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April 1, 2011

Greetings,

Enclosed is your investment report through March 31, 2011. Your YTD return is 4.7%. The return of the S&P 500 is 5.4%. It is nice to see that we are off to a good start to the year with an excellent absolute return. Without a doubt, I would love to be doing better relative to the market. My goal is to do great in both absolute terms and relative to the market in the long term and as much as I would love to do great in both terms each and every quarter, regrettably, it's simply not realistic. I have made some adjustments during the last quarter and I expect that our results will improve as a result of my actions.

During the recent quarter, we did experience a pullback in the stock market. Even during the strongest bull markets (in my view, we are in one of the strongest markets that I have seen in the last 25 years), the market does not go straight up. This pull back was expected. No one knew exactly when it would occur but most people who follow the market knew that it was coming. What impressed me so much was how quickly it was over. Let's face the facts; if you didn't pay attention to what the market did on a day to day or week to week basis and waited for my report to see what was going on, you would not have known that there even was a pull back. I do expect that there will be some volatility in the near future. High energy prices are going to grab much of the headlines which of course will make some people nervous. Corporate earnings have been fantastic and I think that earnings for the current quarter will continue to be great, even with some tough comparisons in the technology sector. The market is forward looking. A concern that I have is that many companies, especially in the technology sector, will give cautious guidance because of the Japan earthquake. Many of the components that go into the products that technology companies sell are manufactured in Japan. Since many people who control the big money react rather than think, as well as not having a time frame longer than three weeks, there could be some serious down days in April. If you insist on following the market each and every day, just prepare yourself. Since this market is so resilient (mainly because of its liquidity and cheap valuation), I would expect that many of these bad days will be followed by some pretty good days.

Now that the threat of a nuclear meltdown in Japan is over and the riots in the Middle East have subsided, the chatter of the day is high energy prices. As mentioned in previous letters, it is important to me to know why things occur, not simply the bottom line. If there was a supply shortage similar to the mid 1970's, then it would be a major concern to me. That is not the case now. Energy prices are going up because of a combination of speculation (many hedge funds make their money by trading energy futures) and by purchases of emerging market countries, especially China. I am well aware that when the vast majority of consumers fill up their gas tanks and have to pay anywhere from $10-20 more per week, they don't really care why prices are going up. What they do know is that they are tight with cash and can't afford the price increase, for whatever reason. One of the reasons the market gets so nervous about the rise in oil prices is the uncertainty about how much higher it will go. The reason it is important to know why prices are going up is because it helps to determine if the price increase is sustainable. Since the supply of oil is not an issue and much of the increase is because of speculation, I don't think that energy prices will go that much higher.

There was some interesting timing today in that I read a great opinion piece in the Wall Street Journal about the effect of the high energy prices on the economy. One of the points the writer made was that while energy prices are 30% higher than they were three years ago, they are 30% lower than they were at its peak just less than three years ago. When oil was at $ 147 per barrel in the summer of 2008, it didn't kill the economy. What killed the economy was the collapse of the financial sector because of the greedy, short sighted people on Wall Street, with the acquiescence of the government. If energy prices go up say by another 10-15% over the next 3-6 months, I acknowledge it will put the breaks on an already fragile economy. Even if energy prices stay as they are, it will not be good. I do not believe that higher energy prices will cause another recession or anything close to it.

I am much more concerned about this lousy Real Estate market. Historically, it is rare that you can have a strong economy with a poor Real Estate market. What is even more disturbing is the fact that from all the recent data that I have seen, the RE market is getting worse rather than improving. One of the problems is all the foreclosures. With such a high inventory of foreclosed homes on the market, at low prices, the prices of homes that are for sale that aren't being foreclosed are under pressure. Here is an interesting real life example of what is going on; I moved into my place just under two years ago. The RE market back then was in pretty bad shape so I got a good price and the seller, who only lived there for a couple of years, took about a $ 100,000 loss. From what I gather, even though I got what appeared to be a real good price, the value of my residence is down about 10%. I will go one better. The other place that I was strongly considering purchasing is not only still on the market (for a total of 3 years), but the listing price is now 21% lower than it was less than two years ago. The listing price two years ago was lowered by 12% from its original listing price from a year before. Please be aware that I am talking about condos in upscale developments in prime neighborhoods. Mortgage rates are only going to go up, not down. When the 30 year mortgage rate increases to 7% or higher 2-3 years from now, I will find it difficult to believe that this will help housing prices to increase. Not to put more fuel on the fire but just today, I saw a big story in the Wall Street Journal about a new regulation in the nearly 2000 page Dodd/Frank bill that will increase borrowing costs to prospective home owners.

One pleasant surprise so far this year has been that for the first time since the bull market started two years ago, some new cash has come into the market. Bond funds have been seeing redemptions for the last several months. While the amount of redemptions as well as the cash coming into the market is tepid as compared to the bond fund inflows of 2009-2010, something is better than nothing. The main reason that I think that the market will continue to be strong for at least the next year is because of the liquidity. After several years of a near zero return in the bank and meager bond yields (the ten year Treasury note is still just 3 ½% yield to maturity), investors are figuring out its not the worst thing in the world to put some money to work in cheap equities. I always say, better late than never.

If you have any questions on anything, please by all means give me a call of send me an email.