J.J. BURNS & COMPANY, LLC

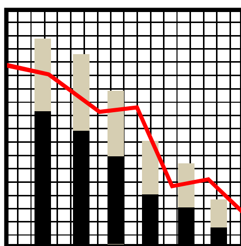
2nd Quarter Newsletter, January 2010

"Same As It Ever Was…."

Some of you may remember the rock band "The Talking Heads" and lead song writer David Byrne who wrote the Top 100 Hit, "Once in a Lifetime." The song "Once In a Lifetime," and lyrics "Same As It Ever Was" suggests that we have been here before and although it happens once in a lifetime, it ends up that life simply repeats again and again.

From our first quarter newsletter through today, the markets have shown a significant amount of volatility and true to form as we penned in previous interim market updates, we will cross Dow 10,000 for the 26th, 27th or perhaps 28th time this year…. "Same As It Ever Was….."

The Stock Market



After a solid performance in April, stocks took a turn down in May and June, erasing previous gains for the year and then some. For the second quarter, the S&P lost 11.4%, while the Russell Midcap and the Russell 2000 were both down nearly 10%. Within the quarter we witnessed the Dow Jones Industrial Average drop by almost 1000 points on May 6th, intra-day along with a sharp increase in volatility afterwards. In many of our conversations and media appearances, we reminded investors that the market also has a downside. Leveraged investors, especially hedge funds who had made this "risk trade," were hurt badly this quarter.

The shift from overconfidence to anxiety was abrupt. During the market's 14 month increase, investors' and many bullish pundits' governing assumption were that the economy was recovering and that many companies stock prices who did the worst in the previous decline would conversely be the greatest performers on the recovery. Today, concern about the strength of the US economy is widespread, and the possibility of a "double-dip" recession is looming. In fact the "double dip" scenario has been the topic of many discussions I have had of recent with the media.

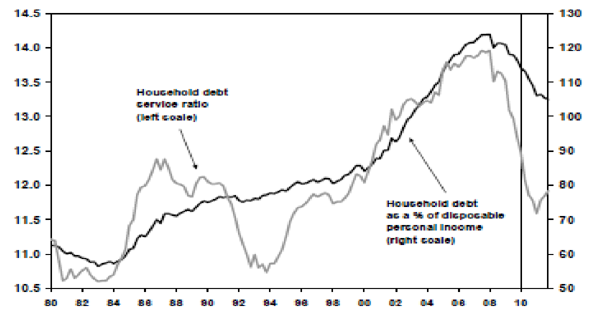
J.J. Burns and Company, LLC
1895 Walt Whitman Road
Melville, NY 11747
631.390.0500
jjburns.com

What Stimulus?

Growth in retail sales has slowed, and housing activity has weakened following the expiration of the Government lead tax credit for first time home buyers. In addition, unemployment benefits were not recently extended by the US Government, which will ultimately result in less consumer spending. Let's not forget, the American consumer is smart. For the most part, we know when it's a good time to spend and when it is not.

Total employment in the US for the month of June was down 4.8% from December 2007. Go to any small business conference or local Chamber of Commerce meeting and the average business owner will tell you they are reluctant to hire as it is difficult to get a loan from banks that have been wounded by this financial crisis (note: the FDIC continues to shut banks at record levels). Businesses are driven by consumer demand. As consumers continue to pare down the large levels of debt they have accumulated, spending will continue to suffer. Thanks to our friends at Morgan Stanley, the graph below shows the consumer balance sheet is improving, however, we have a long way to go:

Consumer Deleveraging



Notes: 2Q10-4Q11 values represent Morgan Stanley Research estimates.
Household debt is defined to be the sum of home mortgages and consumer credit, and excludes the liabilities of nonprofit organizations and other entities classified under households in the flow of funds accounts.
Sources: Federal Reserve Board, Bureau of Economic Analysis, Morgan Stanley Research

We think it's important to revisit a few of our thoughts which we wrote to you on April 9th, 2010:

- U.S. equity funds posted a net $926 million outflow while retail investors ploughed another sizeable $8.74 billion into bond funds (on top of the $9.24 billion the week before).
- Investors are overly optimistic, put/call ratios are optimistic; portfolio managers and letter writers are too bullish.
- Longer Term - Liquidity is becoming troubling.
- The velocity of additions is diminishing.
- Valuation on the market is at the high side of normal.
- Market momentum is also waning. Our short term models are showing volume

J.J. Burns and Company, LLC
1895 Walt Whitman Road
Melville, NY 11747
631.390.0500
jjburns.com

divergences and have not been confirmed by volume breadth models.

- Short Term Market Direction: Best case side ways move to the market, worst case a 10% correction.
- Long-Term Market Direction: The market will take a substantial downside move when the Fed tightens.
- Confidence is still well below the January level of 56.5, and not only that, but it is below the 55 consensus estimate for February.

* Most of the thoughts above have materialized to date.

Portfolio Rebalancing

With respect to portfolio rebalancing, many investors at both institutional and individual levels are adding to bond holdings recently as the Treasury has had a large refunding (or refinancing) of higher coupon bonds to lower coupon bonds. We at JJ Burns and Co., have seen some of our US Government bonds called or refunded of late. This leaves us with some cash in portfolios to redeploy into the fixed income markets.

