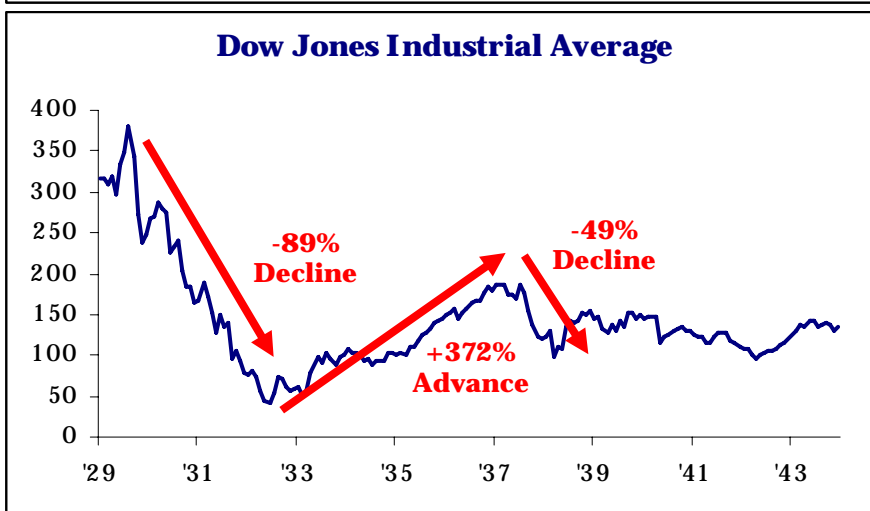
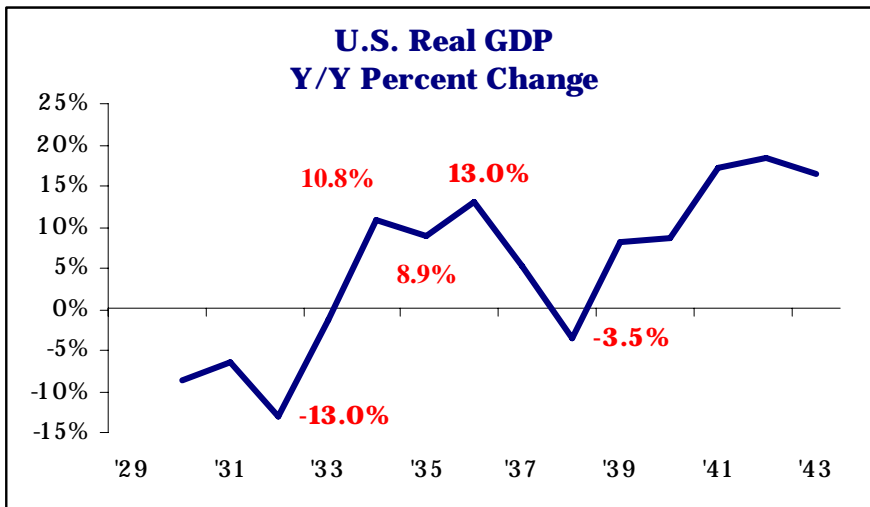


