Economic Update

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November 2, 2010

As we head toward the end of what has been an up and down year, we were thinking that we might be at a loss for words (rare for us) in discussing what has occurred in 2010 and what we see in the near to midterm future. Fortunately (or unfortunately, depending on your perspective) we have found plenty to write about and discuss, some of which may surprise you as much as it did us.

First, on a disappointing note, the Phillies are not in the World Series. As in investing, the Phillies relied too much on one element of their "portfolio", i.e. hitting, and the hits did not come. Pitching was great, but you cannot win, or successfully invest, without a diversified attack with all elements at least achieving decent results. Next year!

On the other hand, the economy at first glance seems to have no visible elements having any success, whether you use real estate, employment, interest rates on savings or, for most of the year, the stock markets as your benchmark. Nothing seems to have moved one way or the other. However, looking a little deeper, a different picture emerges, one of slow but somewhat steady progress.

In September, the S&P 500 gained 8.8%, the best September since 1939 and the 4th best month in the past 20 years. It followed that performance with another 3.7% advance in October. Also in September, new houses sold at an increased sales volume of 6.6% over 2009 and re-sales of homes rose at a 10.0% rate (*Wall Street Journal*).

Currently, we are at the end of a rather volatile election season. We have purposely finished this letter before the election results are known, but it seems clear to us that there will be some repudiation of the last two years' policy initiatives and we will return to the good old days of gridlock. We do not think that will be a bad outcome as under both Presidents Reagan and Clinton, each had a successful

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(economically speaking) presidency while having to collaborate with the other party's Congressional control.

We continue to see a muted, but nonetheless significant amount of fear for our future. While we can understand concern for our present situation, in particular with the visible unemployment and real estate woes, we think that the future (assuming the election outcome) is very bright. Here are a few items of note:

- Private sector employment has risen every month in 2010, averaging 95,000 new jobs per month (*Bloomberg*). This figure is not enough to do much about the unemployment rate, but it is some progress nonetheless and it is anticipated that 2011 will accelerate the growth in hiring.

- We are just past the one year mark following the end of the recession. It does not seem like much of a recovery so far, however the average recovery following the last 4 recessions has lasted pretty long, specifically 7, 10, 9, and 8 years. There is no guarantee that will occur this time, but no reason to think that if we continue to address major financial structural problems, we will not have a typical length (or longer) recovery this time.

- We are in the first year of a decade that follows a ten-year span where market returns (S&P 500) were less than 5% per year on average. That has happened only 11 other times in our history. In the 10 years following those periods, the S&P 500 increased between 7% and 18% per year for the next decade, with the average being 13% per year.

- All of the ads for the 2011 Super Bowl have been sold out, a number of months earlier than in the past. Not sure what that means, but to us it sounds like some of the big firms are betting on a recovery in 2011. Among the companies that are back, after sitting out the last few years, are General Motors and Pepsi. Normally, ad space is available up until the week of the game itself.

While the current slow growth and persistent high unemployment are weighing on many of us, two recent surveys, one by Vanguard and the other by Duke University, offer some perspective that we believe is very positive, both long and short term. The Vanguard survey set out to determine how many of the 500 companies that make up the Standard and Poor's 500 were founded during what would be considered "hard economic times", either in a recession, the great depression or at a time where growth was below average. The answer, which really surprised me, is 400 companies. That is 80% of the biggest and most successful companies in the US were started at a time where conditions were less than average, and in some cases a lot less. The Duke survey is very recent (September) and asked leading CEOs from major US companies why their firm, and others, were holding so much in cash reserves instead of expanding. The overwhelming answer was uncertainty of future federal government policies. That could and should begin to change as the anticipated changes in the makeup of Congress force compromise.

We really have 2 global economies, one which is struggling currently (unfortunately we are in that one, together with Western Europe and Japan) while the other is booming. This division between the developed and emerging worlds is likely to remain, with the emerging economies like China, India, and Latin America continuing to grow at a faster rate due to lower debt (at all levels), less regulation (some good, some bad), and a younger population.

Although some people tell us "we do not make anything in the US anymore", the fact is that we make plenty and remain one of the top 3 manufacturers in the world, though we have less people engaged in the industry due to improvements in technology and productivity. Decades ago, most people in the US were farmers. Today it is less than 2%, yet we produce a lot more from fewer farms that employ fewer people. Our economy and overall employment have grown dramatically over the decades, but fewer are employed in manufacturing. Fortunately, that is not the whole story in terms of what we make here and sell internationally. For example, here is a small list of US companies with more than 50% of their revenue from overseas:

- Pfizer: 56%
- McDonalds: 67%
- Qualcomm: 94%
- 3M: 63%
- Coca Cola: 75%
- Apple: 60%
- Google: 52%
- Hewlett-Packard: 64%

This is a small sample of what global growth is doing for US companies. This impact will be even greater as foreign economies continue to grow and need or desire goods made in the US.

