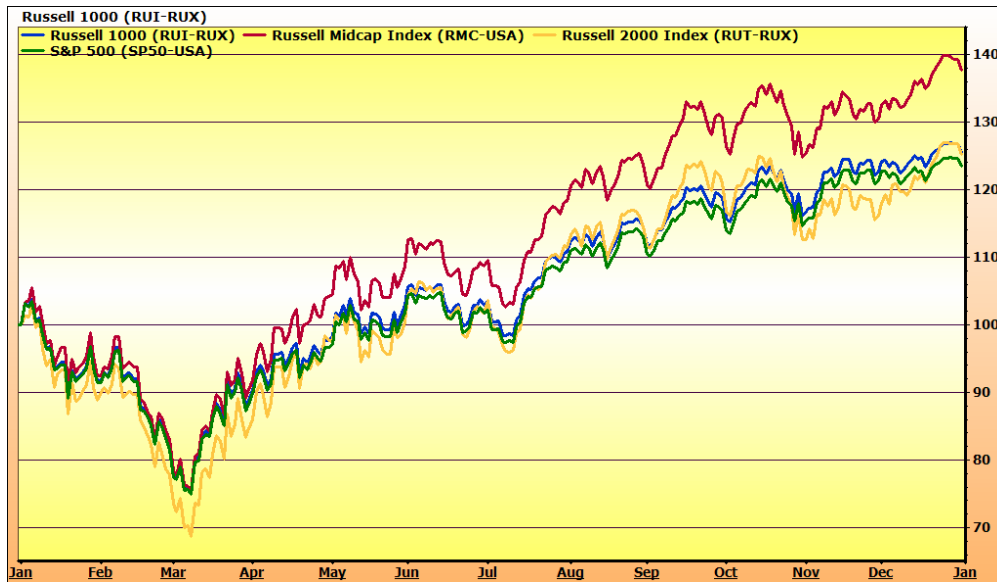


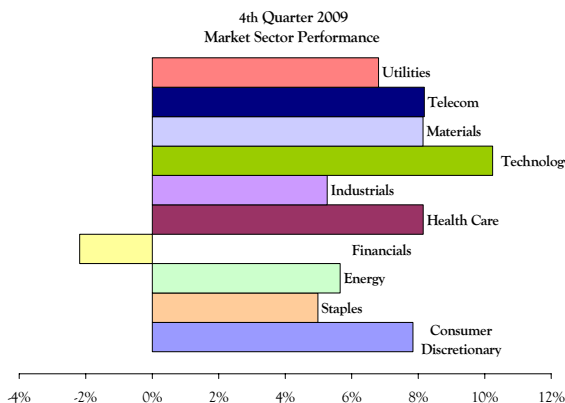


## Investment Commentary January, 2010

### Stock Market Commentary



It was one of the best of times—something that no one contemplated in early 2009. The popular indexes enjoyed their best year since 2003 with the Dow Jones Industrial Average returning 18.8% and the Standard & Poor’s 500 increasing 26.5% (over 6% added in the fourth quarter alone). Four out of five stocks, or 80%, in the S&P 500 finished the year above their 50 day moving average. There was no broad market correction of greater than 7% since the market bottom in March, 2009. It was a year of turnarounds. The top 50 best performing stocks in 2008 gained only a 9% return in 2009 while the worst 50 performing stocks in 2008 were up at least 100% in

