# JULY 2009 MARKET COMMENTARY

**In the second quarter,** global markets enjoyed their best quarterly performance in 20 years. Of course, this was after the worst January in history followed by a dismal February and early March. The result has been quite a ride. Overall in 2009, the S&P500 is actually up slightly. During this time of incredible volatility, there have been much bigger winners and losers than is normal. High risk has been rewarded with risky, "low-quality" stocks contributing disproportionately to market gains. Financials, energy and commodities lead the recent rally. And even many of the specific winners were companies seen as bottom dwellers. Ford is up 165% since the beginning of the year and over 228% from its low. Bank of America is up over 250% from its low on March 9th.

**More recently, a mild June** rounded out a tumultuous first six months. June saw little movement up or down finishing within 0.02% of where it started. And, we didn't see a lot of movement during the month either. This is a sharp contrast to the previous five months which saw an average move of over 8.5% either up or down. After suffering through severe panic during the first part of the year, and then a rapid reversal as people slowly recognized the world really wasn't ending, June's movements have been much more measured – and likely more rooted in an ambiguous reality rather than wild projections.

**The primary winners** of the recent rally have been anyone who has been in the market. While the magnitude of gains has differed sharply, nearly all stocks are well up since early March lows.

**The current environment** reveals many positive indicators which are mostly relative improvement from very poor levels. We're still lacking overly positive numbers showing a strong turnaround. This largely explains the recent turnaround in which markets have bounced back sharply from panic induced levels, but haven't continued to rocket forward because of the lack of truly positive numbers.

Numerous other indicators are moving in favorable directions, but seemingly nothing is overwhelmingly positive. Housing is picking up, but there are declines still occurring in many markets. Inventories are way down leaving little slack in the system which bodes well for a faster recovery when it eventually arrives. Business activity is also picking up in both manufacturing and service sectors, but it's more of an improvement from very low numbers rather than a return to growth. Credit markets continue to strengthen in various areas, but are certainly not strong. And, layoffs and announcements of layoffs are slowing.

As of mid-May, there was also still more cash in money market and checking accounts than was invested in the stock market. This is highly unusual and indicates a possibly very high level of demand for investments as confidence in the economy returns.

**Looking forward longer term,** there's both good and bad news. The good news is that eventual economic recovery, reversion to the mean and reinvestment of cash should result in strong returns for many different asset categories that are currently depressed. Whether its stocks, private equity, commercial real estate, vulture funds, venture capital, oil and gas, etc., today's prices likely represent a very good buying opportunity. Also, as it appears we're drawing nearer the end of this deep recession, growth is hopefully drawing closer which normally spurs increases in valuations for many different types of investments.

**The bad news is likely longer term in nature.** Investors saw their net worth decline during this last downturn by 20% versus a downturn of 12% in 1974 and 1975. In addition, consumers still have a significant debt overhang even with their jump in savings rate during the last six months. While increased savings is likely a great help for future financial health of the average American, it hurts the economy in the short term and will likely contribute to a slower recovery.

Probably more disturbing is the growth in government spending and the resulting vast increase in government debt. At some point, it's reasonable to assume that this debt will need to be paid down. The expanding debt is also very likely to create inflationary pressures in the future. And, increased government involvement and control of the economy has historically lowered growth rates.

In addition, significant increases in regulation are being proposed, with some already passed. While the benefit of any of the new regulations appears tenuous, there is wide agreement that increased regulation will increase costs and further slow economic growth. Unfortunately, this is likely to slow economic recovery, and may also increase drag on the economy.

**We seem to have two different major trends pulling against each other.** Many short term improvements combined with valuations that are historically low may make many assets including stocks very attractive investments. However, increased government involvement in the economy and increased regulations could slow growth. In spite of this less positive trend, I believe that the economy will continue to grow and expand as technological advancements allow entrepreneurs and businesses to innovate and grow in spite of the efforts by government to regulate and control. The combination of reversion to the mean and the ability of Americans at all levels to progress and advance regardless of the obstacles will likely result in not only a solid economic growth longer term, but also will create significant growth.

**Put more succinctly, bet on the U.S., the microchip and innovation, but not the government.**

**Looking forward to the next six months and beyond**, I believe there are many opportunities to excel as an investor. Also, following a few key principles likely will assist investors in enhancing success..

**I believe the primary long-term opportunity** remains investing in assets that contain some type of risk. Because of declining asset values associated with the flight from nearly any asset not guaranteed or backed by the government, most risk assets are probably a good long-term investment. Very specifically, this includes stocks, but also a host of other asset classes that have seen their value drop through the economic crisis and credit crunch.

It is probably wise to incorporate investments that include some type of inflation hedge. Various assets can accomplish this. Stocks tend to be a good long-term inflation hedge, and other assets can also work well. Hard assets such as real estate and commodities tend to offer a good inflation hedge.

**As taxes** are likely to increase in the future, tax planning could also become more valuable for some people. While this probably shouldn't be a primary investment consideration, its importance may grow in coming years if taxes increase as anticipated.

**Lastly, I think it's wise to maintain a long term perspective** during challenges that are likely shorter term in nature, but may appear more severe. My daughter was reading a book from the Laura Ingalls Wilder series which followed the adventures of Laura Ingalls growing up in the 19th century. We were talking about the economy and she immediately asserted that people in the book had panicked because of politics. She related that Pa, Laura's father, "bought a cow really cheap from a neighbor" who felt the whole country was going to implode because of the policies of a newly elected president. Pa benefitted from someone else's panic. We face challenges today, some apparently more structural in nature, but I believe we'll move past these by adjusting and innovating as we have in the past. And, short-term opportunities are likely abundant.

**Daniel Wildermuth and the Kalos Team**
**CEO/Money Manager**



Investment Advisory Services offered through Kalos Management, Inc., an SEC Registered Investment Adviser.
Parkside Terrace West, 3780 Mansell Road, Suite 150, Alpharetta, Georgia 30022
Phone: 678.356.1100, Toll Free: 866.525.6726, Facsimile: 678.356.1105, ClientServices@KalosFinancial.com