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REGISTERED INVESTMENT ADVISOR

2011...Reasons for Optimism are Very Real

The much anticipated and hoped for "Santa Claus" year-end rally did occur and was very welcome... with his bag filled with bipartisan goodies from Washington politicians which were meaningful for once. Wasn't it nice to see some attempts at compromise and unification and not too much confrontation and gridlock? Other stocking stuffers included extended benefits for the unemployed and the extension of the Bush tax cuts for all. Holiday-related sales were much better than expected as most retailers rang in record results between Thanksgiving and year-end (up 13.9% over the previous year).

I won't bore you with a long list of trend line statistics and data patterns, but in summary, I can tell you there is increased evidence that a self-sustaining recovery in consumer and business spending is slowly taking hold. The fact that the recovery is so **uneven** tends to be frustrating. For example, consumer spending rose at an annual rate of almost 4%, with most of that surge occurring in the last four months of the year. The lingering European sovereign debt worries and problems may still act like some coal in the stocking and this remains a "downer".

Corporate earnings for large and mid-cap companies have been improving and the dividend "candy" rewards to shareholders are beginning to be "sweet" again (i.e. GE, a proxy for the industrial sector, rose its dividend twice, from 10¢ to 14¢ to 17¢ per quarter or about ½ what it was back in the 2007 peak when it was 33¢/quarter). After a loss of 8.4 million jobs in 2008 and 2009, private payrolls have expanded at an average of 100,000 per month here in 2010, so the reversal of this depressing trend and the decline in initial claims for unemployment insurance was music to everyone's ears.

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Unfortunately, it wasn't the jingle bell melody everyone was hoping for, as unemployment remained high at just under 10%.

Performance Reflections and Recap

The **Dow and S&P 500** composites both serve as "broad-brush" indicators for the U.S. economy and large cap stock market. Thanks goodness for the year-end rally because the Dow 30 and **blue chip S&P 500 were up 11%-12%, respectively, in 2010**. Respectable performance, but not too exciting as a return. However, when compared to declines in emerging markets like China and Brazil, this is somewhat remarkable. U.S. stock indices even surpassed the small gains achieved in the MSCI World Index (which tracks equity results in developed nations).

Quantitative easing has led to some fragmentations in the U.S. bond markets. There was an oversupply of bonds and fixed income in our "paper" markets in 2010. A flood of new, secondary issues from AIG, GM, Citibank, Wells Fargo, and Bank of America, etc., which were designed to raise capital so TARP funds could be repaid, added to the supersaturation of supply. Furthermore, the moratorium on mortgage foreclosures and small business defaults created wide gaps in bid and ask pricing and generally caused net asset values to fall 5%-10% as the buying side dried up some. U.S. Treasury Auctions (for T-bills, notes and bonds) came up long and short as the government tried to offset the country's debt load while rates are at record lows. All in all, **regular bond funds** turned in **very uninspiring returns** for 2010, **ranging from 2.5%-4.0%**. Money market rates were dismally low and insured money market funds were yielding a mere 10-40 basis points. **Selected bond funds** which used preferred stocks, first and second traunch mortgage agency bonds and step-up coupon corporate bonds, as well as TIP's (Treasuries that are inflation-protected) provided 8%-11% yields but depreciated in market value, thereby delivering 5%-9% net returns. Selected no-load, closed-end funds like **ACG, MRF, BSP, CSP, JHI,** and **PTY** fit in this category and several **pay out monthly**. **So stocks outperformed bonds in an otherwise mediocre, transitional year, but the comeback was cheered.**

Mirror, Mirror on the Wall

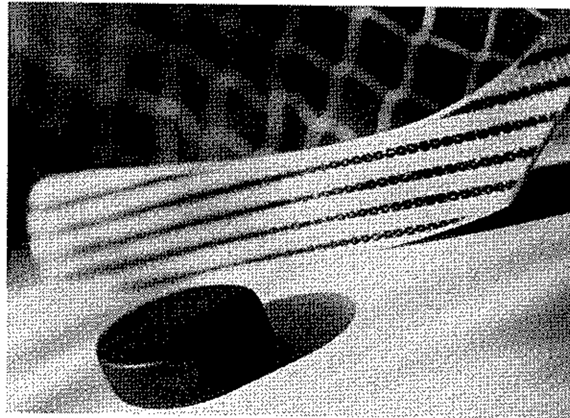
As bad as things have been, it seems to me that many of the bearish arguments are losing their steam, but aren't entirely fizzled out. After all, there are plenty of bearish themes and projections out there. It's beginning to sound like a broken record, because it may be overdone. U.S. banks need to make a strong comeback and face reality and begin to lend responsibly, again... Some banks have gotten the message, while others are not lending at all...Deficit reduction at the Federal Government level will become a "**hot**" political subject moving into the 2012 Presidential Election...while the unemployment woes linger longer and housing prices remain dull and stagnant in light of the huge glut of unsold inventory and still high joblessness... some remind us that municipal debt defaults will become more threatening, and colleges and universities will begin to titter with bankruptcy, reducing student loans and financial aid in the process...food inflation will become a big concern and the cost of the wars in Afghanistan and Iraq become more debilitating and less cost effective in terms of lives lost and results. I'll stop there because I think you get the picture and although I don't want to overdo the negative, I want to respect it, as we all know it's far from a perfect world.