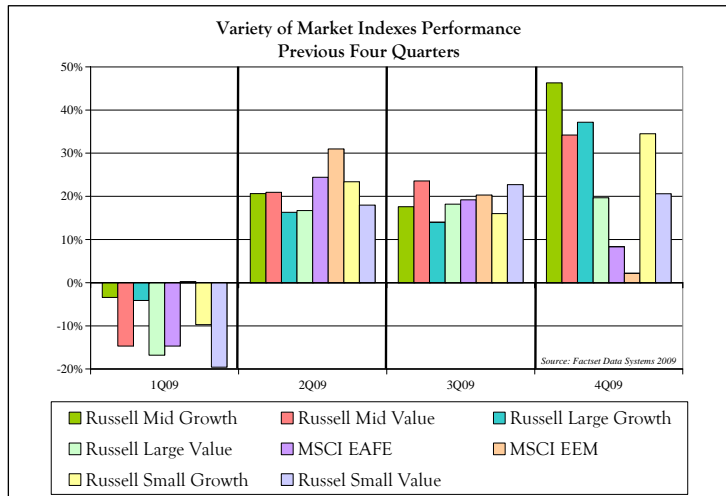


2009. Commodities did well with oil surging 78% to \$79 per barrel by year-end. Gold prices hit record highs 27 times during 2009. After a tough year in 2008, Mid Cap stocks lead the way, outperforming small and large companies.

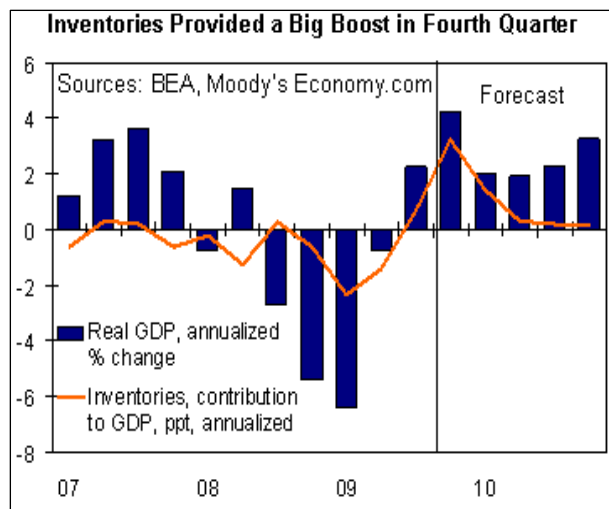
During the fourth quarter, market indexes were up between +3% to +8% depending on the area. The best performing sector was Technology in the Russell 3000 broad market. Expectations for increased capital expenditures by corporations

pushed Tech companies like Cisco higher. The worst sector for the quarter was Financials (-2.2%). The Healthcare sector enjoyed strong performance for the quarter, increasing +8.2% in a relief rally, as Congress disclosed more definitive information on the changes they hoped to make to medical care.

Surprisingly, this surge in stock prices happened while the average investor was dumping their stocks by the billions. Of the \$11 trillion invested in US stock mutual funds, over \$35 billion was pulled out in the last 12 months ending November. While US funds were forced to sell their holdings to provide cash for these withdrawals, international stock funds were attracting more than their share of cash. The stock markets of developed countries performed in line with the US, earning +32% for the year, the emerging markets, as measured by the MSCI Emerging Market index, booked in a whopping +79%. At the same time, money market funds fell from \$3.9 trillion in assets to \$3.3 trillion. Some of this money apparently found its way into FDIC insured accounts at local banks while \$390 billion in new cash was deposited into bond funds as investors looked for less volatile outlets. As a result, many investors missed out on impressive US equity returns.



