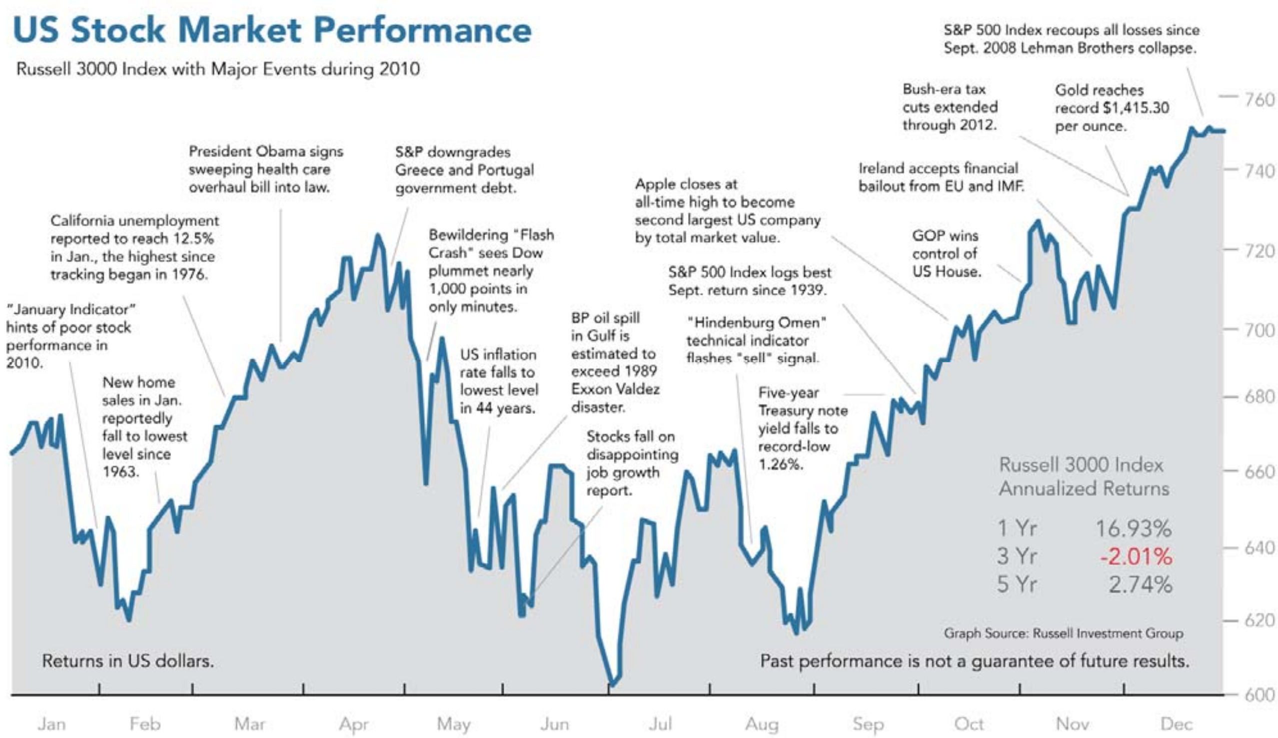
J.J. BURNS & COMPANY, LLC

4th Quarter Newsletter, January 2010

"Roller Coaster Rides"

We enjoy risk. It's innate to the human psyche, but we enjoy our risk in carefully measured amounts, much like a roller coaster ride – just long enough to exhilarate, but short enough in duration that the fear is forgotten on the walk back to the end of the line for another ride.

The year was filled with volatility as there were no fewer than eight mini bull and bear markets (see graph). Bullish investors today don't remember how they felt on the roller coaster last August. The markets appear to be assessed daily or weekly, at best maybe a quarter at a time. What this means to investors is volatility is continuing to occur. Risk must be reassessed and even readjusted at all times. It has become more apparent, even since JJ Burns and Co.'s most recent alert, that strategies which aim to preserve capital and can participate in slower growth environments are investment management themes that make sense.



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Various financial commentators told the investor the only way to generate returns is to have been in the stock market for 2010. Even today this continues to be flawed thinking. The portfolios managed at JJ Burns and Co. were not over-weighted in equities, but more broadly diversified into specific asset classes which include income generating investments such as high yield bonds, hard assets, gold, preferred equities (income), high quality corporate bonds, and real estate investment trusts, to name a few. It's not about the bullish or bearish roller coaster ride of stocks, but about being able to generate returns while minimizing your downside risk. Tactically allocated portfolio management is the essential ingredient for accomplishing this.

