J.J. BURNS & COMPANY, LLC

1st Quarter Newsletter, January 2010

The New New Deal

This week marks the 65th anniversary of the death of Franklin Delano Roosevelt, the 32nd president of the United States. Many will remember FDR for his "Fear Itself" (speech at his first inauguration on March 4, 1933) and "Date which will live in infamy" (speech the day after attack on Pearl Harbor day, Dec 7, 1941). From an economics perspective we may all remember FDR's "New Deal" which was touted as saving the economy on the brink of financial disaster which became known later as "The Great Depression." Interestingly, the facts do not support the perception that FDR's policies shortened the Depression. Many pundits point to facts that similar policies today will pull our economy out of its current economic downturn. Nothing could be further from the truth.

The main goal of the New Deal was to get people jobs. Ultimately there were fewer jobs after FDR took office and this continued even with government employees working fewer hours than ever before. Total hours worked per adult were 18% below their 1929 level between 1930-1932, but were 23% lower on average during the New Deal (1933-1939). It was not just jobs that remained scarce during this time period. Per capita consumption did not recover at all, remaining 25% below its trend level.

The Depression's impact on the economy

	1929	1933
Banks in operation	25,568	14,771
Prime interest rate	5.03%	0.63%
Volume of stocks sold (NYSE)	1.1 B	0.65 B
Privately earned income	$45.5B	$23.9B
Personal and corporate savings	$15.3B	$2.3B

Thanks to the work of Nobel Laureate Robert Lucas and Leonard Rapping who calculated on the basis of Federal Reserve Policy, the economy should have been back to normal by 1935. The biggest impediment which stopped an economy from recovering was "The New Deal."

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The benefits of the safety net created by the New Deal included unemployment insurance benefits and the creation of the Social Security System. Bank insurance (FDIC) eliminated the "run" on bank deposits, as did the creation of the SEC (Securities Exchange Commission) in helping to regulate the stock market.

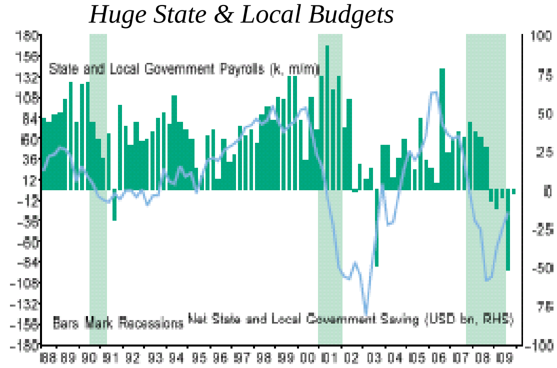
Ultimately, it was the unforeseen and unintended consequences of setting prices and wages in many sectors of the economy above normal levels which suppressed natural market forces to lead to an economic recovery. In short, the anti-market policies prolonged the depression, which by all measures could have been minimized and back to a level of normalcy by the mid 1930's.

The Depression's impact on people: Consumer spending (in billions) on selected items, 1929-33

	1929	1933
Food	$19.5	$11.5
Housing	$11.5	$ 7.5
Clothing	$11.2	$ 5.4
Automobiles	$ 2.6	$ 0.8
Medical care	$ 2.9	$ 1.9
Philanthropy	$ 1.2	$ 0.8
Value of shares on the NYSE	$89.0	$19.0

We think it is important to understand history, as some of our policies today form interestingly similar parallels. The New Deal may have prevented the very worst of all possibilities. However, in the end, the fiscal largesse was paid for by the upper-income earning class as top marginal tax rates surged from 25% to 80% by the end of the 1930's. Taxes in the U.S. are destined to soar in coming years because too much of the spending is nondiscretionary; indeed, this is already happening at the State and local government level.

Huge State & Local Budgets



Source: Reuters EcoWin Pro, BNP Paribas

State and local budget deficits are widening and will remain substantial for years. Thus, states and local governments will have to continue cutting services, slashing jobs and raising taxes.