In contrast, there is much to rejoice and be happy about. We avoided the dreaded double-dip recession and the outright collapse of the Eurozone, which were all grave predictions and news-grabbers in the past twelve months. To put it in further perspective, it was only eighteen months ago that almost half of the investment community had us believing that an Armageddon-like depression resembling the 1930's version of 45% unemployment, bank failures and long soup lines would last a decade or more.

It's not difficult to understand why over two trillion dollars sits on the sidelines uncommitted. It was easier (and more fashionable) to paint a gloomier picture than any other type of outlook. The tendency, pure and simple, was to look backwards and we all know that "objects in the rear view mirror appear larger than in reality". The bad seemed even "badder" and the media helped hype this doom and gloom scenario. Also popular was extrapolating the future by being "caught" and "mired" in the past, citing old data or wicked comparisons to what followed the 1929 Crash. It was even "in vogue" to believe that any improving news or better than expected statistic must be an errant aberration or a fluke. That was the scene and the tone, but now I'm able to say that the glass (which is far from full) is ½ full and not ½ empty or "bone dry".

As a hockey fan, I'm reminded of a famous quote from legendary scoring great, Wayne Gretzsky; a quote which seems very appropriate in describing the bullish investment opportunities that I foresee in the next one to two years:

> ***A good hockey player plays where the puck is while a great hockey player plays where the puck is going to be.***



After all, anticipation is the definer of where the financial markets are going and in this Newsletter, I'll help lead the way. **2011 will be a year when anticipating where to be and where not to be is very important...**

Predictions for 2011

Concentrating on jobs and shifting focus...By most accounts, Federal and State governments will put tremendous focus on job creation and this does deserve tremendous attention. Consumer confidence remains daunted by the 9.4% number, which many pundits believe is really 13%-15% nationwide for the whole workforce. The data indicates that the U.S. continues to forgo and lose manufacturing jobs to foreign and emerging markets where labor costs are much cheaper. We must accept that the U.S. is no longer the "make it" manufacturing powerhouse we once were. One of my colleagues reminded me that we have become a service-oriented economy, whereas **ingenuity** (i.e. Facebook, Apple's technology, Google), **creativity** (new and better drugs, inventions, cures, educational products, popular/smart clothes, recreational items, toys, housewares, appliances and gadgets) and **intellectual property** (i.e. stem cell, security and surveillance systems, conservation, batteries, new power sources for energy and light) **better define our economic landscape**. **Service is in; manufacturing is out.** The rebound to 5%-

5.5% unemployment is going to take longer than thought. This factor will keep out GDP growth in the moderate range.

Economic Growth...

For 2011, GDP growth will outpace 2010's somewhat anemic 2.8%, but not by much. The consensus opinion is for **3.5%-3.8%** expansion in the U.S. economy. Certainly better than a "stick in the eye", but a far cry from the typical and more robust rebounds often experienced coming out of a recession (of 5% to 7% expansion). The emerging markets will accelerate in the impressive 6%-10% range with Brazil, Germany, India, China and other Asian countries leading the way. These countries will be forced to raise interest rates and take steps to contain inflation and these actions could put pressure on the U.S. dollar's value as a currency and also hurt our import/export balance of trade. Nothing too new here, as the 2010 plot further plays out and we'll see higher prices in commodities, metals, and oil as a result. In essence, the same worries and a few new ones will play out. The Eurozone worries will spook the markets, cause retreats, and break up rallies. It is likely that Korea, Venezuela, and the Middle East remain "potential powder kegs" so the financial markets will play second fiddle to that drama, again, in 2011. Smart actions need to be taken on our country's debt ceiling and any deadlock or inaction on this assignment will add frustration and worry to the equity markets in particular.

RELATED CONCERNS...Trends to watch include savings patterns (Can they be maintained and rewarded?). Construction shows no sign of returning to bubble-era levels nor are there any indications that debt-burdened families are going back to their old habits of spending all they earned (hence, the holiday retail sales numbers actually scare some economists who say the consumer may have overspent). Watch developments in health care reform (and repeal), as well as the regulatory environments for banks, lenders, and insurance companies as many fear the Dodd-Frank legislation, although well intentioned, may actually miss the mark.

