



BOYER & CORPORON
WEALTH MANAGEMENT, LLC

Investment Commentary August 1, 2009

The stock market enjoyed another positive month, rallying over 7% during July. It has increased over 40% since the market bottom on March 9th. Interestingly enough, it is still down over 35% from the market peak in October, 2007. This illustrates how important it is to avoid the investing "torpedoes". When your investments decline by 50%, they have to double (a 100% rate of return) to get back to even.

Gross Domestic Product for the 2nd quarter ONLY declined 1%, much better than the 6.4% contraction in the 1st quarter. And quarterly earnings were announced during July for many companies, almost all of which were "better than estimated". Better than estimated doesn't mean the companies had good earnings. It means earnings expectations were overly pessimistic. But many people perceived this as a positive and a sign that the recession/depression is over.

On closer inspection, perceived improvements in earnings were not a function of an economic rebound. They were a result of significant cost-cutting. Massive lay-offs helped corporations cut expenses to the bone. Even though revenues declined dramatically across the board, corporate earnings "appeared" healthier. This may seem like a positive but it is probably lost on the millions of workers whose

jobs were eliminated and who are still looking for work.

I told you last month we would likely see positive earnings surprises from bank stocks and other financial companies. They didn't let us down. With few exceptions, financial companies benefitted from the change in the "mark to market" accounting rules.

One of the other bright spots in the economy is the pickup in auto sales. The "Cash for Clunkers" program has successfully stimulated purchases of automobiles by consumers. The \$1 billion allocated to this program was exhausted in a matter of days and another \$2 billion is being considered. We have no doubt an additional \$2 billion will be allocated to the Cash for Clunkers program.

Governmental stimulation of the economy (in some fashion) was necessary during this period in which the credit markets became paralyzed. However, we question why there has been a pronounced and focused stimulation on one industry (autos). We would assume that the government is partial to the auto industry because the government is the largest shareholder of the U.S. auto industry and has a vested interest in its survival and prosperity. As soon as the Cash for Clunkers program has ended, we expect auto sales to return to their previous anemic levels.

On a side note, why has no one pointed out that the Cash for Clunkers program rewards only those consumers who purchased Clunkers? If you purchased a fuel efficient Honda or Toyota a dozen years ago, you are overlooked but if you purchased an 8-cylinder Crown Victoria, the government will pay you to purchase a new automobile.

We frequently get asked about inflation. When is it going to happen? How bad will it be? How long will it last? Why aren't we having it right now? How can I invest to protect myself against inflation? The conventional wisdom is, if the U.S. Treasury is issuing a lot of debt and the Federal Reserve is printing a lot of dollars, inflation is inevitable. When you have an ever increasing number of dollars chasing the same (or fewer) goods, it should take more dollars to buy those goods...i.e. inflation. So far, that is not the case.

The primary indicator of inflation, the Consumer Price Index, has declined 1.43% for the past 12 months. In other words, prices have declined and we have experienced a year of mild "deflation". Although the CPI is criticized for not being a reliable indicator of actual inflation, we expect it would reflect the type of rampant inflation that everyone seems to be expecting. Yet on the inflation Richter Scale, it hardly even registers a tremor. Why is that? How can the Fed burn up the presses printing money and not cause massive inflation?

The answer may be "they can't" indefinitely....but for right now, they can. They can for several reasons. The first reason is the "velocity" of money or rather, lack of velocity. Velocity is how fast the dollars move from banks to consumers (as loans), back to banks and back to consumers again. The faster the funds get lent, spent, deposited and

then lent again, the faster is the "velocity" of money.

Printing massive amounts of dollars in a healthy economy would likely cause hyper-inflation. In the current economy, it only causes good conversation. Last fall, there was virtually no velocity of money as the banks seized and refused to lend money to anyone, including each other....in some cases ESPECIALLY to each other. Today it is only slightly better. Banks were given (loaned?) billions of dollars but most had a lot of work to do to improve their balance sheets so they were reluctant to lend. Consumers became reluctant to spend. The savings rate increased. This is all part of the "de-leveraging" of America. The amount of money being printed seems to just barely be taking the place of the amount of money consumers are taking out of the system by saving.

Another reason inflation shouldn't be feared at this time is that one of the major components of inflation is "wage pressure". When prices are increasing, employees typically demand increased compensation. With unemployment approaching 10%, employees are not in a position to demand higher wages. Most are just happy to be employed. After the bankruptcies of General Motors and Chrysler, unions have much less clout for demanding increased compensation.

If and when inflation does heat up, you can always expect higher interest rates as bond holders demand a higher return to offset the decline in the value of money caused by inflation. Higher inflation equals higher interest rates.

We think it is possible that we might experience higher interest rates WITHOUT increased inflation. Interest rates might be artificially low due to

the large investments in U.S. debt by foreign investors, primarily China. We purchase their products with dollars and they use the dollars to purchase Treasury Bonds (among other things). Their willingness to purchase our debt has helped to hold down interest rates. Needless to say, our purchases of foreign products have declined dramatically this past year providing fewer dollars to purchase U.S. Treasuries. Meanwhile the U.S. Treasury will have to issue additional bonds to fund the Administration's stimulus program(s).

If the recession ends and the private sector begins to demand credit, we could see higher interest rates without experiencing inflation.

During June, there were 336,173 new foreclosures. Because Governor Schwarzenegger has declared a three month moratorium on foreclosures, the number of new foreclosures will decline for a few months. This will only mask and postpone the problem. The month following the moratorium will likely see a large spike in foreclosures.

If you watch the business news shows, you might believe our economic problems are behind us and the stock market will continue to rally. Of course, the same shows were touting technology stocks in 1999 and 2000. A year ago, they had experts who were convinced oil would trade at \$300 per barrel because of the increased demand from China and India.

Governmental stimulus can make the economy appear better than it is. This reminds us of the spring of

2008 when President Bush sent "stimulus" checks of approximately \$500 to almost everyone in America. If you recall, we had positive GDP that quarter which ended June 30th. As soon as the government stimulus checks ended, the economy immediately turned south.

On a local level, I continue to count real estate signs in my neighborhood as I have since the summer of 2007. Riding the identical route, I counted as many as 8 "For Sale" signs in the summer of 2007. Last summer I counted as many as 26. This past month the number of homes for sale reached 29 although it was back down to 26 at the end of July. I have to confess that one of the homes I count every month is in a very upscale subdivision and was probably listed for over \$1.5 million at one time. It had a sign in its front yard for over a year and then one day it was gone....the house, not the sign. The house was burnt to the ground. The only thing left standing was the four-car garage. Now it is a driveway leading up to a vacant lot with a very nice home on each side of it. I still count it even though there is no "For Sale" sign in the yard.

Unemployment is still almost 10% and the economy only looks less bad. It doesn't look good. Nevertheless the emotional climate is much better and will cause us to be "cautiously less hedged" for the near future. We expect to slightly and gradually increase our equity exposure, always remaining diligent to limit our risk rather than to maximize our reward.