**Economy Commentary**

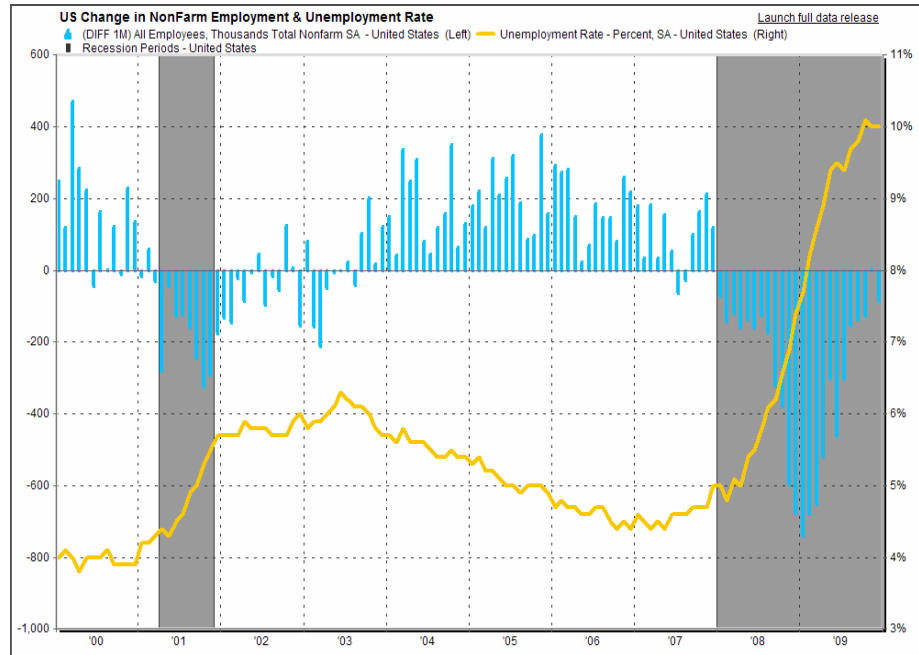


Even though 3<sup>rd</sup> quarter, 2009 GDP has been revised lower to 2.2%, it is the first positive report in over a year, signifying the recession is over. Fourth quarter estimates are for stronger growth, spurred by rebuilding of inventories, better exports, improved capital expenditures and a “somewhat less negative” housing market. Estimates for 4<sup>th</sup> quarter GDP growth range from 3.3% to 4%.

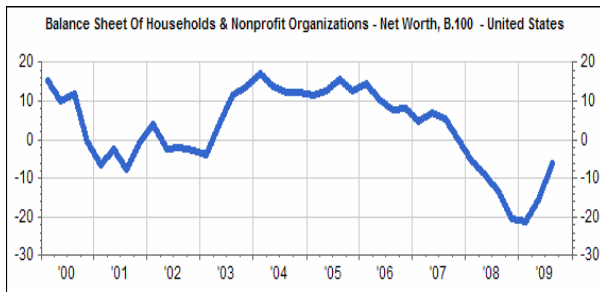
A slower than normal economic recovery is anticipated in 2010 as the after effects of such a nasty recession will take longer than we’d like to rebuild. It is estimated that the recovery phase will last five quarters, averaging 3%-3.5% growth

per quarter before the real economy is back to its previous peak levels. Previous recoveries happened much faster. In the 1973-75 recovery, GDP was back on track in three quarters of boom times. In 1981-82, the recovery took two quarters with real GDP growing at an average of 7.2% per quarter.

Jobs continue to be an area of weakness during this recovery and beyond. The days of 5% unemployment are not likely to return for years. Competition in the job market will remain tough, requiring increased focus on value added experience and education. The millions who are working are producing more with less which helps corporations keep expenses down and profit margins fat.

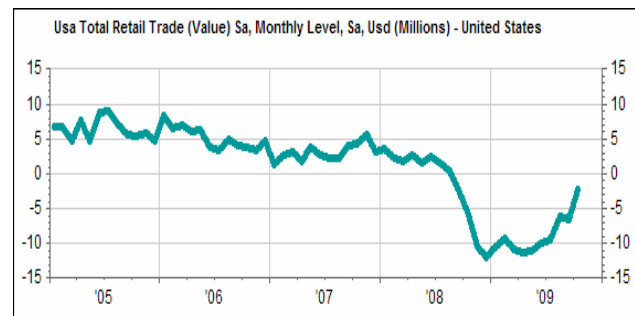


Corporate earnings have remained strong with solid cash flow. Corporate stashes of cash provide fuel for mergers and acquisitions which have already started to heat up during the quarter. Corporate spending will help fuel the economy while consumer spending is likely to lag behind.