“G” CAN WORK FOR MARKETS & ECONOMY UNTIL THE BILL COMES DUE



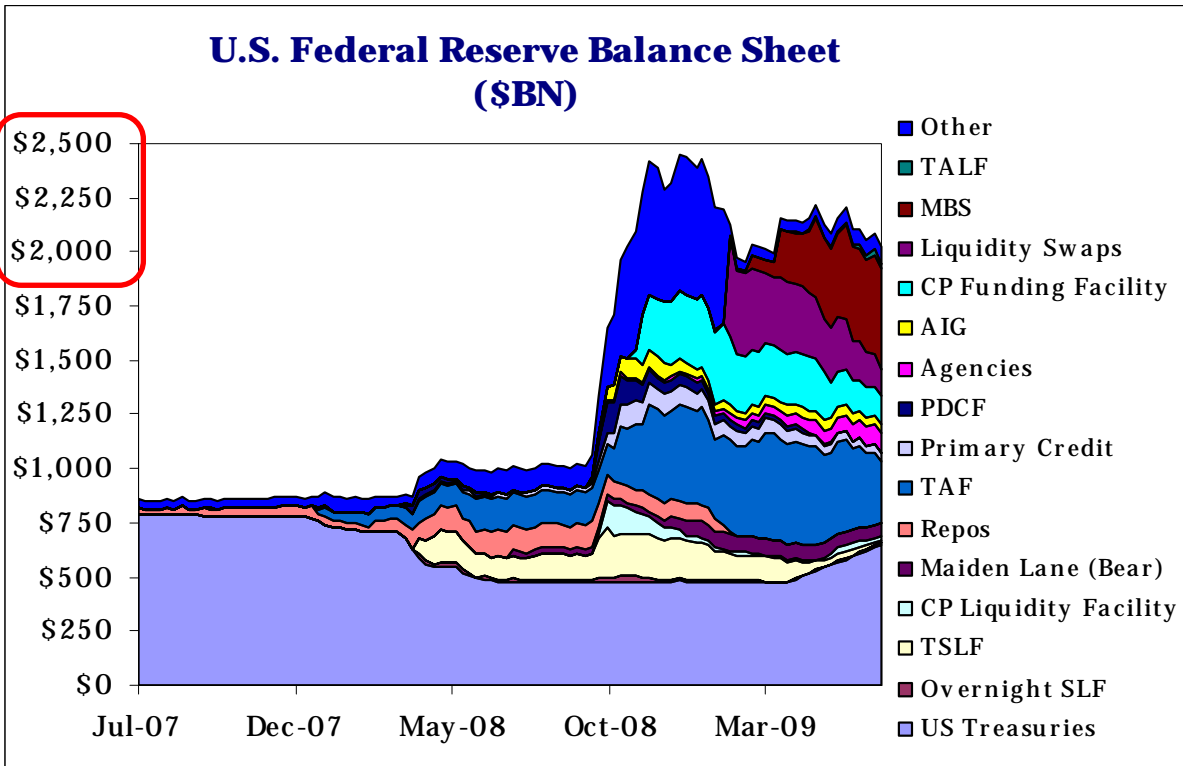
While monetary stimulus is dependent upon the health of the financial sector to act as a proper transmission mechanism, fiscal stimulus is directly in the GDP equation and thus can have effects on both the economy and the markets. While it's one thing to fade monetary policy and say the Fed is “pushing on a string”, it's much harder to fade fiscal policy – even in the 1930s, once the government decides to spend money, it generally “works”.

That is until, of course, the bill comes due. The 1930s is again a good case in point: massive fiscal stimulus resulted in year-over-year GDP gains of 10.8%, 8.9%, and 13% in 1934, 1935, and 1936 respectively. The Dow rallied 372% during the same period, weakening only when the bill for government spending came due with higher marginal tax rates in 1937. For the time being, it might be hard to fade government spending (cyclical bounce). In the long-term however, stocks are likely to have trouble when both long-term interest rates and taxes move higher (secular problems).