Just a Few Sessions in 2010

2010 amounted to twelve days of returns of the S&P 500. Barron's "The Trader" column pointed out that 94% of the entire year came down to these twelve days in the stock market. In addition, 134 points of the S&P's 143 point gain in 2010 primarily occurred in the first trading days of each month, ergo, the best days last year were the first day of nearly every month in 2010. Interestingly, January 2011 has started off that way and has since had a balance of lackluster performance thus far.

On the bond side of the market one can say it seems like old times. In December 2009 bond yields backed up a bit. This past December 2010 we saw similar performance. Yields on the US Treasury market across most maturities have firmed up and have rallied since the end of 2010. Corporate bonds have followed as well. Out investment team recently shared that long maturities in US Treasuries are yielding over 2.5% higher than the yield on the S&P 500. Low yields may continue for most of 2011. We still don't see an end to a persistently low interest rate environment.

Employment: The Jobs Picture

Each month we wait to hear if the US economy created jobs. Americans with jobs add to consumption and increase output, thus producing increases to GDP. It would also help to prove the Federal Reserve's case that the economic stimulus is working. On the same day the employment report was released, Fed Reserve Chairman Ben Bernanke stated we are seeing signs of a "self-sustaining recovery in US consumer and business spending." Around the very next turn, we hear Chicago Federal Reserve President Charles L. Evans cautions that "the data do not point yet to a sustainable, self perpetuating recovery." The reality is there was nothing much going on in the way of employment in December. What would be reasonable job creation if we were having a "normal" recovery? Answer: Payrolls coming in reflecting 200k jobs, but the reality is the current 103k is anything but normal. In fact, 103k figure is not even enough job creation to keep pace with population growth. 83k of the jobs were in the leisure industry and hospitals. Large corporations added a fraction of new jobs to this figure. The jobs market continues to be under duress which underscores the fragility of the economy. We could also say that had it not been for the massive amount of government stimulus which is ongoing, we would still likely be in recession.

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Looking deeper into the employment numbers, the long term unemployment numbers are getting larger with each passing month. Nearly 6.5 million people are currently unemployed. The average weeks of long-term unemployed remaining without a job has increased. Unemployment benefits have been extended recently, however, the long term implication if workers remain unemployed is a growing risk that states will have an increasing welfare demand. Jobless recoveries followed on the heels of the last two recessions, but neither prefigured the depth of the trouble this time. After the 1990-91 recession it took 23 months to add back the lost jobs. After the 2001 recession, it took 38 months. As noted by a recent NY Times article, the jobs were created as part of the great housing and credit bubbles in American history. It's not likely something like this would happen today. The question remains: Can states afford more welfare when unemployment insurance runs out? If we continue to grow jobs at this anemic rate it would take some 70 to 90 months, until the year 2016, to get back to pre-recession levels.

States/Municipalities

It's hard to ignore all the negative implications surrounding state budgets. It's said that the US has more than one recession /recovery going on as we have 50 states. State budget deficits are expected to increase from $120 billion in fiscal 2011 to $140 billion in 2012, thanks in part to underfunded pensions and growing health care costs as noted by The Wall Street Journal. There has been a significant sell off in "muni-bond land". As a whole, the sector is off nearly 5% since November. Investors have pulled nearly $25 billion out of municipal bond funds.

- Muni-bonds 101: muni-bonds are typically issued by states, counties, cities, schools, airports, bridges, hospitals, and public works. Typically investors like these securities, especially high tax bracket individuals as they pay tax exempt interest (again, typically free from Federal, state and local tax).

The risk currently abounding is many states are having fiscal troubles to balance their respective budgets. Revenues in many states have decreased thus putting pressure on the possibility of defaulting on the payment of the muni-bond interest. We are concerned about many states and municipalities; however, some of this news may be getting a bit overblown. Of course it is possible a municipality may default on its debt. However, even in some states which have significant budgetary problems such as California its important to point out that only teachers come in front of bond holders when it comes to the state making wage or interest payments. In many other states, the debt holders are the first to get paid, a fact that is surprising to many people. In many states, tax free bonds, which have funded the water or sewer districts in municipalities, are one of the first bonds to be paid.

