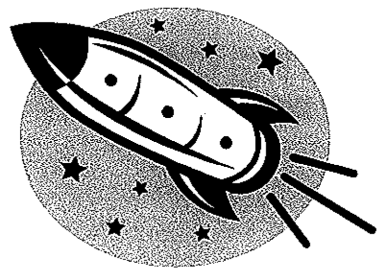
Colley Asset Management, Inc.

REGISTERED INVESTMENT ADVISOR



# TODAY, IT'S A BETTER SEPTEMBER TO REMEMBER

In my opinion, the minor pullback in stocks just after the June and July "double dip" was just another hiccup. It is actually quite normal to see such pullbacks in an improving bull market. The technicians refer to it as "pop, back and fill" action.

We can expect many to proclaim the rebound as a "sucker's rally", or that stocks have come "too far, too fast" (often forgetting how fast and steep the preceding selloff was). Expect any sideways movement or brief retreat to be heralded as evidence that the sucker's rally is spent. In many ways, the rally is unfolding in typical new bull market fashion. The initial bounce off the bottom point is usually strong and the industry sectors knocked down the most typically lead the rocket as the bull comes out of the dust. Financials, Home Builders, Materials, Industrials, Tech and Consumer Discretionary – the hardest hit – have indeed performed best since the March 9 low. Similarly, energy stocks have begun to rally too as the recessionary side effects begin to disappear and fundamentals improve for transportation, shipping and commerce.

Although optimistic signals which have been overlooked by many continue to surface globally (Germany, France, Japan and China all turned slightly positive in GDP growth last month)...economic data has been far from stellar (i.e. unemployment). Put in proper perspective, "less worse" is still encouraging and much better than the catastrophic predictions made only 7-8 months ago, which called for a deep, dark, protracted 7-10 year recession/depression. However, we remember that a stock market rally doesn't require the current economic news to be great; rather, the financial markets discount future conditions, not old and past-tense information. In short, the look ahead is what matters and the rearview mirror is less important. Therefore, CAM expects stocks to move irregularly higher between now and year-end and into 2010 as the eventual economic recovery becomes priced in. Official data (and a host of lagging indicators) will remain weak for a while and often anchor rallies and cause pauses and even steep declines as the staircase recovery unfolds with stutter steps.

THE GRANITE PALACE, 358 BROADWAY, SUITE 304, SARATOGA SPRINGS, NY 12866
(518) 581 0500 • (800) 581 0501 • FAX (518) 581 0525

Global monetary and fiscal stimulus continues to grow and expand; both are bullish developments. Especially notable is the European Central Bank's next move to expand its balance sheet by 25% ($625 billion) overnight. In the USA, massive amounts of already approved stimulus funds have yet to be deployed (in fact, as of this writing, the US has disbursed a mere 6% of the $787 billion stimulus package) and some banks are planning to pay back TARP-borrowed funds by year end (i.e. Bank of America, JP Morgan, Goldman Sachs, PNC and Wells Fargo). Meanwhile, China's similarly huge stimulus package has been put to work quickly and efficiently, which bodes well for China leading the world out of recession (watch its year end GDP numbers top 6%).

Among the gloomy concerns is that massive money creation (and a huge national debt) will soon lead to explosive inflation. In CAM's view, Bernanke is vigilant on the inflation front and will keep rates low for now to avoid the risk of stunting the recovery. We will first need a recovery to unfold, and that will take 2 to 3 years to fully play out. Expect the economists to talk about it soon in anticipation of it, but higher inflation won't become an actionable risk for some time, and even then problematic inflation levels can hopefully be contained by raising interest rates and other monetary policies. Central bankers, in my opinion, are rightly providing liquidity in an effort to stave off deflation and bolster the balance sheets of banks and insurance companies. If consumers and small businesses can do well, everyone wins. When money velocity accelerates in sync with increased manufacturing and improved labor capacity (again, 2-3 years out), interest rates will rise. For some, this will signal the time to switch to fixed income from stocks (which have been appreciating). After all, why not lock in some higher guaranteed income yields?

**Summary:** The capital markets are demonstrating encouraging signs of normality and seem to be "on the mend". Credit markets have eased considerably from last September's severe dysfunction. The path to recovery will include setbacks, which could cause uncomfortable volatility from time to time. Nevertheless, CAM foresees that remaining invested and positioned is still the best strategy for the improving course ahead. CAM has been dedicating research and focus on "blossoming green shoots" and spring loading the right sectors (where earnings momentum is strong and total returns are solid) to garner the safest and best results.

