Delta Financial Advisors

July 2009

Economic Comments

At its late June meeting, the Federal Reserve's Open Market Committee expressed its belief that inflation will remain subdued for the foreseeable future despite the recent increase in energy and commodity prices. As a result, the FOMC indicated that overnight interest rates were to remain unchanged from their current target of between 0.00% and 0.25%. Furthermore, the Committee also highlighted its ongoing purchase of as much as $1.75 trillion of longer maturity securities in the Fed's continued effort to reduce long term interest rates.

Through these and other efforts, Fed Chairman Bernanke has expanded the nation's monetary base by more than 110% in the twelve months through May-end. To put this increase more in context, the 2nd largest yearly increase in the U.S.'s monetary base was less than 16%. With the economy teetering close to deflation, the Fed's intervention has been timely. The June inflation reading showed prices increasing at slightly more than a 1% annualized rate although deflation, i.e. a reduction in prices, has actually occurred over the prior 12 months in the face of the sharp decline in energy prices since the summer of 2008. The key moving forward is going to be how, and when, the Federal Reserve unwinds its mammoth monetary infusion.

In the face of the severe economic conditions, American consumption patterns have continued their sharp about face. From levels of effectively zero early in 2008, the U.S. savings rate swelled to almost 7% in May following a large increase from the prior month. Concurrently, consumers also trimmed their borrowings for the fourth straight month as the recession took another bite out of investments and drove unemployment higher.

Many economists now predict that consumers will stay cautious in the months ahead, possibly foreshadowing a lethargic economic recovery. Highlighting the more cautious consumer was the Federal Reserve's recent report of an almost unprecedented decline in consumer credit as it fell at an annual rate of 1.5 percent from the prior month.

These new figures mark the latest move by consumers to curb borrowing and pay down debt. The paradox of this thrift, though, is that what is good for the individual is not necessarily in the interest of the whole country. A nation of savers does not encourage robust economic growth (for instance, Japan over the last 20 years).

Less than 9 months since requiring the nation's major financial institutions to accept governmental capital infusions, the Treasury has now allowed a number of these players to return this money. Positioned as a tool to provide key support to the U.S. financial system, the program provided critical stability to the financial sector during the recent financial market implosion. By allowing the stronger firms to return theses funds, following the independent raising of replacement capital, a "top tier" group of more stable firms has become differentiated from those requiring additional governmental support.

Assessing economic activity, much of the steep 5.5% decline in 1st quarter GDP can be attributed to drawing down of existing inventories. However, with inventories having been drawn down so sharply, orders to manufacturers have shown sharp increases in recent weeks – a possible harbinger of resurgent growth.

Unemployment, always a lagging economic indicator, has risen by more than 1 percentage point over the past quarter, hitting 9.5% in June. Importantly though, U.S. payrolls have continued to show surprisingly large drops with June's employment report showing a decline of 467,000 and meaningfully greater than expected.

In recent days, senior Obama Administration officials have discussed the potential need for a second round of stimulus spending. We are appalled by this thought. With barely 10% of the mammoth $780 billion stimulus bill enacted this past Spring having been utilized, it is extraordinarily premature to be discussing further stimulus targeted spending.

Looking forward, we continue to anticipate tepid signs of economic growth by year-end. The larger issue remains whether, once growth recommences, if it will be sustained or possibly slide back into further decline. On the final resolution of this issue, we remain unsure.

Market Comments

Stocks came roaring back to life in the 2nd quarter as they clocked in an enormous 15% gain for the quarter. Having led the market down for the last several quarters, the financial sector rallied sharply with a 35% gain for the period. While all sectors of the market profited from the recent rally, telecom was the unloved child showing gains of less than

Performance as of 06/30/09				
	Close	***Month***	***YTD***	***1 Year***
DJIA	8447.00	-0.41%	-2.01%	-23.01%
S & P 500	919.93	+0.20%	+3.16%	-26.22%
NASDAQ Comp.	1835.04	3.42%	+16.36%	-19.98%
	Month end yld.	***Prior Yr. end yld.***	***12 mo. prior yld.***	
10 yr. U.S. Treasury	3.52%	2.24%	3.98%	

2%. From its early March lows, the S&P 500 has surged by more than 35%, albeit still remaining more than 40% beneath its Fall of 2007 highs.

Across the market, and which should come as no surprise, the leaders for the quarter were those stocks who had suffered the greatest losses and those companies with the most risky balance sheets while more stable dividend-paying franchises meaningfully lagged during the quarter's market resurgence.

In addition to the stock markets, investment grade corporate offerings showed enormous returns during the quarter as this fixed income sector surged by almost 11% for the period. U.S. Treasury securities, which had been almost the only gainer during 2008, showed a decline of more than 3% as governmental bond yields increased and prices declined.

As we get ready to enter into the earnings reporting season for the just ended 2nd quarter, expectations are for a 36% decline in corporate profits over the levels reported in 2008. However, non-financial corporation's earnings are anticipated to show a much less severe 14.9% decline as the result of aggressive cost cutting. This profit downturn is expected to be comparable to that seen in the mild 2001 recession and to be far less severe than the reduction of corporate profits seen during the recessions of the 1970s and 1980s.

Of recent concern has been the increasing appetite for risk that investors have shown as the year has progressed. The market volatility index, also known as the VIX, has declined by almost 50% since the year's high in January. Rather than fretting about the potential for losing capital, investors now appear more concerned about being left behind by a rebounding market.

We anticipate pressure to remain on the recent market recovery as long-term interest rates have risen appreciably, housing prices remain severely depressed and the Federal Reserve's most ready tools have been utilized. The market is likely to struggle finding its course while the economic horizon remains so muddled.

Analyst Corner

In times of uncertainty, reliability is given greater consideration. Consistent with this belief, we have found Pitney Bowes (NYSE: PBI) to be an attractive franchise. The highly profitable company is the largest global provider of postage meters; this business line provides 90% of the company's earnings.

Given its close governmental relationships, the barriers to entry into Pitney Bowe's core business are formidable. However, this key strength is somewhat offset by the low growth of the postage meter use. Nonetheless, with extremely robust and consistent cash flows, the company handily supports heavier debt levels along with a large, and growing, dividend. While no stock is without its own unique risks, we believe that PBI can be an attractive addition to the appropriate portfolio.

Planning Thoughts

With some regularity, clients ask about the need for long-term care insurance. Basically, this insurance helps pay for care needed as individuals become incapable of caring for themselves. Neither Medicare nor Medicaid pays for this type of service unless an individual's assets are largely depleted. Many individuals will buy long-term care insurance to insure that in the event of old age disability they are able to afford services better than those made available than through Medicaid. Others purchase the insurance to insure their heirs have an estate to inherit.

No matter the reason for purchasing this type of policy, there are a number of key issues to examine before acquiring a policy. Among the most important considerations are inflation protection, the benefit period, the care covered and the illnesses and injuries covered. If you would like our help in evaluating your possible needs in this area, please let us know.

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