DELTA
FINANCIAL ADVISORS
Investment Counsel

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IN THIS ISSUE

Economic Comments

The critical question looking further into 2010 is whether the economy can continue its nascent expansion in the absence of the massive monetary and fiscal stimulus put in place during 2008 and 2009. The Federal Reserve itself seems somewhat conflicted as to how to remove these emergency measures. At its last meeting in mid December, several members of the interest rate setting Open Market Committee expressed concern about how the Fed should go about removing the support it has been providing to the housing market by buying long maturity mortgage securities thereby driving down mortgage rates.

Moreover, some Federal Reserve officials raised concerns that high unemployment might make it desirable to expand some of the Fed's expiring asset purchase programs. Another policy-maker pushed his belief that improvements in the financial markets and the economy might warrant a scaling back of the Fed's recent purchases.

That being said, the economic recovery still appears fragile with 3rd quarter GDP growth having been revised down further to 2.2%, according to the Bureau of Economic Analysis. Driving the downward revision of 0.6 percentage points were reduced assessments of nonresidential fixed investments, inventory investments and consumer spending for services.

With the economy still in low gear, the Consumer Price Index (CPI) has remained fairly constrained with the most recent December reading being up by 0.4%, following increases of 0.3% and 0.2% in the prior two months. The majority of the latest increase was driven by resurgent energy prices relative to the depressed prices of last Fall. Compared to a year ago, consumer prices have increased by 1.8%; however, this jump has been driven by the big CPI declines from last Fall rolling off of the 12 month calculation.

Although highly inefficient in its execution, the staggeringly large stimulus package approved by the Obama Administration last Spring has played a vital role in warming up the tepid economy. As 2009 ended, roughly half of the almost $800 billion economic adrenaline had been injected into the economy with the remaining funds expected to be largely spent by mid year. The trillion dollar question is how to wean the U.S. economy off of its ill-thought addiction to cheap money and massive government intervention.

To our dismay, there are some Washington eggheads already proposing that another stimulus package of $150+ billion be approved. This remarkably poorly

(Continued on page 2)

Economic Comments continued from cover

thought out recommendation has been put forward even though half of last year's stimulus is still yet to work its way into the economy!!

Since September, unemployment has continued to creep up, hitting 10.0% in December. Unfortunately, job creation remains erratic with an unexpectedly large 85,000 jobs being cut in December—far worse than expectations of an 8,000 drop. Unfortunately, these reports suggest that many jobless people are giving up on their search for work.

Meanwhile, consumer confidence posted another modest gain in December, increasing to its highest level in two years. However, income expectations for consumers remained pessimistic and appear likely to play an important role in spending as the new year starts.

There continues to be signs of hope from the housing market—in so much that housing is now giving mixed signals rather than the full bore collapse that was playing out last year. Specifically, housing starts and building permits rallied at the year's close to hit the highest level since early 2007. Leavening this good news was the slow down in new home sales to their lowest levels since April.

Looking forward, it is our expectation that a modest recovery in the economy is in progress We believe that the most likely direction for the economy is for a sluggish recovery to continue—characterized by modest inflation and an unemployment rate of roughly 10% sustained into 2011. While elevated risks remain of a renewed slow -down, we are cautiously optimistic that this will not occur.

Analyst Corner

While the markets have largely recovered from their near fatal heart attack last winter, we continue to see value in more stable franchises. As such, Emerson Electric (*NYSE: EMR*), a diversified manufacturer of electrical and electronic systems has received additional scrutiny from our team. With the majority of its sales being generated overseas, Emerson has attractive exposure to more rapidly growing economies. Mitigating this positive attribute is the limited near-term growth in infrastructural investment at this stage of the global economic recovery. However, we believe that this headwind will be transient and quickly surmounted. When coupled with a solid balance sheet, good cash flows, healthy return of capital via dividends and good longer-term growth prospects, we believe that EMR should provide attractive returns to its shareowners along with lower levels of volatility.

Market Comments

Looking at the past decade, some pessimists point out that a lump sum invested in the S&P 500 at the start of the decade would have returned a negative 3.5%/year, adjusted for inflation. However, this morose viewpoint does not take into consideration the entire picture. Most investors have a 50+ year investing horizon. The latest 10–year snapshot taken from December 31, 2009 started at a time where stocks were massively over-valued. Using a more realistic picture of an annually re-balanced diversified portfolio of stocks and bonds that includes dividends and interest along with dollar cost averaging, the picture is vastly different with positive returns in excess of 5% per year.

For the year just ended, it was an unfortunately exciting ride. After plunging almost 25% during the year's first quarter, the broader stock market rallied by 65% to end up with gains of more than 25% for all of 2009. Leading the market's charge was the information technology sector with full year gains topping 60%. The non-glamorous utility sector was the laggard with returns of almost 9%.

The fixed income markets for the year were more mixed as Treasuries suffered badly as 2008's flight to quality ebbed and reversed itself. As fears of economic collapse abated, and bond yields returned to more normalized levels, both corporate and municipal bonds showed extremely strong gains with returns of 14% and 20%, respectively. More speculative securities in these sectors performed far better with very low quality junk bonds rallying by 94% for the year.

In general, fixed income investors have a better track record of looking forward to assess the economic outlook. If this is the case, we all should sleep easier. The interest rate yield curve, through its extreme steepness, is signaling investors' belief in a sustained economic recovery. While we are not quite convinced of this evidence, it does provide support to our recovery hypothesis.

One key issue, and highlighted by the many large, daily market swings experienced in 2008 and 2009, is market volatility. At this stage of the market, we think that the easy money has been made with analysts already anticipating solid recovery in corporate earnings during the year. Stock market volatility, as measured by the CBOE's VIX index, has returned to its more normal historic average of ~20.0, suggesting a level of complacency by investors. However, we do not believe any investors should be lulled into thinking that this market does not have the potential for sharp swings. As such, we continue to believe a strong defense should complement the risks naturally inherent to investing in the capital markets.

Performance as of 12/31/09

	Close	Month	YTD	1 Year
DJIA	10,428.05	0.95%	22.68%	22.68%
S & P 500	1,115.10	1.93%	26.45%	26.45%
NASDAQ Comp.	2,269.15	5.81%	43.89%	43.89%

	Year end yld.	Prior Yr. end yld.
10 yr. U.S. Treasury	3.84%	2.24%

Planning Thoughts

An exciting planning opportunity is now available; effective January 1, Congress lifted the income limitations on converting Traditional IRAs into Roth IRAs. If you have long had a desire to shift assets into a tax-exempt Roth account but have been constrained from doing so due to the IRS' income limitation, now could be the time. We would be eager to help you evaluate the appropriateness of this action for your specific situation. Please give us a call!!

Other Matters

We are excited to issue our re-designed newsletter along with our new logo. We decided that it was time for a fresher image. We are in the final stages of developing our website which will allow clients to have access to their brokerage accounts, to assess key market information and to view both their monthly account statements and their year-end tax reports. We believe that it will be a valuable tool in accessing market information along with key account information. We will let you know as soon as it is ready for unveiling.

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