

## REVIEW AND OUTLOOK

*Fourth Quarter 2009*

### **Market Overview**

What a difference a year can make! In December of 2008 we were receiving the official news that the U.S. economy was in a recession and everywhere you looked the media filled our thoughts with fear about rising unemployment and the demise of the financial sector.

While most people in the U.S. would say they are still feeling the effects of the recession, 2009 has definitely provided us with hope for a stronger economy going forward. The S&P 500 stock index plummeted to a decline of 37% in 2008, but rebounded nicely in 2009 with a return of 26%. Even more remarkable is the fact that the index was up approximately 68% since its low in March of 2009.

On December 23rd, the S&P 500 rose above 1,120.84, which amounted to a 50% recovery of the loss experienced during the bear market between its peak in October 2007 and the low on March 9, 2009. The index declined 57% over this period marking the worst stock market collapse since the 1930's.

The strong performance of the stock market in 2009 was led by the cyclical sectors of the economy which typically depend upon economic growth and vibrant consumer spending. The three top performing sectors of the market were Technology (+61.7%), Materials (+48.6%) and Consumer Discretionary (+41.3%). Also encouraging to note was data from Standard & Poor's indicating that all 10 sectors of the S&P 500 were in positive territory this year. This was an about-face from 2008 when all 10 sectors of the market declined for the year. With a gain of 26% the S&P 500 achieved its largest annual gain since 2003.

In 2009, international stocks resumed their outperformance versus domestic stocks after lagging the domestic market in 2008.

The MSCI EAFE Index achieved a total return of 32.2% for the year. International stocks had outpaced domestic stocks every year since 2002 until the credit crisis halted overseas economic growth. The crisis also brought with it higher unemployment levels in some European countries than those experienced in the U.S.

Even more impressive than the stocks of developed foreign countries was the performance of emerging stock markets. The MSCI Emerging Markets Index, including countries such as Brazil, Russia, India and China, had a return of 78.3% for the year. According to fund flow data by EPFR Global these four so-called BRIC countries alone attracted \$41.9 billion in investment for the year. In early summer 2009 we increased our exposure to emerging market stocks and expect this sector to be an important contributor to the growth component of our portfolios in coming years.

Global equity markets were bolstered in 2009 by record-low interest rates and an estimated \$12 trillion of stimulus funding committed by worldwide governments (according to Bloomberg News). While government assistance was necessary to reverse the trend of declining global growth, investors will be watching closely to see how equities will perform in 2010 as programs such as the first time home owner credit expire and central banks begin to remove excess liquidity from their respective economies.

### **Economic Review**

The Federal Reserve Chairman, Ben Bernanke, is expected to be reconfirmed by Congress for a second term in early 2010. All eyes will be on the central bank as they try to strike a balance between continued economic improvement and staving off the ill effects of inflation.

The Bureau of Economic Analysis reported that the U.S. economy grew at a 2.2% annualized rate in the third quarter of 2009, marking the first gain in the economy after four consecutive quarters of decline. This string of declines was the longest continuous drop since the Great Depression. It is expected that the U.S. economy continued to grow in the fourth quarter as we continued to receive positive data reports.

In November, consumer spending increased 1.3% and personal income increased 0.5%, which was the seventh increase in the last eight months for private wages and salaries. The increase in personal income and strong performance of the stock market since March are slowly restoring confidence in the minds of consumers. Spending data is closely watched because consumer spending is the largest driver of growth in the U.S. economy.

Other positive news in the fourth quarter included a decline in the unemployment rate from 10.2% to 10.0% indicating the rise in unemployment may be close to peaking. Inflation has remained tame over the last 6-months with the “Core” Consumer Price Index rising at an annualized rate of 1.5%. The Federal Reserve’s normal target range for inflation is between 1% and 2%.

While it is clear the economy has improved over the last 6-months it is much harder to predict the direction of future fiscal and monetary policy. Economists are at odds about whether it is time to start raising interest rates and winding down stimulus to ward off inflation or whether an additional round of stimulus is needed in order to keep the economy from declining further. Regardless of what the future holds we are positioning client portfolios to be successful for the long-term. Through the use of alternative investment options we are addressing risks such as higher inflation, a declining dollar, geo-political turmoil and higher than average stock market volatility.

Some examples of the strategies we are using include:

- 1) Gold - as a hedge against a decline in the value of the dollar, geo-political risk and inflation.
- 2) Commodities – as a hedge against inflation and a play on continuing demand growth in emerging market economies.
- 3) Absolute Return Strategy Funds – these funds employ investment strategies whose returns have very low correlation to stock and bond returns and provide further reduction of volatility to a portfolio.
- 4) International Bonds – high quality bonds issued by foreign governments and companies can provide further diversification to a bond portfolio and protection against declines in the value of the dollar. While each of the strategies above may not make sense for every client portfolio and financial plan we are employing them individually or collectively as appropriate based upon each client’s needs.

We appreciate your continued confidence in Broadway’s Investment Management Group and wish you a safe and prosperous 2010!

Index	YTD	1 Year	3 Years
Dow Jones Industrials	22.7%	22.7%	-3.1%
S&P 500 Index	26.5%	26.5%	-5.6%
EAFE*	32.2%	32.2%	-5.6%

\*EAFE = Europe, Australia, & Far East International Index

2 Year Treasury Bond Yield as of 12/31/09	1.14%
2 Year Muni Bond (AAA) Yield as of 12/31/09	0.56%