J.J. BURNS & COMPANY, LLC

4th Quarter Newsletter, January 2010

Not Long Ago In a Galaxy Not Far Away…

It was not long ago when this time last year we indicated that 2008 would go down as one of the worst years in the history of the financial markets. It's interesting to go back and revisit history, certainly in the short term but also in the long term as well. There are many similar conclusions, which can be drawn from today to more than fifty years prior. From peak to trough the S&P 500 was down nearly 60%. Except for US Government bonds, most other asset classes were down significantly. Surprisingly, even investment grade corporate bonds were "shot" as the events of 2008 were liquidity driven. Even commodities and gold were down at year-end 2008. In short, the bubble of credit, which allowed "anyone" to own a home, went "bust." Cost cutting by businesses led to increases in unemployment and underemployment. The de-leveraging process of the consumer was well under way, and still ongoing today. Fear, was gripping the markets and led many to believe that Financial Armageddon was upon us.

Cloudy With A Chance Of?

The above statement could pretty much sum up the state of the financial weather going into 2009. Banks and many financial institutions were seeking bailouts (any many continue to be closed). The consumer and many small businesses had limited access to credit, and in fact the housing market led many individuals to walk away from their homes as their mortgages were under water. Globally, not much was different. The American led housing bubble, affected many and even put a country on the brink of total bankruptcy. We have seen unprecedented government intervention in an effort to stem some of the losses and to support institutions so that the banking system would not completely fail. Government led stimulus injected liquidity into the financial system to divert a total collapse.

Somewhere, we found a bottom in stocks as cost cutting measures played a significant role in equity market valuations and "just like that," the markets rebounded to power higher, reversing a downtrend of nearly -20% in the first quarter of 2009 to return more than 26% on the S&P 500 by the end of the year. In early 2009 we wrote that, in nearly every economic recovery, globally speaking, the credit (bond) markets tend to lead the way in advance of economic activity prior to the resumption of GDP (gross domestic product) growth. The Federal Reserve expanded its balance sheet to historic proportions. The Fed expanded its reserves at 11x the rate seen in 1934 (the era of The Great Depression). This "jet fueled" injection lead to impressive results around the globe, and for many asset classes. These returns were not limited to the equity markets. Below are a few market indices, some of which posted impressive returns. Many of these returns were present in your well diversified, asset allocated portfolios.

*Equity Indicies

• S&P 500	26%
• Dow Jones Average	22%
• Dow Jones Midcap	44%
• Dow Jones Small Cap	41%
• Intl/Em Mkt	77%

* Fixed Income

• High Yield	44%
• Int Corp. Bonds	23%
• TIPs	11%
• Intermediate US T.Bonds	1.5%

*Quoted year to date 12.31.2009 from active Std. Poors Depository Receipts (SPDR) and other active ETF (electronic traded funds) portfolios where noted

Interestingly, 2009 reminded me of three very important investment fundamentals, which are often so simple yet can be forgotten by many:

1. *Diversification* does actually work. A risk-adjusted portfolio consistent with a good plan can work quite well in up and down markets.
2. *Asset Allocation* works if you continually monitor your portfolio, rebalance (at times, frequently) and monitor all asset classes for value and possible addition.
3. *Manage to your need.* Don't take unnecessary risk when you may already be achieving most of your objectives.

2K-10: Looking Ahead

Although we are extremely pleased by the results of the markets across the globe in 2009, our perspective has not changed too much from where we stood in the fourth quarter of 2008. You may recall at that time we wrote, "some pretty strong medicine has already been applied to an ailing economy." This medicine cannot go on forever, as if to support a patient (state) who in some parts of the country is on life support. Perhaps we have ultimately avoided the "Financial Armageddon," but what is left does not spell "Recovery" in our opinion.

