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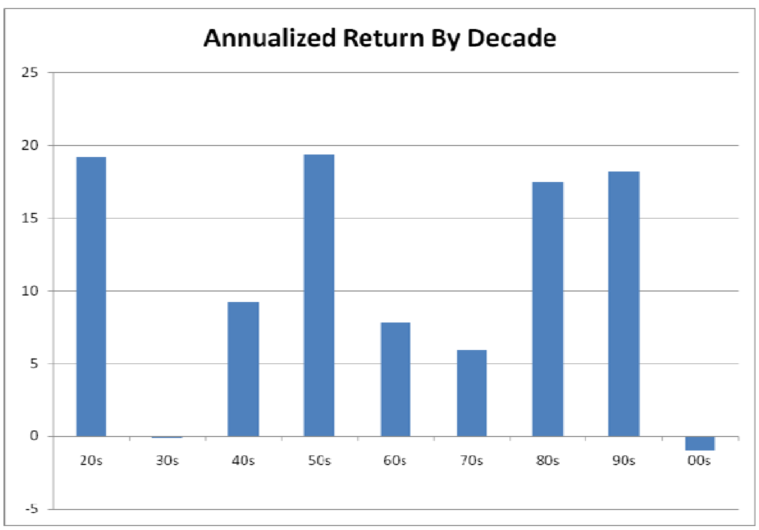
All is Not Lost

Fourth Quarter Market Review From Your Portfolio Management Team—January 7, 2010

We have been hearing and reading in the media lately about the so-called “Lost Decade” for American investors. They use this phrase because both the Dow Jones Industrial Average and the S&P 500 index (two of the most broadly followed indexes of U.S. stock returns) made no money in the ten-year period ending December 31, 2009. That’s right, from 12/31/99 – 12/31/09, both of these indexes are actually slightly lower today than they were ten years ago. In fact, using data from Ibbotson Associates, this decade is actually the worst decade for stock investors going back to the 20s—even worse than the 30s.



Source: Ibbotson & Associates, FSA
The decade of the 20s covers the period from 1/1/26 – 12/31/29.

While this news is not very comforting for the many investors that tend to invest passively in stocks, hoping that over the long run returns will be positive, for clients of FSA, the news is not dismal at all. All five of our strategies (including Income, Income & Growth, Conservative Growth, Core Equity, Tactical Growth) generated positive returns over the most recent 10-year period, with cumulative returns varying between 60% and 85% depending on the strategy. Obviously, these results reflect our composite returns, and individual client results may vary. Nevertheless, don’t let the gloomy news of the day deter you from an investment approach that is helping you prudently build long-term wealth—even during these challenging times.

Below we review the five broad strategies that FSA manages. Keep in mind that your specific portfolio may differ to some degree from the averages, as our portfolios are individually managed.

Conservative Growth

*Current Money Market Allocation: 25%**

Conservative Growth accounts finished the year in fine fashion, relying on consistent gains from the multi-sector and high yield bond funds to push higher in the final quarter. The investment-grade bond funds and the municipal bond funds (for taxable clients) stalled out in the fourth quarter with only modest gains and even some minor losses in the case of the municipal bond funds. We made virtually no changes in the fourth quarter, but will look to adjust the portfolios after volume picks up again in January when we can get a clearer picture of the underlying market trends. Most accounts have 20% - 25% in money markets, so we have a nice cushion if the markets turn down in January, and we also have some powder to use if things begin to heat up again. On average, these accounts were up over 2% for the quarter, and finished the year up almost 12%.

Core Equity

*Current Money Market Allocation: 21%**

Core Equity posted the best returns of the five broad strategies in the fourth quarter, a welcome result given that this strategy has struggled to keep pace in ’09, due to our preference for bond funds over stock funds this past year. We believe that fortunes may turn in favor of Core Equity in 2010, so for those of you with Core Equity accounts, this year may be a better year for you. We made no changes to the portfolios in the fourth quarter, but with 20% in money markets on average, we have some fuel to invest if the markets get off to a strong start in 2010. On average, the Core Equity accounts were up about 3% for the quarter, and are up over 9% for the year.

Tactical Growth

*Current Money Market Allocation: 7%**

Our most aggressive and flexible strategy finished 2009 with another solid year. During the quarter we purchased an inverse real estate fund, as this area seemed to be forming a base. In some accounts we also purchased an inverse energy fund as energy stocks seemed to be stalling out near year end. Finally, right near the end of the year we purchased a natural gas ETF for the qualified accounts (waiting until January to add the fund for taxable accounts since this fund will issue a K-1—an additional headache around tax time). On average, the Tactical Growth portfolios rose about 2% for the quarter, and are up roughly 19% for the year.

Income & Growth

*Current Money Market Allocation: 17%**

A solid year for Income & Growth accounts, with its blend of conservative stock funds and collection of bond funds. During the quarter, we trimmed back one of the equity positions, as well as exited one of the municipal bond funds which had hit its safety net (taxable accounts only). Later in the quarter we added a less volatile municipal fund back in the portfolio, as conditions improved in that area. On average, the Income & Growth accounts were up roughly 2% for the quarter, and are up over 13% for the year.

Income

*Current Money Market Allocation: 15%**

The Income accounts finished the year with their best return since 2003. In taxable accounts we exited one of the municipal bond funds as it hit our safety net, but added a tamer municipal fund in December as conditions calmed down in that area. Otherwise we have been content to hold our collection of bond funds and enjoy the ride. For the quarter, these portfolios rose over 1% and are up almost 14% for the year.

*These allocations represent the money market levels of our various strategies, including trades through December 31, 2009.

Outlook For 2010

As we talk with clients around the country, we get the sense that few of us were spared from some impact of the severe recession—job losses by family members and friends, reduced values for homes, difficulties getting loans, low rates on savings, etc. At this point, it seems that the worst has passed, and while things are not nearly back to normal (however we might define that), they appear to be on the road to recovery. 2010 will be the pivotal year in which we either continue on the road to recovery, or we slip back into recession. The outcome will be determined in no small part by the actions of the Federal Reserve and the government over the next twelve months.

There is a great deal of financial stimulus still in the pipeline for 2010 which should give the continued appearance that conditions are improving. At some point this year however, the Fed will be faced with the dilemma of needing to raise interest rates to hold off inflation, but by raising interest rates they run the risk of choking off the housing recovery and potentially pushing the economy back into recession. It will be a delicate balancing act.

Well, at FSA we like to have a fundamental perspective of the market to provide additional color, but our primary decisions are based on market trends. Right now, the trends remain rather good, particularly for our corporate bond funds. We have enjoyed the ride with these funds, and relative to the risks we would have endured by being more heavy in stocks, we believe corporate bond funds were the hands down winner on a risk-adjusted basis.

We are spending a good deal of time these days trying to identify new areas of opportunity. Where are the significant money flows going in 2010? At this point the evidence still points to bonds, but if inflation rears its ugly head at some point this year, bonds may lose their favored status. We also like commodities, energy, emerging markets, technology, and health care. At some point this year, we may increase or add to our positions in these areas. Stay tuned.

Please accept our best wishes for the New Year and let us know if there is anything we can add to these monthly reports that will help you better understand what is happening in your accounts.