Consumers are responding to the financial pressures by saving more and paying down debt as they rebuild their balance sheets. Consumer credit outstanding has been falling since mid-2008—partly due to banks cutting back on their lending. The consumer needs to participate in

the economy's growth before we have a sustainable recovery. Retail sales remain anemic although they are expected to gradually improve. Car sales enjoyed a major push through the Cash for Clunkers arrangement and then attractive financing deals offered by the car companies. An average new car loan is about \$32,500.



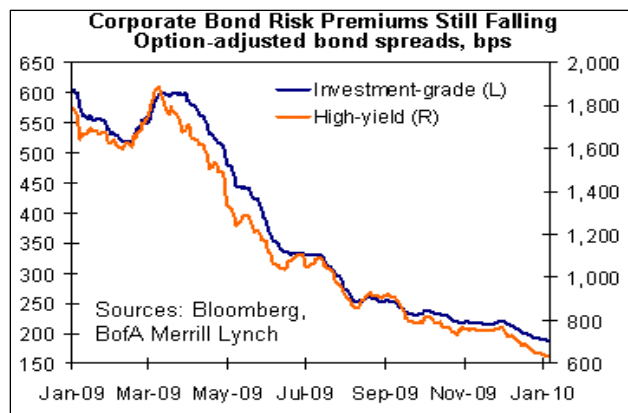
Fiscal policy continues to be expansionary. The housing market has benefited from the first timer's tax credit that was supposed to expire at the end of 2009 and, instead, was expanded into 2010 with broader definitions of who can participate. Existing home sales and new home sales both surged, helped by low mortgage rates as well. The year-end statistics are likely to be somewhat distorted due to the "off and then on again" nature of the program, but the program has made a difference in moving housing inventory. A stable housing market is key for consumer confidence and comfort level.

The Federal government has had a busy quarter. Despite enormous amounts of time and effort, major legislation regarding health care, financial regulation and climate control remain far from complete. The recent election of a Republican Senator, decreasing Democrats to less than filibuster-proof 60 seats, will likely cause greater gridlock over these important pieces of legislation. In the meantime, the rest of the stimulus spending earmarked from the American Recovery Act should help the jobs situation. Social security beneficiaries received no cost of living adjustment so they may receive another one time extra payout closer to the November elections. The Bush era tax-cuts are due to expire at the end of 2010. If no action is taken by Congress, many families, including those making less than \$250,000, will be paying more during these tougher economic times.

### Fixed Income Commentary

Bond Market Indexes as of 12/31/09	4th Quarter	2009 YTD	3 year	5 year	10 year
iBoxx \$ Liquid High Yield Index	+5.0%	+44.5%	+4.0%	n/a	n/a
JP Morgan Emerging Market Bond Index	+1.6%	+28.7%	n/a	n/a	n/a
Barclays Intermediate U.S. Credit Index	+1.6%	+15.9%	+6.0%	+4.8%	+6.4%
Barclays U.S. Credit Index	+1.0%	+16.0%	+5.7%	+4.7%	+6.6%
Barclays Intermediate Gov/Credit	+0.3%	+5.2%	+5.9%	+4.7%	+5.9%
Barclays U.S. Aggregate Index	+0.2%	+5.9%	+6.0%	+5.0%	+6.3%
Barclays 1-3 U.S. Treasury Index	+0.0%	+0.8%	+4.9%	+4.0%	+4.5%
Barclays Government/Credit Index	-0.2%	+4.5%	+5.8%	+4.7%	+6.3%
S&P Municipal Bond Index	-1.4%	+12.2%	n/a	n/a	n/a
S&P/Citicorp Int'l Treasury, ex U.S. Index	-2.0%	+6.4%	+8.6%	+4.9%	n/a
Barclays 7-10 year U.S. Treasury Index	-2.4%	-6.0%	+6.9%	+5.1%	+6.7%

Higher risk takers were rewarded in the bond market during the fourth quarter. As illustrated in the table above, high yield securities (commonly called junk bonds) and emerging market bonds were among the best performers for the quarter and the entire year. Quality corporate bonds generated strong double-digit returns for the year. It is unlikely that these levels of returns will continue as the bond market spent the year adjusting from the extreme situations that occurred in 2008. We anticipate 2010 to be a year of gradually rising rates as the credit demands of a recovering economy kick into gear.