I have read numerous reports predicting 2010 as the year of corporate earnings growth. The bullet points below summarizes many of the firms and colleagues whose 2010 outlooks I have read, many of which, I have shared the stage at CNBC and other media outlets with as well. Many of these people are very smart and I have much respect for them. Collectively, we have spent many hours with our investment committee team, which exponentially increases the consistency of the consensus views below. There is a consensus, which develops, and I think it's important to have this perspective:

Consensus Views:

- Equity markets will be up by year-end. Most of the ranges are high single digits to low double digit percentages
- US dollar will have a recovery
- GDP will have positive but muted growth.
- Little to no risk of a double dip recession.
- Long term Treasury Bonds are a losing investment as rates are so low, they will only lose value by year-end.
- Positive on commodities
- Volatility will not be an issue in 2010.
- Federal Reserve will be forced to raise rates by year-end.
- High yield (junk bonds) will do well as baby boomer will have to reach for yield as 1% or less in banks won't pay the bills.
- Emerging markets will be in a bullish cycle and are less risky at these levels than US domestic equities.

One of many market adages I have taken to heart is, "When all forecasts and experts agree, something else is going to happen."

I don't believe nor do I view the economic events of the last two years typical of a "garden variety recession."

The ratio of household debt to disposable income is up from a 30% ratio back in the 1950's to 125% today. More than $7 trillion of household credit will need to be eliminated over the next several years. If we lived in an economy of valued at some $16 trillion two years ago, mostly functioning on credit, then today the true reality is once you strip out the credit and clean up the balance sheet, we should have an economy valued at roughly $9 trillion. A year or so does not remedy this problem, which took several years to develop.

The Japanese stock market has had four or five 50% rallies since 1989 and there still has been no time period of growth that we can say was a sustained economic expansion. In The United States, we are in a post-bubble credit collapse. This bubble continues to be supported by government stimulus, which has little to no effect on the small business in the US, which employs 70% of the workforce.

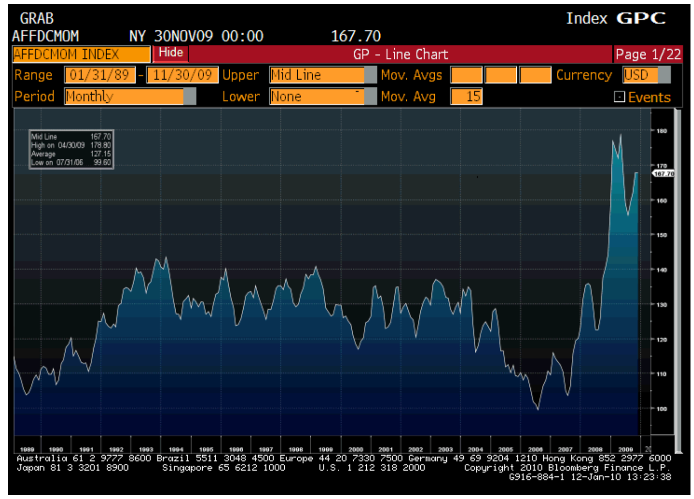
We have had a significant government stimulus. In the third quarter, $100 billion of government aid leads to 90% of the growth. What little growth we would have had without stimulus is concerning. At 2.2% growth subtracting stimulus gives us flat to negative growth. Looking back at GDP recovery when coming out of a recession, history shows us we should be expanding at better than 5%. Again, if we are out of recession then show me recovery!

Its Still About Housing

We hear in the media that banks have an aversion to lend. If you could borrow from the Federal Reserve at near 0% and purchase Treasury bonds at 1% or higher, you are guaranteed a profit with virtually no loss and no underwriting. Some banks are lending but only to qualified borrowers, which are becoming harder to find due to rising unemployment levels.

Twenty-five percent of US homeowners with a mortgage are "upside down," that is 15 million households with negative equity, which likely means more foreclosures on the horizon. More houses will be in the inventory stockpile, which in turn leads to downward pressure on home prices. Even with President Obama's stepped up loan modification plan, it has done little to help save homeowners and help to maintain homeownership.

