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# A volatile quarter

Client Newsletter
Quarter Ending June 30, 2010

A quarter in which volatility ruled saw the Dow Jones Industrial Averages slide 10%. The crash of 2:45 PM (Flash Crash) detailed earlier in my notes to you, concern over Sovereign debt in Europe, especially Greece, and evidence of a slowing economy led to concerns about a double dip recession. (Please see my Daily Journal of Commerce column recently forwarded to you.) All of these concerns led investors to seek safety and pushed bond yields into record low territory. Mortgage loans plumbed all time lows.

Our policy has been to be defensive for some time, while still seeking growth. Our composite outperformed the S&P for the quarter, the year to date, and for the trailing twelve months, in both up and down markets. We also beat our multi cap growth peer group for all three time frames. So our strategy is working. Individual results may vary of course especially as clients add or subtract from their invested assets.

Looking forward, we see inflation benign. Interest rates should remain ultra low through the first part of 2011. The dividend yield on S&P stocks now exceeds the yield on ten year treasury bonds which means that if stocks go nowhere for the next ten years, they will outperform bonds. Bonds have a great deal of risk because of the threat of rising interest rates. Yields on cash are very low so you are losing money in cash when giving effect to inflation. Cash would be a good holding if we have a deflationary economy and there is some fear of that. Many commodity prices have fallen.

Paul Krugman, Nobel Prize winning economist has warned of a third depression unless the government continues to spend generously and incur great deficits. The counter argument is that we should go on an austerity diet and reign in our deficits and spending. Krugman says that is a proven recipe for Depression. I have discussed this at length in my Daily Journal of Commerce column previously forwarded to you, which I recommend to you for reading. The likely scenario with the current administration is more government spending with more budget deficits, to little effect on the economy. The giant stimulus package of a year ago still has not dented our persistently high unemployment rate.

The government seems more intent on Health reform and immigration than employment and the BP oil spill. Unless there is a remarkable turnaround in government priorities, there will be a remarkable turnaround in the composition of congress in the November election. I expect President Obama to emerge considerably weakened. Republicans will not have enough votes to institute a new program, even if they had one, so we will drift until the next presidential election.

The economy is slowly growing and will continue that slow growth trajectory for some time. Minutes of the June 22-23 Federal open market committee show that the Fed has lowered GDP growth rates for the U.S. economy. The Fed predicts growth of 3.0 to 3.5% for this year, down from 3.2-3.7%. The last time the Fed lowered forecasted growth was in April 2009. For 2011, the Fed forecast slightly higher growth rates than previous, about 3.5% to 4.2%. In its forecast, the Fed noted persistently high unemployment and tight credit for small business and households. I have noted before that tight credit would retard the economy.

If the government were ever to get serious about job growth they could continue the Bush tax cuts, grant tax credits for capital investment, grant a social security holiday for wage earners. The Federal government is also going to have to address the problem of the various states that are on the verge of defaulting on debts. The Federal Reserve has done about all they can do, so it is up to the executive and legislative branches, and I see no inertia there.

It is clearly a stock pickers market with an emphasis on defense. It is also a trading market, but since we are investors, not traders, we will not become traders. Our strategy has served us well, and will into the future.

If you have any questions, please call me at any time.

We are growing our business, so we appreciate any referrals. Please fill out the client satisfaction survey that we have sent you recently. Thank you.

Best personal regards,

***William D. Rutherford, President***
*Rutherford Investment Management LLC.*

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