While we continue to hear of problems in the US with commercial and office real estate, that is not an issue in the emerging markets. For example, while there is pretty much no new office development scheduled for New York for 2010 and 2011, Mumbai (Bombay to us older folks) is constructing 30 million square feet of office space between now and the end of 2011, Dubai is adding 20 million, and Singapore is adding 14 million. Chicago, Los Angeles and San Francisco will add 120,000, 695,000 and 515,000 respectively during that same period (*Business Week*). The emerging economies are growing; we may not see it here as much, but as the world's leading economy we will benefit from the global growth.

We also expect to see a continued advance in almost every technology category, further enhancing productivity and creating new companies, industries, medical treatments and life enhancements. Even a few years ago, who would have ever thought we would have the iPhone, iPod or iPad? Flat screen TV's for well under $1,000? Robotic surgery? Gene therapy, cloud computing and alternative energies are just a few of the areas where whole new industries and many new companies will be created. We are a long way, literally and figuratively, from the 1899 quote from Charles Duell, Commissioner, US Office of Patents, when he stated, "Everything that can be invented has been invented". Nice call.

On November 17th, one of our past (and most popular) dinner speakers, Dr. David Kelly, chief market economist from JP Morgan, will be hosting a nationwide "town hall" teleconference. The call will begin at 12:15 pm, the call number is 800-857-8000, and the code is MARKETINSIGHTS. We will send a reminder before the call, but Dr. Kelly is clearly one the nation's leading economists and his thoughts on how the markets and economy would develop over the past year have been extremely accurate. This will be a very interesting interactive discussion with Dr. Kelly and except for the fact it is in the middle of the day, it would be worth dialing in. If there is a replay that you can access at your leisure, we will let you know.

Despite what seems to be growing good news, which sometimes you have to really dig for, there remains a concerned population, especially those over age 50. They face a future of longer lives, but less money to live comfortably. What money they have may be either earning almost nothing at the banks and other fixed income investments, or needs to be invested in markets that many see as little more than casinos. A recent survey by US News and World Report magazine found that 60% of those between 50 and 61 years old have indicated that they will delay planned retirement. Of greater concern is the ongoing debate about whether we are more likely to experience inflation or deflation in the coming years. A few months ago, deflation was the headline, today it is the growing fear of inflation. Neither is good and other than our recent experience with deflating real estate values, we have not experienced deflation in our lifetimes. Inflation is a potential devastating force, especially if you are in retirement and not investing to keep up with inflation. Even with the relatively modest inflation we have experienced between 1989 and 2009, purchasing power has declined by 40% (*US Labor Department*). There is really only one asset class - common stocks - that have kept pace with the inflation rate.

While we share the concerns for the economic recovery, at the same time, we see the glass as "half full", not "half empty".

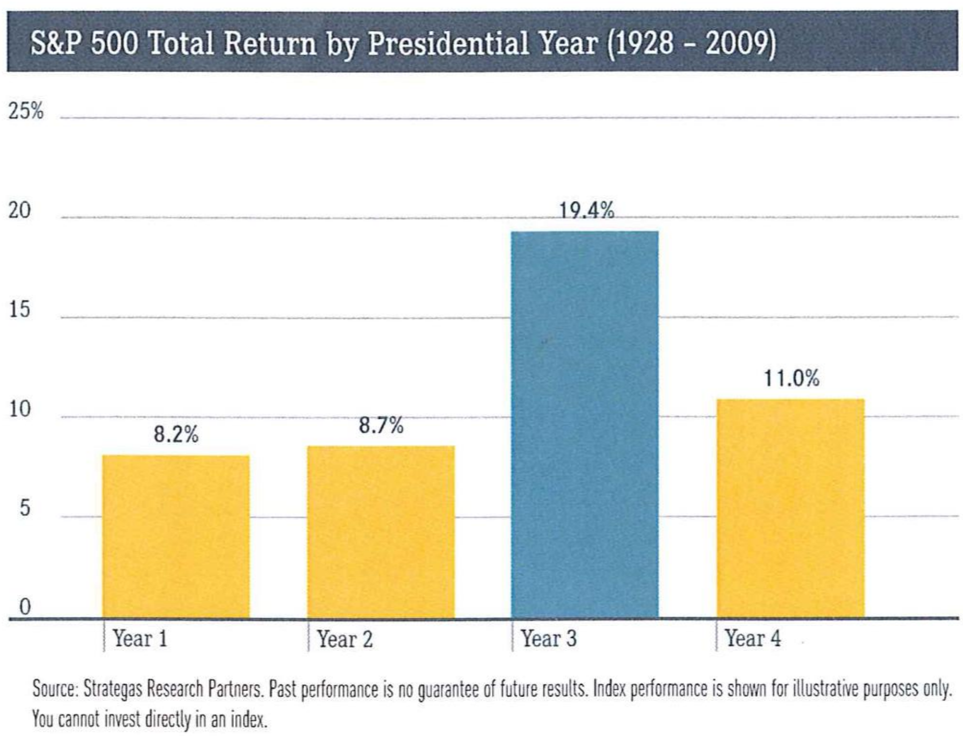
First, we think people have adjusted saving habits and spending habits to bring both in line with reality. The US savings rate in 2007 was 2%, now it is 6%. Clearly money saved and not spent is keeping the economic recovery from growing, but as a country we are over indebted and people are realizing (even some political leaders) that you cannot continue to spend more than you make.