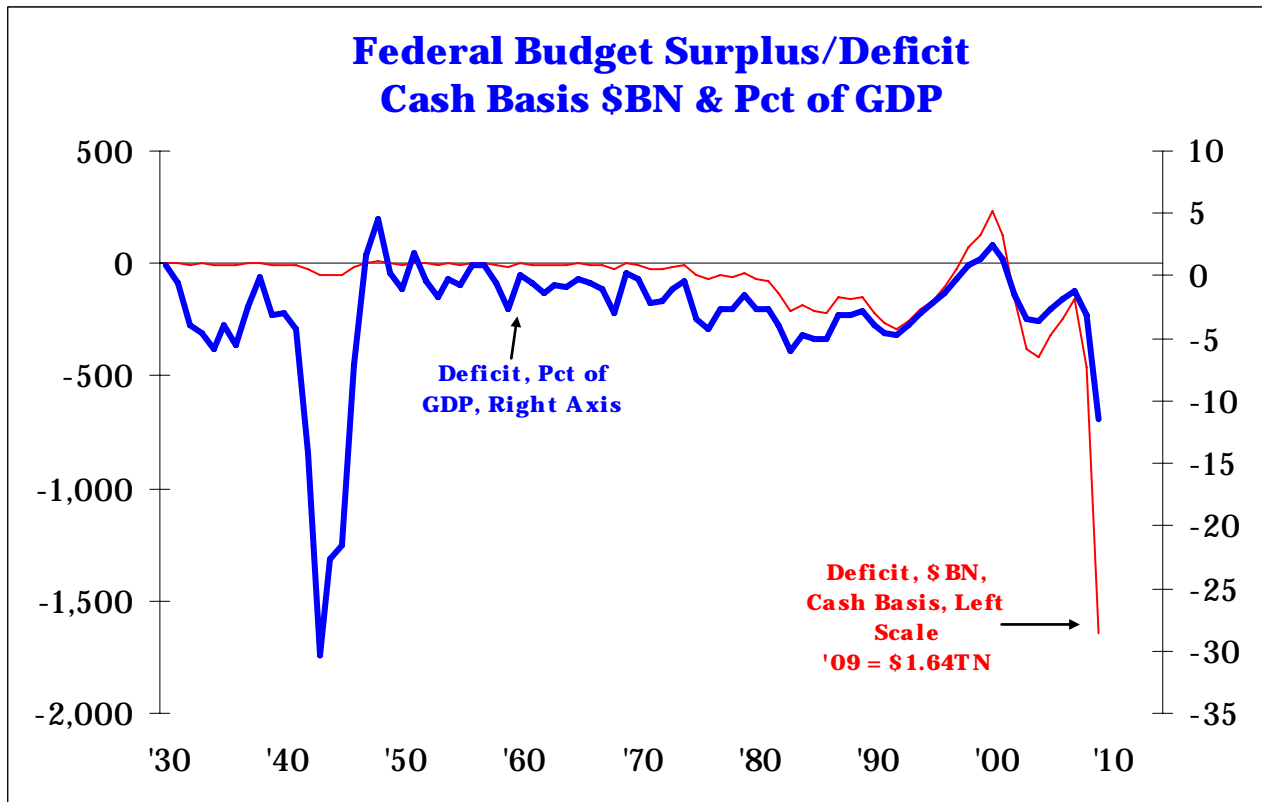
We're Bullish Until... (Bearish Inflection Points Worth Monitoring)

1. A poorly subscribed Treasury auction signals reduced appetite for U.S. debt.
2. 10-year yields break out above long-term down-trend.
3. Increased anxiety over significant tax increases to close the structural deficit gap takes hold.
4. Holiday sales come in below expectations with income under pressure as government transfers fade.
5. Commodity price inflation prompts China to slow economic growth (again).
6. Mortgage rates push above 6.0% in 2010.
7. Signs of protectionism creep into global policy.