If you really want to get a first hand perspective on what occurred in the 1930's, take a look at Benjamin Roth's diary of The Great Depression. It's quite fascinating how a 38 year old mid west attorney in the 1930's kept his thoughts and observations through this time period. His numerous entries indicate how many times he thought the worst was over, only to be proved wrong on multiple occasions. Mr. Roth's stories are confirmed from speaking with family members.

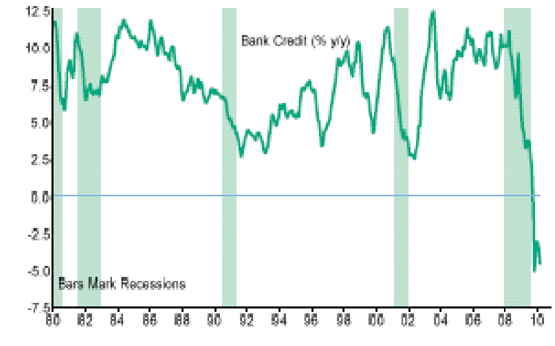
The appreciation of being careful with ones money ruled the day for many years. The result: Generations of savers were created.

Climbing The Wall of Worry

It is said, when stock prices rise regardless of market uncertainties, Mr. Market is said to be climbing a wall of worry. These worries may include political or economic risks. Once the perceived risks have been resolved or have past, average market share prices tend to decline.

The US economy has received tremendous support from government handouts. Some $243 billion of "income" has gone to the household sector compliments of Uncle Sam. Where does the additional income for consumers to spend come from? It certainly does not come from organic growth, such as an increase in wages or new jobs. We believe that a source for at least a portion of this additional disposal income is coming from our fellow Americans defaulting on their mortgage. If you don't have a mortgage payment because you decided to walk away from that 2nd home, guess what? You have more money to spend. Wages and credit are still deflating.

Bank Lending is Plunging



Source: Reuters EcoWin Pro, BNP Paribas

Bank lending has plunged by an unprecedented 10% in the past 15 months. Lending has declined in all major loan categories and reflects both banks' unwillingness to lend and a lack of demand for credit.

Yet, we hear reports that consumer spending is higher at a time when household credit contracted $235 billion and 2.3 million jobs were lost. To wit:

- Decline in savings rate: $22 billion
- Strategic mortgage defaults: $120 billion
- Government wages: $30 billion
- Tax Reductions: $65 billion
- Government income assistance: $245 billion

As noted from our colleague Dave Rosenberg, former Chief Economist at Merrill, "this is a cash flow boost of $475 billion, or equivalent to 5% of consumer spending, and offsets the negative impact from lost private sector wages by a factor of nearly 4 to 1." It's only natural for retail stores to show signs of improvement!

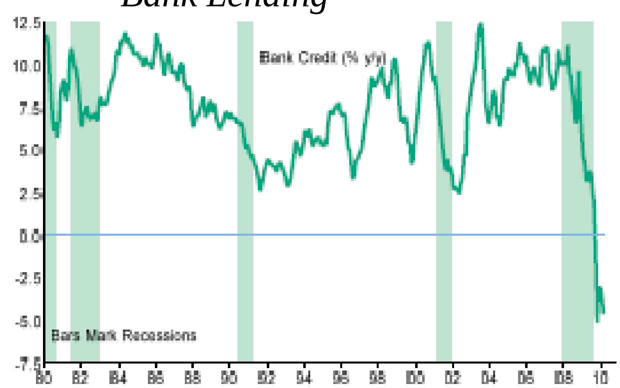
Homes Need Help!

The current loan modifications and forced foreclosures seem to have worked their way through the economy. The extended deadline of the homebuyer tax credit on April 30th does not appear to be benefiting all that much in home sales. The malaise continues in the housing market. Locally we have seen some houses moving a bit. In addition reports from a few larger realty offices indicate they are busy on the lower priced homes market trying to meet the April 30th deadline. The graph (below left) represents existing and new home sales. Although we have had a "blip" the general trend is heading back down. As we discussed in previous newsletters, this does not represent the whole picture as foreclosure sales are omitted. Prices will likely have to fall further to stimulate sales. In addition bank lending has plunged over 10% in the past 15 months. Lending has declined in all major loan categories and reflects both banks' unwillingness to lend and a lack of demand for credit (graph below right).

