# Economic & Market Commentary

## Dow 10,000?
## *Déjà vu again?*

In prior *Commentaries* we have been quite detailed about our concerns and hopes for the economy, and our earlier comments still are valid. In short, the global economy appears to be recovering after weathering the worst world-wide recession since the Great Depression. The massive, globally-coordinated stimulus programs, critical in creating a catalyst for stability, have begun to creep into economies. The reported economic data have been mixed, with some good and some bad news, but generally a level of confidence has been restored and the economic freefall has been arrested. In response, and in 1938-ish style, the S&P 500 leaped approximately 60% from the lows of early March, anticipating better data on the horizon. After falling approximately 25 percent in the first two months of the year, the S&P 500 has gained approximately 16 percent and the Dow Jones Industrial Average has gained approximately 11 percent for the year-to-date period. A more complete reference to the potential relationship between 1938 and 2009 can be found in our March 2009 Commentary *Déjà vu or Something New* on our website -- www.stellarmgt.com.

The recent return of the TARP funds received by some banks seeking to avoid politically charged oversight and regulation has reduced reserves in the banking system. Continued caution surrounding the valuation of reserves tied to commercial real estate exposure, the return of the TARP funds, and a supposed lack of qualified borrowers has kept a lid on new credit creation. The TARP funds were a good idea at the onset but became a political football, and after seeing one of those things being tossed around often enough, one learns that sometimes it's best not to play the game. We would have preferred for all the TARP funds to remain in play as a longer-term, temporary source of capital until the commercial real estate shoe drops, but if it is really not needed, the return of that capital may help reduce inflationary pressure later in the economic cycle.

Removing the stimuli without adversely affecting the fragile state of many economies will prove to be quite challenging. The key will be coordinating monetary and fiscal policy on a global scale and avoiding a trade war with our trading partners. In the past, countries have been able to use currency weakness and excess capacity as tools to export their way out of a domestic crisis, thereby increasing employment and economic growth. But due to the global nature of the downturn, everybody cannot export their way to a recovery at the same time, which will limit the speed of the recovery and increase global trade policy tensions. Employment data typically lag an economic recovery and this time is proving to be no different. This should not surprise anyone, but since it has political implications it will remain in the headlines for sometime to come.

Two longer-term themes we continue to view as important to investors are the weakening U.S. dollar and the renewed focus on top-line revenue growth as a catalyst for stock performance. In a seemingly heartless fashion, corporate expense reductions as a percent of revenue reductions have run at about the

same rate as experienced during the last recession. Considering the magnitude of the revenue drop this time around, the ability of firms to cut that deeply in such a short time surprised many analysts and helped many to outperform earnings expectations. Those earnings surprises combined with a general reduction in fear and loathing have caused stock prices to jump. Well-run firms should outperform expectations on the way up as well, since a number have been increasing their market share at the expense of lesser firms, and when revenue growth turns positive, these firms should shine. The U.S. consumer has withstood a considerable shock, and it will require renewed confidence in the employment situation to turn newly minted savers into spenders again.

The last time I wrote a *Commentary* with *Dow 10,000* in the title, it was December of 2003, and before that, March of 1999. As we've tacked back and forth over these waters for almost 11 years, the Dow 10,000 mark has become a milestone on the way up and a tombstone on the way down. But despite coming under fire during this period, being a long-term investor is about the only way to increase wealth.

Long-term investors may participate in business ownership either directly as an operating owner or passively as an investor. While many would like the control of running their own business, having access to the money needed to start and grow the business; the quality people required to operate it successfully; and the ability to accept risk, illiquidity, and complying with a growing list of regulations is not everyone's cup of tea. For those not interested in managing all the responsibilities of owning and operating a business, the financial markets have made it possible for investors to participate in the benefits of business ownership without operational or financial headaches. The markets are a pretty decent system that offers standard accounting requirements as a basis of analysis and a liquid market to buy and sell ownership interests. In the end, it is the liquidity that most covet that creates the most headaches, as liquidity and price volatility go hand and hand. To manage that volatility, investors use asset allocation and diversification just as business owners use products or services to tweak a revenue stream towards growth or consistency.

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September 30, 2009

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