Corporate and high-yield bonds benefited as the debt markets returned to more normal spreads. The chart on the left illustrates just how far corporate and high-yield bonds adjusted in 2009. The average quality corporate bond started the year trading 6.0% higher yield than the equivalent US Treasury bonds. Junk bonds were trading at 18.0% higher than the equivalent Treasury. By the end of 2009, junk bond yields were only 6.0% higher and quality corporate bonds traded only

2.0% more than Treasuries yields.

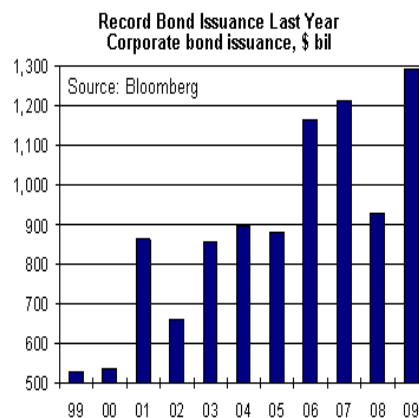
The Federal Reserve has maintained its easing monetary policy. Chairman Bernanke, who is up for reappointment for his job, has continued to express concern about unwinding the Fed's easy stance too soon. Fed funds rates, the vehicle the Federal Reserve uses to control short term rates, remains at its lowest range ever, trading between 0.0% to 0.25%. This has influenced other short term rates, especially Treasury bills and other securities used in money market funds, providing virtually no net return for months. With no "low risk" investments that are attractive, investors have moved up the risk continuum, loading up on longer maturities and lesser quality fixed income choices.



Investors have chosen to move their dollars away from longer term US Treasuries despite their attractiveness during desperate times. The chart above shows the yield of the 10-year Treasury over the past two years. Their interest rates have returned close to pre-crisis ranges, which is actually a good sign of returning normalcy. It was December 2008 when 10-year yields dropped close to 2.2% because of the fear of a global market collapse. Treasuries in the 7-10 year maturities were the worst performers for the 4<sup>th</sup> quarter as their return declined -2.4% and dropped over -6.0% for

all of 2009. Remember, as interest rates move higher, bond prices decline, dropping the securities total return.

The outlook for Treasuries remains under pressure. Given the huge budget deficits that must be financed in the coming year, the bond market may not readily absorb all of the supply. The US Treasury increased debt by \$1.6 trillion in 2009. Corporations were also in the mix last year with over \$1.3 trillion of new issuance. The US Treasury will need to raise another \$1.8 trillion in new money in 2010. With the economy recovering, corporations will likely borrow more as well. It adds up to plenty of bond supply.



Bond demand has increased throughout 2009 as investors have moved out of the stock market and money market funds, throwing billions of dollars into bond funds and fixed income ETFs. Foreign countries, in particular China, have been significant purchasers of US bonds. It is not likely that this demand will continue at the same pace in 2010 and so higher rates will be needed to satisfy suppliers and keep buyers of bonds happy.

### Market Sectors Commentary

Over-weight	Under-weight	Neutral
Materials	Utilities	Consumer Staples
Technology	Consumer Discretionary	Telecommunications
Health Care		Financials
		Industrials
		Energy

The table above lists our rankings for the major market sectors going into 2010 for Large Cap. Our Mid-Cap sector weightings are similar except for Utilities, which is rated as a Neutral.

The Health Care sector weighting has been increased from its former neutral rating. The Health Care sector is greater interest now as the political situation is not as extreme, making it easier to analyze which companies will do well as the US grapples with the many health care issues. Stocks in this sector in many medical industries sold off in past months and now are at intriguing valuations.

With an improving economy, we continue to like the Materials sector and Technology. Both sectors will benefit as corporate spending and inventory rebuilding improves. The Industrial sector was downgraded to Neutral as it has already had significant valuation improvements and is not as interesting relative to other areas.