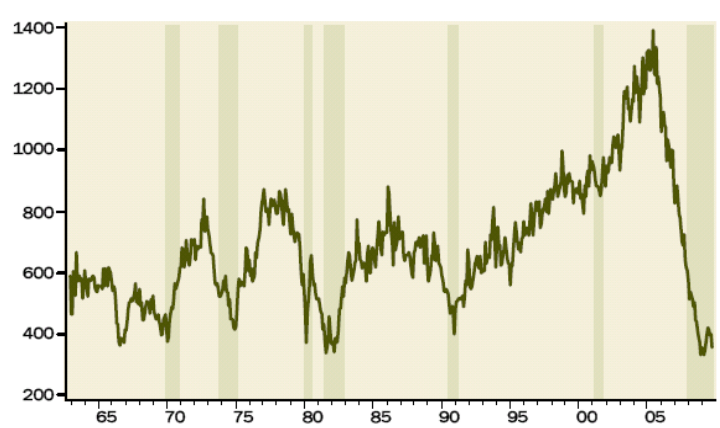
Housing affordability since last year has not improved by much, but actually slipped in the last quarter, as the graph below will show (updated). Plans to purchase a new home over the next six months dropped to the lowest level in 27 years.* (US: Consumer Board Consumer Confidence Survey, plans to purchase a home in next 6 months)



Bloomberg

With government stimulus for first time homebuyers, we saw a blip up in home purchasing. New home sales were down 11% month over month. Sales of completed homes are down 38% from what were already depressed levels a year ago. Inventory for new homes is back up to nearly 8 months supply. On average it takes a builder 14 months to find a buyer for a completed home.

United States: New Single-Family Home Sales
(thousands, annualized)



Shaded region represent periods of U.S. recession

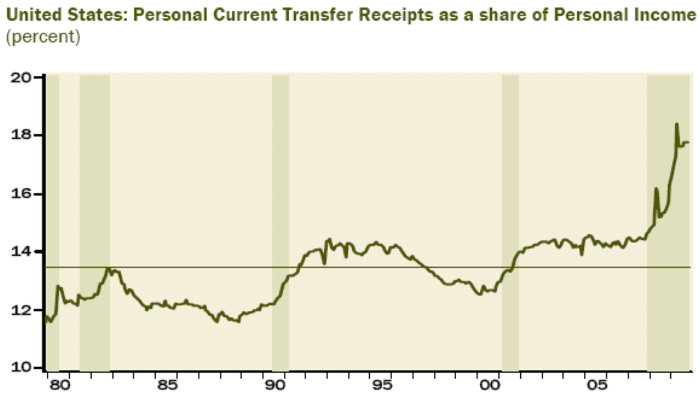
One in seven Americans with a mortgage are in arrears or already in the foreclosure process. Speak to any debt counselor, especially in Florida, and they will tell you banks don't want to foreclose on any more properties as it weakens their balance sheet. Instead they keep these loans on their books, which are not priced correctly. The U.S. Government has set the "too big to fail" precedent. Nobody seems to notice that of the $7.4 trillion of US banking assets, there are nearly $400 billion that are classified as "Level 3 illiquid loans or the equivalent of their entire core capital level. The Economist recently indicated these loans are being carried on the books at a $76 billion premium to "fair value, suggesting we are nowhere near close to knowing the true value of these assets on the banks balance sheet.

In 2009 alone, more than 170 banking institutions were closed by the FDIC. This trend is continuing into 2010, as Horizon Bank was the first bank to be closed this year. This figure has now exceeded the 1993 savings and loan crisis in institutions closed. Looking at the FDIC's failed/closed bank list is quite sobering, yet many people are still in denial of the reality they are facing today of their current financial situation. In the meantime, the FDIC needs to continually replenish their funds to keep doing the work of shoring up failed institutions as they look to raise funds from all member banks.