GLOBAL CENTRAL BANK BALANCE SHEETS GROWING RAPIDLY

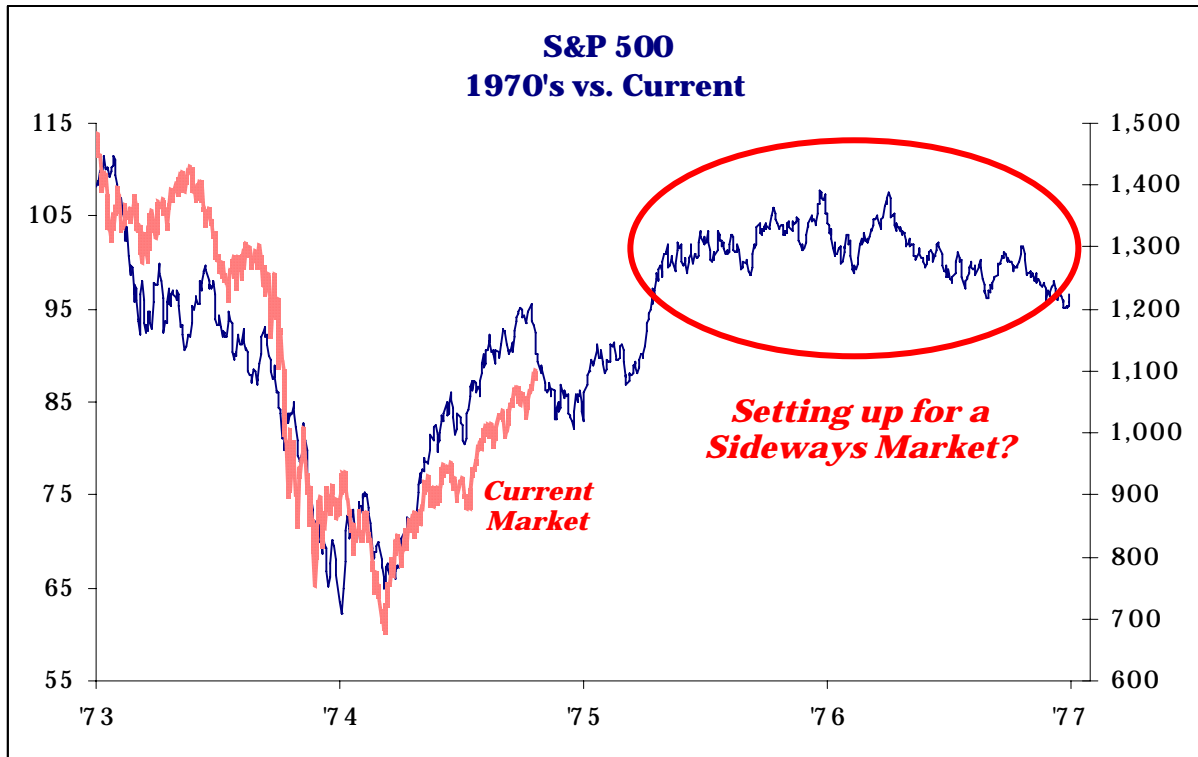


U.S. BUDGET DEFICIT DETERIORATING



1970's REDUX?

Many of our clients and friends that have seen multiple cycles believe that over the next several years, the market will be reminiscent of the period following the '73-'74 bear market. After an initial rally off the bottom, the major market indices marked time for several years. Increasingly we believe the investment landscape over the next several years will likely be bullish for real assets, neutral for stocks, and bearish for bonds.