We downgraded the Energy sector for now. Oil prices gushed higher in the fourth quarter but demand for energy has not picked up in-line with expectations.

We continue to have concerns about companies in the Consumer Discretionary area, which includes restaurants, retailers, etc. Although there are some exceptions, it is too early in the market cycle to move aggressively into these types of stocks. We continue to rank it as an Underweight until we see signs of improving labor and housing markets. Consumer Staples, on the other hand, remains a Neutral rank. Staples include necessities like food, diapers and toothpaste.

### **Holt-Smith Advisors Outlook and Diversified Portfolio Strategy**

The stock market and bond market have enjoyed a tremendous year as they recover from the disastrous 2008. But, we have a way to go to return to prior stock market levels and given the lack of speed we expect in the economic recovery, we would be surprised to reach those old highs anytime soon. Opportunities for positive returns are there but the market never moves straight up. Instead we would expect the normal type of corrections of 5-10% as new data and company fundamentals change. Overall, these market pullbacks will help to ensure a longer, sustainable positive market environment.

We expect interest rates, especially in the Treasury market, to move higher due to greater supply and as the economic recovery creates more rewarding areas to invest. The bond market had an amazing year but given the path it has walked already, it is not likely to repeat in 2010. Therefore, we are more interested in overweighting corporate and municipal bond positions versus Treasuries and do not see a reason to extend the average maturity beyond our Barclay's Intermediate benchmark of 4-5 years.

Holt-Smith Advisors has set our Tactical Asset Allocation objectives based on our assessment of the current state of affairs. These objectives include:

1. **Increase Large Cap Companies allocation.** Quality large companies are a core holding for most investors. They should benefit from improved earnings, strong balance sheets, increased merger and acquisition opportunities, and slow economic recovery.
2. **Increase emphasis on Growth stocks versus Value stocks.** Growth is the preferred area as stronger fundamentals should help the companies do better during market adjustments. Value has its place in an economic recovery but may have come too far too fast. We are increasing both Large Cap Growth and Small Cap Growth while maintaining our Mid Cap Growth weighting.
3. **Change portfolio allocation to Mid Cap Growth and Mid Cap Value.** We are decreasing our allocation to Mid Cap Value somewhat as it has performed almost too well relative to expectations. We are maintaining the Mid Cap Growth allocations as earnings potential remains attractive into 2010.
4. **Increase Small Cap Growth allocation.** Small cap companies tend to lead the markets to

new heights, but the value portion is too heavily skewed toward small banks. Our tactical asset allocation model indicates the growth area will continue to benefit the most in this economic recovery.

5. **Decreasing our International focus.** Emerging markets have proven their ability to grow despite global economic difficulties. China and Brazil continue to be bright spots. We are maintaining our exposure to the emerging countries (iShares EEM) but have sold out our holdings in the non-US large international markets, as represented by the MSCI EAFE (iShares EFA). European and Japan markets will likely to stall out while the US markets continue to do better.
6. **Emphasize corporates bonds over US Treasuries.** High probability of Treasury rates moving up faster than corporate bonds as investors search for more attractive yields.
7. **Maintain cash level at 0% as markets continue positive long term momentum.**

Please keep in mind that markets are ever changing and conditions could and most likely will develop that will cause us to alter our outlook. These thoughts and assessments by Holt-Smith Advisors are based on information believed to be accurate and reliable. They are shared only for informational reasons. Every investor's situation is different and experts should be consulted before portfolio changes are made. If you are not a client of Holt-Smith Advisors and would like to know more about what we can do for you, please contact us as 608-249-4488 or [hsa@holtsmithadvisors.com](mailto:hsa@holtsmithadvisors.com).

*The opinions expressed above are those of Holt-Smith Advisors, and are subject to change. There is no guarantee that the opinions expressed and the forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. Information and opinions are derived from proprietary and non-proprietary sources. Past performance is not a guarantee of future results.*