Main Street America

I think the average American has a better grasp of what is going on than the average Wall Street strategist. Consumer attitudes are changing. I have witnessed many who are getting back to a more "grass roots" perspective of what is really important in their lives. Attitudes toward buying have changed. Today it is vogue to speak about what great deals are online and how you can find value through coupon websites. The malls are crowded only on days when after holiday sales with double value coupons are abounding. My daughter and I were waiting on line to return an item when a woman turned around and offered us an extra $25 off coupon for our purchase. This is happening all over the country as was indicated by a recent NY Times poll, "Americans doing more, buying less." Local food pantry reserves are low, while volunteers are regularly in the local churches and synagogues asking for more donations of food and clothing.

It has become, that if the government is not giving a stimulus, the consumer will do without. (See graph below). In the case of home buying, the first time homebuyer knows that without stimulus it pays to rent vs. buy, as rents are far lower. Ultimately, home prices would need to come down on average another 10-15% to have rents equal the benefits of home purchase.



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Main Street America sees this is a different world we are living in. The signs are very different this time around on Wall Street. Instead of the general public chasing returns in the stock markets, they have changed their approach toward investing as they have been forced to change their habits towards borrowing. The latest mutual fund data supports these conclusions as American investors pulled $2.8 billion out of stock funds in November – the third outflow in a row. Stock funds saw net redemptions of $4.1 billion even as the S&P 500 had nearly 25% in gains for the year (2008 had more than $200 billion net outflows). Once again, I did not see any of this news on the front pages of popular magazines. Money market funds also had net outflows, but these funds did not find their way into stock funds either. Bond funds took in over $360 billion through November. Investors are reallocating more towards fixed income funds in the wake of rising stock markets.

Insight at JJBCo.

What we are currently seeing is losses outside the area of portfolio management such as a real estate failure or declines in small business activity, are affecting the behaviors of many baby boomers, in becoming more risk averse in their portfolio management. Whether they are experiencing an unemployment or underemployment in the family, they nonetheless wish to allow the guarantees of fixed income dictate what they need to adjust their spending habits to live by, not what excesses they may take from stocks which are uncertain. An ill parent or a child, who is unemployed/underemployed, has also played a significant role in how they need to adjust their financial lives. What we have found in building customized portfolio allocations is that bond income allocations, even though rates of return are lower on the income side today, are at a higher percentage. The main reason for this important decision is they are dependent more on income from their portfolio than ever before. This is a time where our country has an influx of baby boomers at retirement age. If only semi-retirement is a possibility, the attitude we see is “I’ll take what I can virtually guarantee and live around that figure.” “I cannot sleep with the uncertainty of valuations and the economic uncertainties of where we are today.” Many small businessmen feel this lack of uncertainty more than ever as banks have pulled back in lending to the small business. From this perspective, we at JJ Burns and Co., LLC can see first hand why there is a significant increase in bond allocations.

At the institutional portfolio management level, more non profits and pensions are getting the demands of future income needs as more employees are retiring on the pension side and many funding sources and program aid is being eliminated or reduced, thus ultimately requiring more demands of income from the respective portfolios. Really not much is different at the individual portfolio management level.

Looking at the big picture across our country also tells the same story: On average revenue at the state level has decreased by 12.5%, whereas state budgets have only dropped some 5% of expenditures. States and Governments can run deficits, individuals and small businesses (the backbone of our economy) cannot.

Conclusion

Markets can stay overvalued for an extended period of time, but as we say in 1987, 1990, 2000 and 2007, overvalued markets are more vulnerable to downside surprises than is the case with undervalued markets.

Our policy of asset allocation, diversification into multiple asset classes and alternate asset classes will likely provide support in volatile environments. We continue to seek our asset classes, which have lower valuations while again, maintaining the benefits of broad allocation. If you refer to the returns in fixed income last year, some areas outperformed stocks by a wide margin. Rebalancing portfolios to the appropriate objectives each of our clients maintain is essential to keeping risk and volatility at bay.

Our team welcomes any questions or comments you may have.

In the meantime, on behalf of our entire staff at JJ Burns and Co. LLC, I wish you and your loved ones a Healthy, Happy and Prosperous New Year.

JJ Burns, CFP
President & CEO