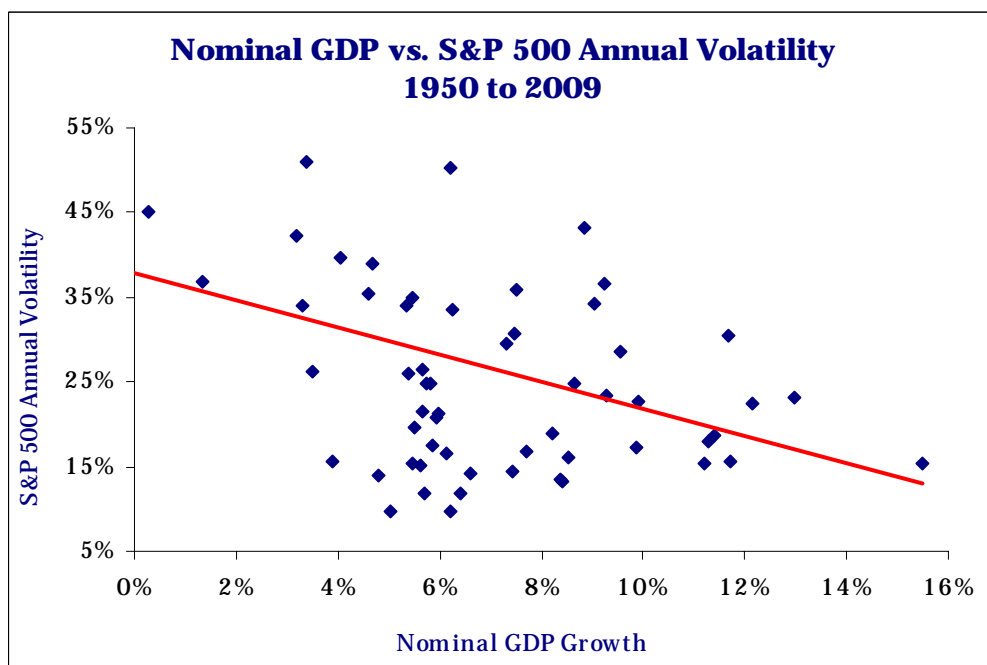
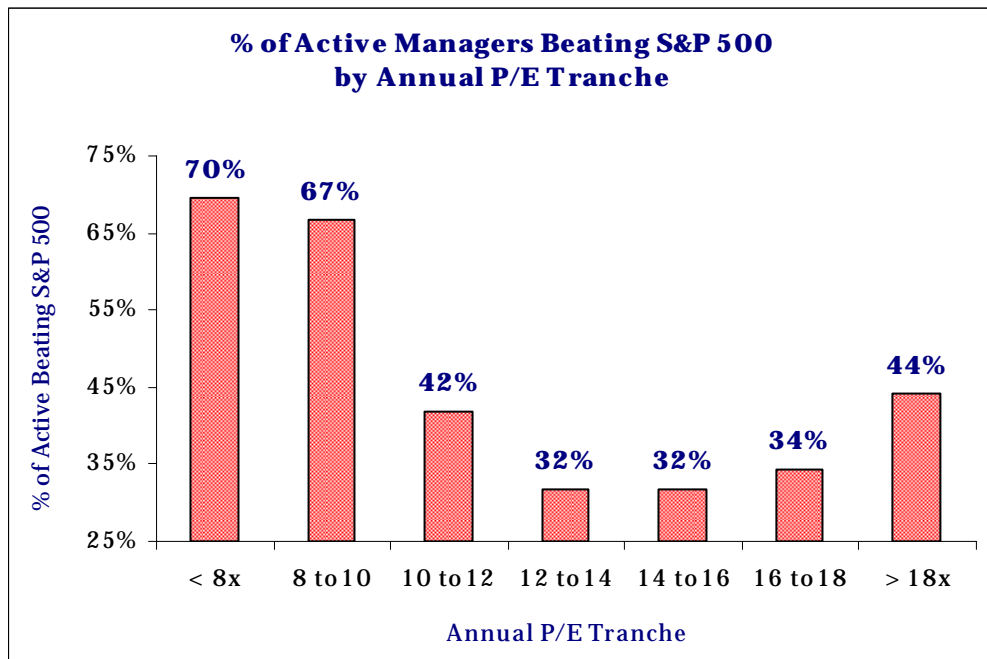
Real Returns Across Asset Class (1975 to 1980)

	Gold	Large-Cap Stocks	Home Prices	T-Bills	Long-Term Corp. Bonds	Long-Term Govt. Bonds
12/31/1974	\$1	\$1	\$1	\$1	\$1	\$1
12/31/1975	\$0.67	\$1.28	\$1.01	\$0.97	\$1.06	\$1.00
12/31/1976	\$0.61	\$1.51	\$1.03	\$0.96	\$1.19	\$1.11
12/31/1977	\$0.70	\$1.31	\$1.09	\$0.95	\$1.13	\$1.03
12/31/1978	\$0.91	\$1.29	\$1.16	\$0.94	\$1.05	\$0.94
12/31/1979	\$1.96	\$1.38	\$1.19	\$0.93	\$0.89	\$0.82
% Return	96%	38%	19%	-7%	-11%	-18%

