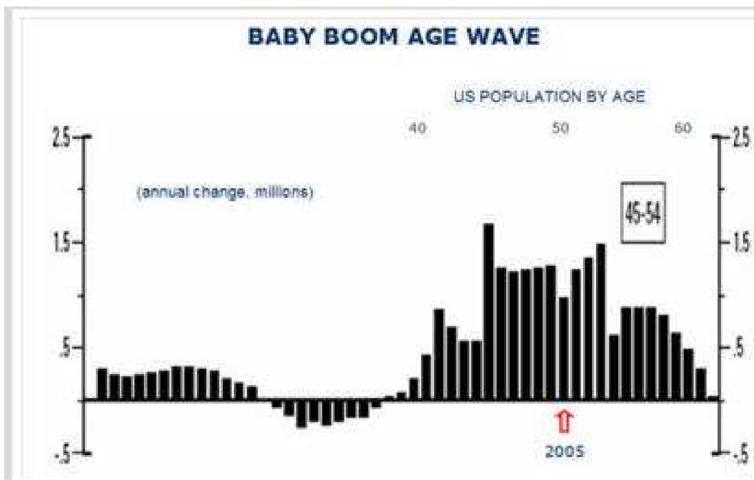
Sectors that may out-perform the market might be:

- Alternate Energy
- Nuclear Energy
- RFID
- Nanotechnology
- International ETF's
- Asset-based companies with little political risk
- Medical devices
- Geriactic companies including nursing homes, assisted living companies and funeral homes
- Consumer staples as food and shelter are always required

Prudent investors should remain cognizant of the following at all times during the year as they could provide clues to the equity and bond markets:

- U.S. Treasury auctions
- Increasing interest rates and widening spreads
- The passage of another stimulus package
- Sovereign debt defaults (national, state or local)
- Drawdown of U.S. Treasury and GSE holdings by foreign interests
- Rising commodity prices
- Decreasing sales tax revenues
- Decreasing personal property tax revenues

As the U.S. mid-term elections begin, the political mood of the country should be monitored. The baby boomer generation is clearly marching towards retirement and hold the biggest voting block. The question is whether this group is willing to further sacrifice their living standards as retirement nears.




## Conclusion

As we rush forward into 2010, the question arises about whether the economy and the stock market are in sync or are the tea-leaves simply not providing information that enables investors to make good decisions.  Various analysts have suggested that the economic recovery could take several difficult shapes and require variable time scales to rebound to the previous record levels.  The following market recovery patterns have been suggested:

- V-shaped
- Hockey Stick
- Flat-line
- W-shaped, or double bottom
- Ski-jump

With all the challenges facing the bond market to finance upcoming debt issues, the increasing delinquency rates in many financial instruments and a Congress that continues to increase deficits, I have reluctantly concluded that the best result would be a "muddling-through" recovery scenario that might last several years.

However, I am afraid that the ski-jump recovery is the most-likely and we have about reached the end of the jump ramp and that it is mostly a free-fall from here with minor rallies as the cloak of deception becomes apparent to not only investors but the general public.

**But then - 'Tis Only My Opinion!**

Fred Richards
January 2, 2010

**Corruptisima republica plurimae leges. [The more corrupt a republic, the more laws.] -- Tacitus, Annals III 27**



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