



Defining QualitySM

WHAT SHOULD WE EXPECT NEXT YEAR?

Since March lows for the S&P 500, we have witnessed a robust rally in the average of about 67%.

I know it is easy to say now, but the rally was inevitable. The market did what it was expected to do and always does after a steep decline. It went up dramatically. It went up while most investors were paralyzed with fear as they watched in awe and with skepticism. While most investors waited for the news to get better, the market blasted upward.

Our behavior during intensely emotional events like a severe bear market is governed more by how we feel than what we know. Coincidentally the same kind of strong emotional response takes place in bubbles that develop in some bull markets. The emotion in bear markets is extreme fear and in the bull market it is extreme greed. Neither is good for our financial health.

We have moved into a period when the survival of the economy and markets is not the primary question investors are debating. Today it is the strength of the recovery. Not surprisingly, the strength of the economic recovery so far has been feeble.

What transpires in stock prices in 2010 will not be as easy to forecast as the rally we have witnessed in 2009. The 2009 rally was about the economy not getting worse. In 2010 it will be about economic recovery.

1. Will the current stability in the economy reverse with further declines in 2010?
2. Will the economy improve steadily but slowly?
3. Will the economy improve unevenly?
4. Will there be a strong economic recovery?

First I do not believe we will witness a strong economic recovery in 2010. Nor do I believe we will see the economy weaken from where we are now.

Curran is anticipating a lackluster recovery. It will be slow and perhaps uneven.

Our outlook in 2010 for the equity markets is positive but cautiously so. We do not expect spectacular returns but we expect investors to be rewarded. Our definition of spectacular would be more than 25%. Our confidence in a recovery

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sufficient to drive stock prices higher is sufficient for us to remain fully invested in equities.

The reason for our caution is about banks and their behavior.

It is clear to us the steps taken by the Fed and Treasury to save the banking system has succeeded. I think we all assumed if banks survived then loans to business and individuals would follow. So far it has not happened. More importantly it is not likely to occur anytime soon.

It is apparent banks are more concerned about regaining their "freedom" from government ownership than they are about their roll in making loans at low rates to revive the economy. To pay back TARP they are again compromising their balance sheets.

Leading up to the financial crises they drove their earnings per share higher than prudent practices would have ever permitted. They employed excessive leverage and they did so without regard for long-term interests of their shareholders or the potential damage to the economy. The banks enriched themselves while competing with each other for bragging rights to include bigger bonuses and more fees from underwriting securities of dubious value.

Now they are paying back the government with money they do not have. To do so they are selling new shares that dilute the interest of their share holders and postpone their ability to make loans that are desperately needed by consumers and small businesses. While they have received all of the benefits of cheap and plentiful money supplied by Washington, very little of it has trickled down.

They have resumed their short term trading activities using cheap funds supplied by Government instead of making loans. In short they have received most if not all of the benefits of the recovery. Now they are preparing to pay bonuses based on short term profits.

Bank behavior is slowing the recovery to the broader economy. Instead of cheap money flowing now to business to enable expansion and hiring, it is being consumed by banks to meet their objectives.

Our conclusion is the economy will remain sluggish. Business will continue to ration capital until they have the confidence that needed funds will flow as required by well run businesses. With funds virtually shut off, business expansion is limited to banks and the largest companies with access to capital markets. Without a broad expansion of the economy even those companies with access to capital will not find it compelling to expand.

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However, we are anticipating underwriting standards will begin to encourage new loans as bank balance sheets are rebuilt. As long as banks can borrow at historically low rates and make loans at very high real interest rates, there is the potential for making loans. Our expectation is we will see new loans expanding by spring.

We believe the Fed when they say they intend to keep interest rates extremely low for a long period of time.

So the challenge for investors is determining how to invest in the near term with no concrete signs that much needed loans are likely to flow to business.

Our view is it will happen but not nearly as quickly as expected.

We continue to recommend investors remain fully invested in equities.

We urge caution in fixed income securities. In short, investors who stay invested in high quality short term securities should do so to avoid the market risk inherent in longer term bonds should rates rise anticipating higher inflation. Higher inflation is very likely in our view. Markets will anticipate inflation before it is apparent.

Contributing to higher interest rates will be the withdrawal by the Fed from purchasing long-term Treasury bonds and mortgages along with competition for funds resulting from trillion dollar deficit funding requirements. Not clear to us is how the Fed will reverse their quantitative easing in the amount of approximately \$1.5 trillion with Treasury deficit funding requirements of more than \$1 trillion.

We are not pessimistic about a sustainable recovery. We are frustrated by the challenges in this recovery brought on by massive involvement by government and the unintended consequences by banks not living up to their part of the bargain. The result is likely to be a recovery but one that is not nearly as dynamic as it should have been.

A handwritten signature in black ink that reads "Tom". The signature is written in a cursive, slightly slanted style.

The comments above are provided as a general market overview and should not be considered investment advice or predictive of any future market performance. Information is derived from sources believed to be reliable; however Curran Investment Management cannot guarantee its accuracy.