**Commodity Exposure
Outperformed**

**Fixed Income Underperformed
by a Wide Margin**

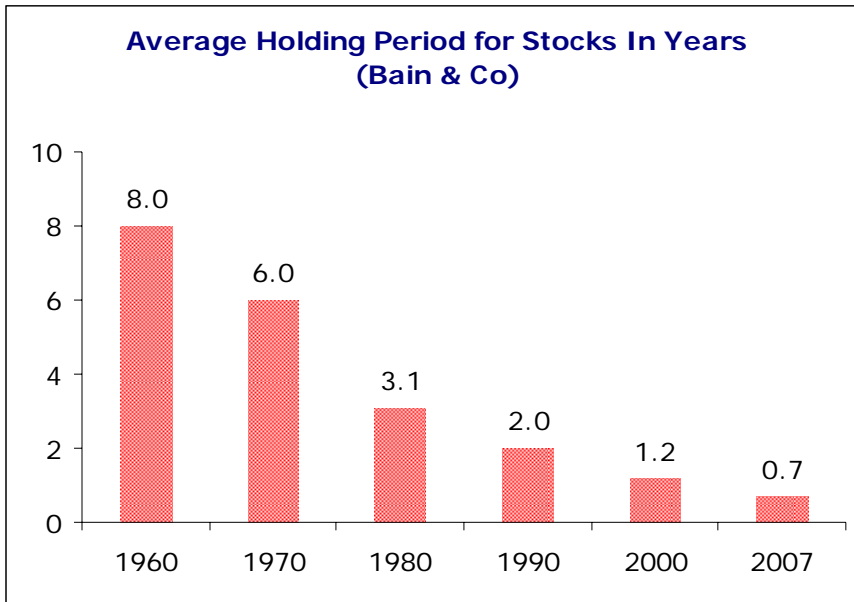
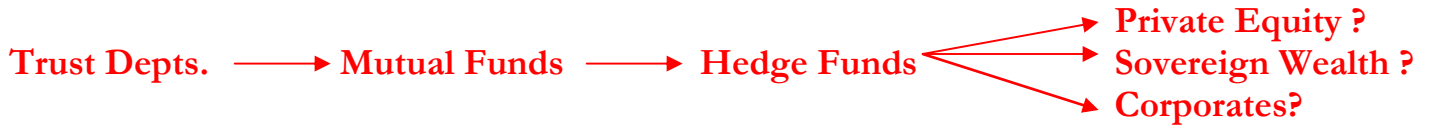
ENVIRONMENT REMAINS RIPE FOR ACTIVE MANAGEMENT TO OUTPERFORM PASSIVE STRATEGIES



In the past 40 years there were really only two periods in which active managers handily beat passive strategies – the U.S. in the late ‘70s/early ‘80s and Japan in the 1990s. Both examples were marked by low real growth, elevated volatility, and one-decision sector bets – overweight Energy in the U.S. in the late ‘70s and underweight Financials in Japan in the ‘90s. As the accompanying table indicates, active managers tend to perform better when multiples are declining, while underperforming in periods of stable growth and stable multiples. One could surmise from all this that depressed growth environments and periods of multiple contraction tend to widen the differences between winners and losers across all industries, provide fertile ground for winner-take-all markets, and often introduce exogenous shocks in public policy that benefit the manager willing to trade around long-term, core holdings.

WHO WILL BE THE MARGINAL BUYER?

1960s 1970s 1980s 1990s 2000s 2010s



**S&P 500 (ex. Financials)
Cash as % of Assets**

Technology	30.8%
Health Care	17.0%
Discretionary	9.6%
Energy	8.6%
Staples	6.9%
Industrials	6.8%
Materials	6.2%
Telecom	2.5%
Utilities	2.4%