DEMAND THEME AND INFLATION OUTLOOK...Natural Resources, by virtue of simple supply and demand dynamics, remain valuable and become scarcer, causing prices and, hence, the shortages in commodities, food staples, fertilizers (and seeds), water, metals (including rare earth minerals), and oil and gas and other energy units to increase.

The biggest component of inflationary pressure will come from rising prices in food, energy, metals and materials. The Consumer Price Index (CPI) will come in at a tame 1%-1.2% most likely in 2010, but expect upward pressures to be felt in 2011 and a CPI in the 2 ½ % to 3 ½ % range. Slower, GDP growth portends lower inflation and oil over $100/barrel is like another tax to the American consumer and business owner.

CRUDE OIL will trade at a higher band range than in 2010...$73 to $103 per barrel is that new, higher range with $85-$95 being the most likely price range. Spikes are more likely to happen to the upside. Oil could potentially trade in a $100-$115 range if inventory shortages triggered by a stronger global recovery cause it.

INTEREST RATES: The Central Bank and Bernanke are not expected to start raising rates until later in 2011, especially given how high unemployment is expected to remain. The long-end of the rate spectrum will likely move first and short-term rates will move last. Remember, as history reminds us, private sector borrowing will start to pick up as growth picks up; the time frame is a 3-4 month jumpstart.

The foreshadowing can already be seen in the recent increases in long-term rates and twenty and thirty year mortgage paper. We want to keep a close eye on the nation's other major creditor—China. We have seen China's government tip its hand a little by buying more gold, silver, and rare earth metals lately and less of our U.S. Treasuries at auction. This has implications for our dollar that has, up to now, been buoyed by China and India buying up our debt and some of our real estate, as well. Right now, they prefer American debt over European debt for obvious reasons, but this makes predicting the dollar's movements more difficult to understand if the dollar weakens at all.

The tug of war in Washington is yet another variable in this puzzle. Rising interest rates colliding with the budget deficit has its logical implications. The debate will continue to encircle two views: reducing spending or raising taxes. The dichotomy during the last two years between the private and public sectors of the U.S. economy will continue because the private sector (and Corporate America and small business) has become more "lean and mean" (in order to survive and prosper), while the public sector, in some areas, has become bloated, inefficient, and deficit-limited. The assignment to fix this isn't easy either, so there will be some good that comes from this, but also some fallout.

Where Does the Dow Go? Up

Experts vary widely in their forecasts for the DJIA, **but bulls win** this argument in my opinion. If you assume the Dow could sell at a better but still muted P/E multiple of about thirteen times (with a forecast of $930 of earnings for the 30 Dow stocks, an 8%-10% increase year over year), the DJIA could easily obtain a watermark of 12,800 to 13,000 over the next year.

If you add in a positive enthusiasm "kicker" reflecting improved investor sentiment and more stable comfort levels, the top-end could be 13,800-14,000 and the P/E multiple would be back to a more normal 17.5-18 level (the 50 year moving average is 18.2 times). Our projected 2012/2013 numbers remain bullish at 15,700±. Thinking further ahead, advanced prognosticators foretell the Dow at 20,000 by 2015. Along the way, we can expect two to three 8%-15% corrections every 12-18 months and several peppered pullbacks (on the order of 5%±) tied to headline news and the normal drama associated with a "staircase" rebound that mirrors the unevenness of this recovery and its bearish crosscurrents.

Rekindle Your Love for Selected Stocks

The anatomy of a wise selection process for picking a winning stock for both appreciation and total return in this kind of market is based on many criteria and much analysis, but in this "give and take economic climate", there are three basic elements I like to follow. All must be met.

1. Find and analyze a secular growth story: A company must possess explosive upside potential for special reasons and because of special advantages. Be mindful, it doesn't require robust growth in the general economy to be a winner. That's good, because economic growth in the U.S. will be moderate and muted in many industry sectors for the next couple years. Think special niché advantages and unique opportunities and think global, too.

2. Accelerated revenue growth is usually germinated from smart business models and agile, smart management teams. Look for turnaround situations or rapidly improving EPS growth. I, personally, like to see improved debt to working capital ratios. Also key are

healthy profit margins to improve bottom-line results and better dividend payouts. Certain sectors of our economy will outperform, while others will be lackluster, riskier, or out-of-favor. "Best of breed" doesn't hurt either. Identify the winners by looking for the upward acceleration curve for the company's revenue stream.