I was recently at CNBC with outspoken analyst Meredith Whitney who continues to forecast "large defaults" in the municipal bond sector. She is now saying that none of the 50 states will default, but that fifty to one hundred cities and hundreds of billions of municipals bonds will default. It's important to note that mutual fund redemptions are driving fund managers to

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liquidate some of the tax free muni-bonds while prices continue to fall. Municipal bonds are not typically valued every day as not every municipal bond may trade every day. Therefore, the municipal bonds pricing doesn't work like the stock market. More mutual fund redemptions occur because unworldly investors get caught up in the media prognostications. It begins to snowball and imbalances occur in supply and demand pricing. In short, there may be many opportunities arising in the fixed income sector of the muni market as there is panic in "The Streets." A long term AAA rated muni is trading north of 5% tax free or more than 1% better than a US Treasury Bond. Our municipal bond fund managers have no problem owning a sewer or water bond in a municipality as people will still likely consume water and require sewers! There is significant value developing in the municipal bond sector and we think this is worth noting as the hype leads to unnecessary panic and, thus, may signify the opportunity to add high quality tax-free municipal bonds to portfolios where tax exempt investing is appropriate.

Global Events

Inflationary pressures are building around the world, from the developed economies of the US and Europe to emerging markets such as China, Brazil, Argentina, Venezuela, India, Indonesia, Vietnam, Malaysia, and Thailand. Investors have a higher demand for bonds that offer protection against rising prices. Rising food and energy prices have triggered increases in inflation over the past six months. Markets are also pricing in further rises over the next few years with some warning that inflation could be the world's next biggest economic event. Emerging markets face this inflation threat.

The investment committee at JJ Burns and Co. speaks with portfolio managers on opposite sides of the world to decide whether the risks of some of these overheated economies outweigh their positive growth stories. Brett Diment, who manages emerging market debt at Aberdeen, warned that investors need to be more selective over what emerging market assets they purchase. "As an example, bonds that are protected against inflation are considered a good bet, while conventional debt could be more risky in an inflationary environment. Emerging market currencies and equity markets could also offer good returns."

In Europe, inflation has jumped because of the rise in food and energy prices, which increased in response to the fall of The Euro at year end.

In the US, the additional infusion of cash into the economy by the Federal Reserve (QE2 – quantitative easing round 2) has helped to fuel inflation fears.

Pressures are building in the world. Looking at Credit Default Swaps (a derivative which trades at a value to show the levels of risk to default) will show the risk of default in the following countries as follows:

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Risk of Default

Greece 70%
Ireland 51%
Portugal 44%
Spain 31%

Greece and Ireland are now paying over 80% of their export revenues towards external debt payments. On a recent conference call with Mohamed El-Erian, CEO/CIO of PIMCO, the largest bond management fund (and one of the funds by JJ Burns and Co.) he indicated that higher borrowing costs raised concerns as to whether Portugal could successfully tap the market in a regularly scheduled government bond auction. Fearing the country would join Greece and Ireland, both losing access to new market funding of bond issuance and costly capital, the Portuguese officials tried to reassure the markets they are ok. But here's the problem: the current game plan used for Greece and Ireland has a low probability of success and Portugal is in much the same situation. One cannot solve a debt problem by heaping new debt on top of old debt.

More experts are beginning to recognize the need for an alternative approach. The Economist calls it a "Plan B": Sovereign debt needs to be restructured in a meaningful way and at sustainable rates. Growth plans need to be enhanced and banks need to create realistic strategies for raising capital. In addition, economies which are healthy need to remain healthy. It's not an easy plan to execute, but it can be accomplished. Until we strike at the root of the problems, we can expect slow growth and a sideways economy. It depends on the rider; some like the thrill of a roller coaster, others the dizziness of going in circles. Being tactically allocated and well-diversified provides balance no matter what the direction of the ride.

2011 has started off much like 2010:

- The S&P 500 is already off to a good start increasing better than 1%
- Corporate profits are being touted as getting better
- More US Government stimulus is here and more on way
- Debt issues abounding in Europe
- Threat of debt contagion is growing
- Threat of inflation still here

All at JJ Burns and Company, LLC, wish you and your loved ones much health, happiness and prosperity throughout 2011. As always if you have any questions please feel free to contact anyone on our team.

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