Home Sales

Source: Reuters EcoWin Pro, BNP Paribas

Bank Lending



Source: Reuters EcoWin Pro, BNP Paribas

However, muted and in some respects convoluted we are getting some stabilization at the cost of a burgeoning tax bill well into the future. This "recovery" may go on for some time. It began in H2 2009 and we continue to believe it will persist. Although we are being driven primarily by policy stimulus, the hope is that some type of "organic" growth will take over and we can eventually say we are in a sustained recovery. We don't believe we can say that at this point for many of the reasons stated prior and more. Households have certainly been at work to repair their balance sheets. Our view is that this process will take time to work out. Household net worth is still well below pre-crisis peaks; unemployment is high, bank lending standards tight, and the trauma of the recent crisis still fresh. The all "clear" flashing green light is not present as of yet. Thus, we cannot justify raising our asset allocations to overweight stocks at this time. As a wealth advisory firm we only see value in having a portion of our assets in well diversified companies with exceptional management.

On recent portfolio management interviews, many of our managers have adjusted their respective stock models to seek companies that have pricing power. This is the power to raise prices in a particular sector of the economy, i.e. shipping and railway transportation are examples. Technology has and continues to be a larger weight to many portfolios. Again, the pricing power of Apple (a larger holding in portfolios) comes to mind. In the corporate bond arena, we continue to enjoy the higher coupon income from high yield corporate bonds. Whether one thinks we are in true recovery or not, the benefit is that many corporations have bolstered their balance sheets and may have avoided a potential bond default. In the high yield corporate area, seeing coupon income in the 8% - 10% area may very be a protective insulation to a volatile stock market. This adds a buffer of inflation protection as it would take a significant swing in interest rates to affect high yield bond values. Technology, telecom, and food tend to be sectors that will maintain or prosper in this period of time. Business equipment has depreciated and needs to be replaced, and businesses have just begun the task. As you can see from the performance of major market indices below, the best performing asset classes this quarter have been small and mid cap companies. However, even if some darker clouds pass, i.e. unemployment, many small businesses that don't have access to the capital markets and face a tighter bank lending environment will make any "full fledged" recovery muted.

<u>Equity/Stocks *</u>	
SPDR S&P 500	4.87%
DJIA	4.11%
SPDR DJ Midcap	7.25%
SPDR DJ Small Cap	9.61%
International MSCI	.76%
SPDR Emerging Mkts	6.96%

<u>Fixed Income *</u>	
High Yield	2.52%
Tres. Inflation (TIPS)	.20%
Int. US Tr. Bonds	.78%
Municipal National ETF	.17%

*Unless noted ETF values indicated on performance for quarter to date, 3.31.10

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There are always issues surrounding the economy. It's never really a perfect world out there. As optimistic as we at JJ Burns and Company want to be, we cannot refute the true economic data present. When economic bubbles burst, the fallout is everywhere. The trickle down effect is in many facets of our economy and world. Greece, California, Colorado, New Jersey, New York and many more states in the US are dealing with the arduous task of balancing their budgets. We have all heard of the cuts in jobs from teachers to state services. In Kansas City, alone the officials closed nearly half of the schools and terminated over 3,000 jobs including teachers and administrators. As a wealth manager and advisor to many businesses and individuals across our country this is of concern. Municipalities will have to make difficult choices which will affect many. As an example, like The US Social Security System, many pension funds across the country are under-funded. What used to be an 8% assumption of return must now be reduced and thus the difference be made up. It will take some time to mop up these excesses and rebuild our economy on a sound financial footing.

Many clients are looking forward to when we will get back to the normalcy of business and investing, even back to the levels we once saw. We will eventually get back to some level of "normal." In the meantime there are opportunities which we continue to uncover and be prudent to add to portfolios accordingly. The climate and environment has dramatically changed, if not for easy credit alone. Mr. Market will seek to find a "new normal," which will ultimately lead us to The New <u>NEW</u> Deal.

In the meantime, enjoy the beautiful spring weather across this great nation!

Respectfully,

JJ Burns, CFP
President & CEO

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