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Greetings,

The most hated bull market ever continues to go straight up while the economy shows modest improvement. Corporate earnings last quarter were much better than what was expected. At this point in time, Wall Street is satisfied with the fact that the strong earnings are being achieved strictly with cost cutting.

One question that has been asked by more than one person is how can the stock market possibly keep going up in such a lousy economy? I believe that is an intelligent question. In the long run, it can not. The stock market is forward looking. The stock market did so well in 2009 primarily because it should not have done nearly as bad as it did in 2008 and in early 2009. As a result of the Lehman collapse, the hedge funds were forced by its lenders to sell its liquid positions to pay part of the massive amount of debt that they all accumulated. The individual investors then panicked, forcing the mutual funds to sell its liquid positions to meet redemptions. Most of those individual investors who sold out were either too scared or disgusted to get back in this year. They then missed out on one of the strongest markets that I have ever participated in. In 2007, the market didn't do well even though the economy was in decent shape. With the real estate market beginning its downward spiral and the labor market deteriorating, the stock market anticipated that bad times were coming (although I don't know of anyone who thought it would become as bad as it did) and it sold off accordingly. If the stock and bond markets are anticipating that the economy will continue to stay as bad as it is now, then there is no way that the stock market will be continue to move forward.

I am optimistic about the stock market, at least in the short to medium term. My definition of short to medium term is one to three years. I wish that I could be as optimistic about the economy but I am not. I will focus on the stock market first.

There are numerous reasons why I feel the stock market still can do well. I will state that there is no way that we will do as well this year as we did last year. The big money has been made. I do think that we can make two to three times what the yield is on a tax free bond or a treasury bond. The reasons why are the following:

1) Ultimately, corporate earnings move stocks. It does make logical sense that if a companies' earnings increase by 12%, then the stocks price should also increase by 12%. Now, if the company is overpriced or if the expectation is for a higher growth rate than 12%, then the stock price won't rise. All things being equal, stock prices should rise along with earnings growth. Corporate profits are expected to grow by at least 10% this year. I believe that expectations for corporate profits are overly conservative and because of all the cost cutting, will do better than expected by the street.

2) Corporate balance sheets haven't been this strong since the end of the last recession. Corporations are flush with cash. As a percentage of assets, companies are holding

nearly twice as much cash as the historic norm. With cash providing a zero return, unlike the individual investor (more on that soon), corporations will be spending that cash. Whether it be stock buybacks, dividend increases (I have already received special dividends from several of my holdings last month) or capital spending, any of those expenditures will be beneficial to the stock market.

3) With money market rates barely above zero and short term CD's yielding in the 1% range after paying the ordinary income tax rate, there simply isn't much competition for equities. Tax free bond funds have done well lately and you can get a 4-5% tax free yield. We did considerably better than that last year.

4) While the economy is still in bad shape, it is emerging from a recession. Historically, the stock market does well as it emerges from a recession. While this will be a muted/jobless recovery, the economic trend is up.

5) Investor sentiment from what I see is extremely pessimistic. While it isn't nearly as bad as it was nine months ago, it is still pretty bad. I had diner last month with one of my mutual fund managers from Janus Capital along with some other Janus capital people and a few Citigroup brokers. I sat across from a Citigroup broker and he made Peter Schiff (Peter Schiff is a noted doomsday forecaster and is the head of Euro Pacific Capital) seem like an eternal optimist. His concern among others was that there was too much optimism out there. I politely asked the gentleman whom that the knew was optimistic? Other than some mutual fund managers, I can think of very few people, either professionals or individuals who are optimistic as far as the stock market. Speaking of mutual fund managers, I was at a Fidelity conference in NYC a couple of days after my Janus dinner. The mood among the attendees was very cautious for the upcoming year. Their continues to be a record amount of cash on the sidelines. Believe it or not, there were no positive inflows into equity mutual funds in 2009. To be precise, $ 35 billion was withdrawn from equity mutual funds in 2009. What cash did leave the sidelines went into bond funds. This negative sentiment is a positive sign for the stock market going forward. If cash had already been invested into the market, then there wouldn't be much to be invested now. If there were no pessimists now, then there would be going forward which would lead to selling pressure on the market which would drive down prices. Personally, I don't think that there will be that much cash going into the market because the individual investor is still disgusted with what happened with the stock market in the recent past, and rightfully so. If I am wrong about cash going into the market, then we could have two great back to back years. Possible but unlikely.

I rarely hope that I am wrong. I hope that I am wrong about the economy. While the recession is over, at least by the government's definition of a recession, I wouldn't want to look one of the 10% of the people who are unemployed in the eye and state that the recession is over. After most recessions, historically, you have a strong economic recovery. It won't happen this time. In past recessions, you didn't have Lehman, Bear Sterns, Washington Mutual and Countrywide Financial going out of business. In past recessions, banks were willing to lend to businesses. 60% of all jobs are created by small businesses. That is a fact. Another fact is that lending is contracting. From everything that I have heard and read, lending is supposed to continue to contract this year. Please keep in mind that many of these banks would not exist if they weren't bailed out with taxpayer money. Without access to credit, small and medium size businesses simply can not expand their operations. If they can't expand, then jobs won't be created. I seriously doubt that the unemployment rate will drop below 9% this year. I could see it possibly dropping to 8% sometime in 2011. I am also not comfortable with the direction of the housing market. While the housing market is no longer dropping, even with incredibly low mortgage rates, it is not recovering. Mortgage interest rates are going nowhere but up. I find it difficult to see the housing market improving in the face of higher interest rates. A housing market on life support will only be a drag on the economy. Banks aren't the only hurdle that small and medium size businesses are facing. The Government is working against business. While I won't get political (I will stay focused on business, the economy and taxes), the fact is that after the last recession their were tax cuts. I don't know for certain as to what degree the tax cuts helped in the previous economic recovery.

I do think that they helped at least a little bit. They certainly didn't hurt. In 2011, taxes are going up, not down. It is true that 90% of the people will not see a tax increase. There are two problems. The 10% of the people who will see their taxes go up are seeing a big increase in one year. More importantly, the people who are seeing their taxes go up are the same people who in the past have created most of the jobs. Without a doubt, I think that it is important to have as much "fairness" in the tax system as possible. At the same time, there is a big difference between a "fair" system that benefits the vast majority of people and a policy that is blatantly against small and mid sized businesses, which is counterproductive to job growth. With record deficits, I can understand the reluctance for business tax cuts. At the same time, there is a big economic consequence when you are not cutting taxes to help stimulate growth versus tax increases that are on the horizon in a lousy economy.

I want to get back to how this all affects the stock market. The worst things for the stock market are inflation, high interest rates and a recession. Everything isn't always a case of black or white. With the economy, it isn't simply a good economy or a bad economy. The economy, for reasons previously stated, won't be good for a long time. However, the economy will be a lot less bad in 2010 and 2011 than it was in 2009. While the poor labor market is not good, the benefit to the stock market will be that it will keep inflation in check. While interest rates will go higher (long term rates are already increasing), the poor labor market will result in interest rates going up slowly rather than rapidly. This will also benefit the stock market.

Our mutual funds performed spectacularly. I have high expectations for our mutual funds and they exceeded even my high expectations. Two of our fund managers were nominated for the 2009 Morningstar manager of the year. Two of our funds returned over 50%. Four of our funds returned over 40%.

If you have any questions or if there is anything that you want to discuss, then please either call me or send me an email