Second, the US consumer is starting to spend again. In September, total consumer spending was up $25 billion over 2009, so there is some confidence and pent up consumer demand now occurring.

Third, we really believe, and New Jersey may be the model (pretty amazing!), that we are going to begin to address many significant financial issues that have threatened us for years. If we can successfully resolve those, we will have a much more stable economy in the future. The president has formed a bi-partisan committee to examine a very wide range of spending and tax issues. That group is to report to him before year end and hopefully their recommendations will be the basis for a serious, adult discussion among our political leaders about resolving these issues.

Although no one can predict the stock markets even a minute in advance, we have some interesting history on our side over the coming months and years.

The 4th quarter of the year is typically a good one, with 16 of the past 20 years producing positive results in the S&P 500. Next, the third year of a presidential term has been the best of the four years, also by a pretty wide margin. Since 1928, the third year of a presidency (21 "third years" in all) has produced an average gain in the S&P 500 of 19.4% (chart below). Also, the markets (based on the S&P 500) have traditionally performed well when Congress and the President's office are occupied by opposite parties. In fact, history shows the best combination for the stock market is when a Democrat is president and the Republicans control Congress. The last "losing" 3rd year of a president's term was in 1939.



As we mentioned above, among the very real problems we face and the fears many people have is their inability to create sufficient guaranteed income in today's economic environment. This is the worst market for income seeking investors that Paul has seen in his 35 years in business. Money market accounts are paying close to zero because what they are investing in pays close to zero as well. Two year US Treasuries pay less than ½% and 5 year Treasuries pay a little over 1%. Even longer term fixed income investments are at close to all time lows. A ten year US Treasury note, which in the 1980's once paid 15.84%, now pays less than 3%.

Eventually, interest rates will go higher, but we do not see that day on the near horizon. When rates do begin to rise, they will most likely rise slowly and in an orderly fashion, as was the case in 2004 when the Federal Reserve began a series of 17 consecutive 0.25% rate increases that took the Fed funds rate from 1.00% to 5.25%. Currently it is 0.25%. The recent issuance of 3 year corporate bonds by IBM, Microsoft and Wal-Mart are not encouraging, as those bonds were priced to yield 0.1%, 0.9%, and 0.75% per year respectively, which is less than each of those firms has paid in recent dividends on their stock.

In early December, Paul will be attending a 2 day conference in Chicago, which will address, among other topics, investments that are specifically designed to produce higher levels of income to combat the low income environment we are in and expect to be in for awhile.

NEWS AT EWS

We hosted our annual economic dinner at RiverWinds on October 12th and had 120 guests attend, our largest ever, with many new clients and also many guests joining us. It was a wonderful night; RiverWinds was a great place to host the dinner and people really enjoyed the entire evening. Our speaker, Doug Sandler, made a strong case for a slow but steady recovery in the US and a stronger recovery in the emerging market economies. He also gave a somewhat sobering view of the consequences of not taking action on our debt.

On November 4th we are hosting a dinner for women at Tavistock Country Club in Haddonfield and have 75 people scheduled to attend. Our speaker is Eleanor Blayney, one of the premier experts on women's financial planning in the nation. Eleanor's new book - "Women's Worth, Finding Your Financial Confidence" - has been a big hit and very helpful to those who have read it. It should be a nice and informative event.

We have recently decided to engage the services of a business consultant, Andrea Schlapia from Ironstone Communications in Atlanta, who will be assisting us in a variety of areas, including how to handle our future business growth, processes, and enhancement of client services. We have looked at a number of firms for this purpose and decided to hire Andrea's firm based on their exclusivity to consulting only firms like ours. We have several peers with whom she works with and she has received strong endorsements. We may be reaching out to a number of you for advice as we work with her over the next year or two.

As we enter the holiday season, our best wishes to you and your family, friends and associates for a time of thanks, giving, relaxation, and the renewal of relationships.

Thank you for taking the time to read our newsletter and for your continued trust and confidence.

Best regards,

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