## Key Points to Understand

1) One step at a time to recovery...while there is still a long way to go before the depreciation damage is erased, please accept that the staircase recovery will take time and will include volatility. We all know that no bull market is ever a perfect straight line up; history has demonstrated that the deeper the recession, the longer and more durable the recovery, so our deeper-than-normal recession could set up a longer than normal rebound too...one that could last 3-5 years.

2) Bullish rebounds off the recession lows have often come all the way back...when tracked since 1929, rebounds have ranged from 88 to 123% recovery. No guarantees, but this is reassuring though patience will be required.

3) Looking ahead, some pessimists still believe we have seen stocks rocket up too fast since the now-established March '09 lows. Yet, while the recovery from the lows has been significant, the MSCI World Index is up only 8% year to date – still quite modest. There is plenty of upside potential and it will set up over months and years, not just weeks. Forecasting surveys that I have studied from Thompson, Reuters and Bloomberg expect the MSCI World Index of stocks to rise 90.3% over the next 36-48 months. It is very possible that we are in the early stages of the recovery with considerable upside left.

4) What would it take to turn "defensive" from "cautiously optimistic"? CAM is not stubbornly bullish, and we're not afraid to get defensive. In fact, some clients prefer this orientation and want to stress income as an objective too. What would cause us to turn bearish is the revelation of at least one big, bad, underappreciated factor not already priced into stocks. It would have to outweigh underappreciated positives. We remain constantly vigilant for such factors.

Ongoing worries continue to dominate hopes of recovery...municipal defaults (i.e. California), credit card defaults, commercial real estate and housing foreclosures, onerous legislation, unemployment, consumer spending, etc. Some believe these factors can keep stocks depressed, but these worries and concerns are widely known and discussed. In our view, they **lack** the probability or surprise power to cause stocks to crash.

Geopolitical tensions heated up over the last few months in Iran, North Korea, Honduras, and other hot spots too. Unrest and threats from rogue regimes are not new and we cannot find a time in history when there wasn't a threat to stability somewhere. Generally, geopolitical conflicts are ongoing and ever-present, rarely having significant or lasting economic impact. To truly knock the markets down, a geopolitical event would have to be far-reaching, massive and unexpected. Such events are nearly impossible to forecast or manage a portfolio around. In short, there is nothing fundamentally new here that would alter our outlook.

5) Inflation? Maybe, but not today. Problematic inflation is not a real concern at present, as the current economic environment is not conducive to substantially higher prices. Although the global economy is slowly recovering, unemployment is still high, consumer spending has subsided and capacity utilization remains low. These conditions preclude prices for most commodities from rising too dramatically. Notable exceptions may be steel, copper and certain other industrial/building materials (including solar).

6) Stocks are undervalued...Although the earnings picture is somewhat cloudy for some companies, 4 out of 5 companies appear to be undervalued in terms of P/E and PEG measures. For example, whenever stocks in the S&P 500 hit an average P/E of 22, normalization of earnings and forward guidance (i.e. projected earnings into the future) are "watch" factors. At the moment, the actual earnings for the S&P 500 Index (of large cap stocks) would stand around $62, suggesting that the S&P 500 would be over-valued and vulnerable at the 1,220-1,230 level (we just crossed 1,000). The target point changes with prices and as earnings change, so this number could be 1,300 in an improving environment, creating this moving target. Hence, the staircase behavior becomes entrenched.

7) Interest rates, currently quite low, are "friendly" for stock appreciation. Since the 1960's one of the best market turning indicators has been the 26-week rate of change for investment-grade bond yields. Bear with me here, as the threshold used to be A+ and better; now it is BAA and better. With the rate of change at -13%, a sell signal is not very close or imminent. CAM, as most readers of this newsletter already know, has been expecting a rally in stocks to take solid hold here in the second half of 2009 and carry well into 2010 and beyond. The bottom seems "in" as of March. Rising interest rates are known to be a deterrent to positive stock market performance, but until inflation and rates rise to 4-5% levels the upward trend in most stocks will be your friend. Down the road, we will have the opportunity to invest in more attractive fixed income.

So, in closing...onward and upward! Please don't hesitate to call me any time with your questions or comments. You can expect the next Newsletter to include some of our favorite investment picks.

JC
9/09

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