

2009 Third Quarter Commentary

It hardly seems like a little over one year ago that one of the most catastrophic times in Wall Street history began, with the collapse of Lehman Brothers, the fire sale of Merrill Lynch and the tremendous bailout of American International Group. The stock market suffered the worst loss that week since the terrorist attacks of 2001, the credit markets froze, the global economy was near collapse, and I was standing in a pile of water due to Hurricane Ike.

On September 15, 2008, tired and hot, I sat with a wireless connection accessing client accounts and moving all money market assets into Treasury Money Market Funds, uncertain even of the how the crisis would affect this supposed bastion of safety- cash! We were extremely thankful that indicators had placed our accounts not only in an abundance of cash but that we had sold out of financial stocks several months earlier. I always say that what we do is not an art but a science and we have no crystal ball, but the weakness in the markets and in the financial sector were apparent that summer.

So here we are one year later: I am about to move back into my home after one year of complete renovation and the market seems to be recovering. For awhile it seemed as though unemployment would raise its ugly head, and the recovery would be like a contractor who promises to be there. But let's look at it in detail, and without the renovation metaphors!

- Low inventories, improving economic data around the globe, and an increase in both consumer and business confidence could yield some upside surprises.
- Although a correction remains a possibility, the market may not have yet fully discounted the potential of even a modest uptick in the demand side of the economy.
- We are in the heart of third-quarter earnings season and the results and outlooks will likely go a long way toward determining the near-term market direction.
- Australia raised its benchmark interest rate and China is reining in some stimulus measures, indicating that global growth is taking hold. International exposure is a necessity.
- Potential dips in the market represent an opportunity for us to raise equity allocations up to target levels.
- After a disappointing jobs report helped push the market lower, we saw a nice reversal on better than expected economic reports.
- Initial unemployment claims continue to fall, returning close to their lowest level of the year in the October 15 report while the 4-week moving average also fell to its lowest level since mid-January—indicating continuing gradual improvement in this leading indicator. While media and investors often focus on the unemployment rate, which continues to move higher, it's a perpetually lagging indicator and typically doesn't peak until well after a recession has ended.

Wholesale inventories also fell for a twelfth straight month in August while wholesale sales rose 1%, leading to inventory/sales ratio falling for the fifth month in a row, dipping to its lowest level since September 2008. Add to that the recent retail sales data that showed a 0.4% gain in September's year-over-year same-store sales (the first gain in a year), and you can start to see the components coming together for a "popping" of the coiled spring.

There are still a fair number of companies issuing cautious guidance and, in some cases, disappointing earnings. There are also concerns about the falling dollar, the possibility of inflation taking hold, rising government debt, and the perceived need for a substantial correction in the equity market. It is, however, this wall of worry (a bullish market trend in the face of negative uncertainties) and skepticism that keeps us relatively optimistic about the near-term prospects for the market. The dollar's fall has been relatively controlled to this point and there is really no viable alternative to it as the world's reserve currency:

- Inflation is quite low.
- There is substantial excess global capacity and labor needing to be sopped up.
- The velocity of money is weak (thanks to weak credit supply and demand).
- The rest of the world is still willing to finance US debt at low interest rates.
- None of these factors signal impending inflation.

What's been more predictable is the continued easy monetary policy that the Fed has kept in place. That predictability might be coming to an end as there have been several Fed members peppering recent comments with messages about "exit strategies" and ending some of the Fed's emergency liquidity facilities. Getting the economy to a self-sustaining phase and removing the excess liquidity before inflation takes hold are both critical challenges facing the Central Bank.

As this past year comes to an end and it seems that the 'blue tarp' (ok, one more) over the market has been removed, we remain positive about the market, inflation and global growth and like a hurricane, will look back at this as a storm of epic proportions.

Very sincerely yours,



Ann Miller

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