It's Not Junk

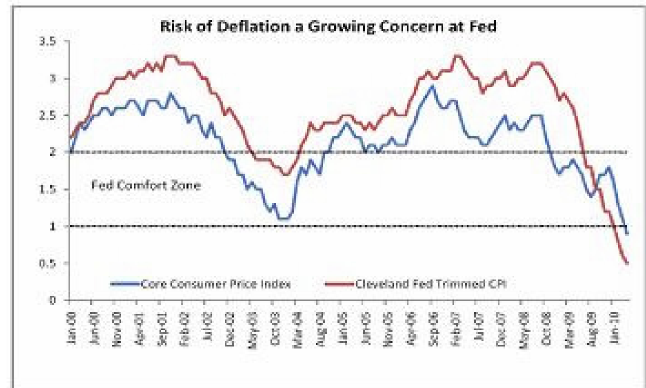
In 2009 our allocation in High Yield (Junk bonds) outperformed most other asset classes. The index was up in excess of 35%. As you know, we rebalanced most of our high yield portfolios away from index related performance to an active managed portfolio. Interestingly, Moody's default rate on speculative-grade bonds has declined to about 2% over the past three months. It was 12% a year ago. This indicates that corporate high yield bonds have a lower risk of default. Typically, the spread between Treasury bonds and high yield bonds averages about 400 basis points or 4%. In other words, with a current yield of 3% on Treasury Bonds, a High Yield Bond should return approx. 7%. Today an average High Yield Bond generates a premium of approximately 700 basis points (7%) above the 3% Treasury or approx. 10%. Comparatively, in June 1997, the spread was approximately 300 basis points (3%) which was quite expensive at that time. Understanding that today is a bit more tenuous time; high yields may be considered quite inexpensive.

J.J. Burns and Company, LLC
1895 Walt Whitman Road
Melville, NY 11747
631.390.0500
jjburns.com

Income From Stocks

Bonds are not the only class that can generate income. Although we are big fans of generating risk adjusted return in bonds, we are equally compelled to look at a quality income stream which may be generated from stocks as well. High quality dividend paying stocks may have the long term performance we look for, again with a risk aversion theme. It's important to note that about half of the return historically in stocks has been from reinvested dividends. There have been over 500 companies which have increased their dividend in the first two quarters of 2010. According to Baron's, "the ratio of dividend enrichments to adverse actions was almost 9 to 1 for the first half" of the year.

The role stocks play in a diversified portfolio varies from growth producing to dividend producing. That said, although we tend to have stocks underweight in some of our portfolio allocations, we continue to believe there are still opportunities in certain sectors even if we maintain a very slow grind of a "recovery." The new winners will be the stocks of companies that can grow earnings and cash flow under challenging economic conditions.



Hawkish tones coming from the Federal Reserve indicated they are not confident an economic recovery is at hand. Rates were kept unchanged. Housing starts, building permits, new and existing sales, home builders' sentiment, mortgage purchase applications, and rising foreclosures and inventories are signaling a dismal future. As we anticipated once the government stimulus was withdrawn, consumers pared back spending. New home sales in May plunged 33% from April as the home buyer tax credit expired. A growing concern we have is the risk of deflation. In a recent Bloomberg commentary, it becomes clearer that "The slack in the economy has resulted in price cutting to lure cash-strapped consumers into the malls. As a result, price declines can be observed in increasing quantities, reinforcing the idea that deflation is the primary pricing risk to the economy." In 10 post war recession's growth has averaged over 6% in the four quarters of any recovery. If the recession ended in

J.J. Burns and Company, LLC
1895 Walt Whitman Road
Melville, NY 11747
631.390.0500
jjburns.com

3Q 2009, the recovery is on track for approx. 3.5%. This is a far cry from past recessions.

Final Thoughts

The current recovery is more vulnerable than past recoveries because of the excessive levels of debt that consumers and governments have built up. Even so, conditions are very different from those that prevailed in the early 1980s, when the US economy did experience a double-dip recession. The second leg of that downturn came because the Federal Reserve, under the leadership of Paul Volcker, forced interest rates well into double digits in a successful effort to counter an out-of-control inflation rate. Current conditions are not the same. The Fed has room to pump money into the system once again by buying financial instruments; however, this could cause an abrupt change to future inflation expectations. Corporate balance sheets are in good shape, the flip side of this high cash balance means corporations don't see any worthwhile places to invest these funds. When a business sees an opportunity to generate revenue they will invest more capital. So when pundits say it's all about the consumer, they may not be far off. A lackluster, debt laden consumer who is unemployed or fears joblessness with limited credit and dwindling benefits could be the deciding factor of the economic recovery. To wit, "Same As It Ever Was."

As always on behalf of our entire team we welcome your comments and questions.

Enjoy the warm summer months.

Respectfully,

JJ Burns, CFP
President & CEO

J.J. Burns and Company, LLC
1895 Walt Whitman Road
Melville, NY 11747
631.390.0500
jjburns.com