Delta Financial Advisors

October 2009

Economic Comments

The U.S. economy now appears to tentatively be on the mend as Fed Chairman Bernanke recently shared his belief that the Great Recession ended during the year's 2nd quarter. At its most recent meeting in September, the Federal Open Market Committee expressed the belief that growth will likely remain weak for some time. Given the substantial level of idle resources, the FOMC further anticipated subdued rates of inflation for the foreseeable future.

Looking forward, the trillion dollar question is where does the Federal Reserve go from here? The Fed must now execute an exit strategy to remove the many economic levers that it has pulled over the last 12 months to combat the collapsing financial and housing markets. The Federal Reserve has put the credit markets on notice that it plans to start removing the support mechanism it has implemented over the last 15 months. Policy makers express the hope that private investors will return to fund these markets, which imploded during the financial crisis.

In general, at least outside of the financial sectors, corporations have weathered this economic hurricane extremely well with non-financial firms in the 2nd quarter producing a record $150+ billion in surplus cash flow AFTER paying for capital equipment. Firms have devoted this cash to buttressing their reserves and re-structuring their balance sheets to provide greater stability.

Modestly good news came from the retail sector in September as it reported its highest sales levels for 2009. However, this relatively good news was tempered by the fact that sales were only modestly above depressed 2008 levels. Given the sales collapse in the summer of 2008, most major retail categories are now only at 2005 levels. While consumer confidence has recovered meaningfully from its December lows, consumers still remain tentative with some retailers showing 18+% declines in sales during the typically robust back to school shopping periods.

As the economy has stabilized, some of the most extreme Great Recessionary behaviors appear to be waning. The personal savings rate, which spiked to more than 6% last winter, has declined by 50% over the last 3 months to around 3%. While the reduced savings rate is a near-term positive for consumer outlays, this shift leaves open the question of how long can America continue to save at artificially low rates.

To no one's surprise, unemployment continues to mount with September's jobless rate hitting 9.8%. Since December 2007, the economy has now shed more than 7.2 million jobs. A vital economic question is if and when the lost jobs will return. Even the rosiest of scenarios now suggests that unemployment is likely to remain above 9% through year end 2010. If the jobs market were to return to its robust employment creation of the 1990s, it could take until the end of 2017 for U.S. unemployment to return to 5%.

In the short term, a growing economy will mean that some businesses will recall laid-off workers. However, many jobs are likely permanently gone. The question remains whether the private sector can create the necessary jobs when stimulus spending winds down.

Looking forward, we see several mountainous hurdles for the economy. The continued disarray in debt-securitization markets, which in recent years were the source of roughly 60 percent of all credit in the United States, will make the Fed's proposed exit all the more challenging. Many of these markets are now operating only because the government is propping them up.

In the same vein, the Federal Reserve also needs to slowly take its foot off of the monetary accelerator and raise overnight interest rates from their current rate of 0%. Further complicating this issue is the laudatory but misguided efforts to reform the health system. We believe that the proposed, and highly imperfect, solution will put an enormous strain on the tentative economic recovery. Given these three factors, we remain concerned about the robustness of this economic recovery and the potential for a dip back into recession.

Market Comments

What a difference a year makes!! While the economy remains in a very low gear, the markets have largely shrugged off their fears. Wall Street continued its sharp rally during the quarter with the S&P 500 moving up by more than 15.5% over the summer. Leading the way were the materials and financial sectors with returns of greater than 21% during the quarter. Dowdy and boring, the telecom and utilities sectors dragged down performance with gains in the mid single digits.

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Performance as of 09/30/09

	Close	Month	YTD	1 Year
DJIA	9712.28	+2.43%	+13.19%	-7.39%
S & P 500	1057.08	+3.73%	+19.25%	-6.92%
NASDAQ Comp.	2122.42	+5.64%	+34.58%	+1.93%

	Month end yld.	Prior Yr. end yld.	12 mo. prior yld.
10 yr. U.S. Treasury	3.31%	2.24%	3.83%

Similarly, the bond markets have also experienced a strong rally as investor money has poured into this sector. Having been burned by a sharp decline in their stock portfolios, investors have fixated on bonds as being a safe haven. The result has been a sharp reduction in risk premiums demanded by investors.

As we prepare to enter into the year's final set of earnings releases, we will be focused on the ability of corporations to enhance their earnings through revenue increases rather than through cost cutting, as predominated in the last several quarters. Through these actions, companies' selling and administrative costs have fallen by more than 5½% in recent quarters - a far more drastic decline than seen in either of the recessions of 1991 or 2001.

Even with this aggressive cost cutting, full year earnings are anticipated to decline almost 17% for 2009 over 2008 levels. For the upcoming earnings season, an operating earnings decline of almost 25% is now anticipated. Despite this precipitous drop, ever bullish Wall Street is currently anticipating resurgent earnings growth in 2010 with a 26+% gain projected for the upcoming year. With the market priced at a price earnings ratio of 20 for expected 2010 earnings, the market is by no means cheap.

Companies remain cautious with their continued hoarding of cash with 3Q09 dividend increases being the worst on record. Year over year, dividend payments have fallen almost 45% with only 191 (out of 7,000 public companies) increasing their payouts during the 3rd quarter.

As we have discussed previously, investors now appear most concerned about being left out of the current market rally. Anticipated market volatility has stayed near its June end levels and reflects a remarkable level of complacency by investors. We are not quite as optimistic about the near term market direction as we believe there remains an elevated likelihood of a market retrenchment. However, we do remain confident that corporate America will weather this crisis and that investors will continue to be rewarded commensurate with their risks.

Analyst Corner

We recently put agriculture giant Archer Daniels Midland (*NYSE: ADM*) under our microscope. With wide spread activities, the company is well situated to profit from the macro trends of rising longevity and increasing global populations.

A capital intensive business, the company is well structured and has a seasoned management team. Moreover, the company has shown good financial discipline in returning money to investors through dividends while maintaining the opportunity for significant future increases. Although this investment is not appropriate for all, we believe it could be a rewarding security for the hungry investor.

Planning Thoughts

With the recent market turmoil, Congress has suspended the Required Minimum Distributions (RMD) from IRA accounts for those individuals over the age of 70 ½ just for 2009. Rather than recognize the income pre-maturely, we recommend that affected clients not take IRA distributions this year. If your specific cash flow needs necessitate the disbursement of these funds, please make sure to speak with us.

Other Matters

The past year has been challenging for both big and small businesses. Despite the recent roller coaster market ride, our own small firm continues to thrive. However, we continue to eagerly pursue opportunities for growth.

Like many companies, our best source of new business is from satisfied clients. If you are aware of any friends or family who are dissatisfied with their current financial advisor, or have realized that they need a financial advisor, we would greatly appreciate the opportunity to introduce ourselves. We would be pleased to learn about their situation and to explore any opportunities to help them better meet their financial goals.

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