3. Look for rising EPS estimates from analysts, insider buying as a bullish statement, and increases in block institutional ownership. After all, you don't want the rocket fuel to burn out too soon. Remember the rules of P/E and PEG valuations: P/E's need to be forward-looking, too, and good results will foster confirmation that multiples can be twice the long-term growth rate. You want analysts to project the numbers out in the future with a degree of vigor and follow-through.

The next couple pages contain some groupings of our favorite stock picks. Kindly refer to the codes and note the high growth picks which have a ☆.

KEY:

- Those marked with a ☆ have extraordinary appreciation potential over the next twelve months.
- Those marked with a + have a very good dividend/royalty.
- Those marked with a ✓means volatility.
- Those marked with **BC** are "Blue Chip".
- Those marked with **TA** are "Turnaround Situation".

Industrial/Global Theme

☆ TA	**GE**	**General Electric**
☆ TA	**MTW**	**Manitowoc**
☆	**TXT**	**Textron**
☆	**ITW**	**Illinois Tool Works**
☆	**PCP**	**Precious Cast Parts**
BC	**EMR**	**Emerson Electric**
BC	**CAT**	**Caterpillar**
BC	**DE**	**Deere**
BC	**MMM**	**3 M Corp.**
BC	**DD**	**Dupont**

Agriculture/Fertilizer

☆✓ BC	**MOS**	**Mosaic**
☆+✓	**TNH**	**Terra Nitrogen**
☆✓	**MON**	**Monsanto**
✓	**POT**	**Potash**

Interest-Rate Sensitive/Financial

+TA	**TCAP**	**Triangle Capital**
+TA	**PGF**	**Powershares Financial**
TA	**WFC**	**Wells Fargo**
TA	**PNC**	**PNC Financial Services**
BC	**AXP**	**American Express**

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Metals/Natural Resources

☆✓TA	AA	Alcoa
☆✓ BC	SCCO	Southern Copper
✓	SLW	Silver Wheaton
☆✓	TIE	Titanium Metals
✓	SLV	Silver ETF
☆✓	MCP	Molycorp
✓ BC	X	U.S. Steel
☆✓	TCK	Teck Resources
☆✓	CLF	Cliff's Natural
✓	VMC	Vulcan Minerals
☆✓	CMI	Cummins Industrial

Special Situation

BC	NKE	Nike
☆	DISCA	Discovery Channel
BC	APPL	Apple
TA	PAYX	Paychex
BC	BRK/B	Berkshire Hathaway
☆	BIDU	Baidu
☆	TFM	Fresh Market

Telephone Utilities

+ BC	CTL	CenturyLink
+ BC	T	AT&T
+ BC	VZ	Verizon
+ TA	FTR	Frontier Communications

Energy

+ BC	BPT	Royalty Trust
+	PBT	Permian Basin
+ BC	EEP	Enbridge Energy
BC	CVX	Chevron Texaco
BC	COP	Conoco Philips
+ BC	KMP	Kinder Morgan
TA BC	FRO	Frontline
+	SFL	Ship Finance
☆	FSLR	First Solar

As you know, I am a big believer in diversification because it provides a portfolio with safety qualities and a degree of insulated security by spreading risk and opportunity around. Obviously, the above selections made the "head of the class" in terms of opportunity advantage. Because I can't do justice to all the ideas we may follow and like, let me offer a few other blue chip names that enhance diversification and defensiveness in the process:

Duke Power (DUK), H.J. Heinz (HNZ), Johnson & Johnson (JNJ), Proctor & Gamble(PG), and Smuckers (SJM).

WRAP UP REMARKS

There is always something to worry about and as I have often said before, "climbing a wall of worry" is what the financial markets do when the economy is not hitting on all cylinders, but when consumer sentiment is gradually improving.

The Report Card from Corporate America will be coming out over the next few weeks as companies, large and small, reveal their year-end numbers and, more importantly, tell us about their future goals and projections. All signs point to a B+ report card with only a few negative surprises likely.

The key to achieving outperformance in 2011 will hinge on the selection process (best sectors, best turnarounds, "best of breed") and being where the action is and will be (thank you, Wayne).

The reason future P/E's are so important right now can be summed up in this factual illustration. At the end of the first quarter of 2009 (March 2009), the average P/E ratio for the S&P 500 Index was a whopping 317 times earnings (this number is not a mistake; it was a rearview mirror or trailing number at the "bottom" of the markets). If we were guided by that piece of information, no one would have bought stocks because they were too, too expensive (excessively so). Instead, as hindsight would have it, it was a terrific time to buy (at the bottom), so that's why CAM looks ahead (and respects the past).

Please feel free to touch base with me at any time. I wish everyone a happy and healthy New Year.

With best regards,
JC
1/11/11

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