



Registered Investment Advisor

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THE FIRST DECADE OF THE 21ST CENTURY — WHERE NOW?

The first decade of the 21st century, just completed, was the most dismal decade for equities since the 1930s when the DOW dropped 39.5%. The first 10 years of this century saw the DOW down 9.3%, the S&P 500 down 24.1%, and the NASDAQ negative 44.2%. Obviously, any “long-term” investor suffered losses during the period and anxiety, as investors saw 10 years of their investments highly negative. Even if long-term statistics show that equities, on the average, grow approximately 10% per annum, outpacing both bond returns and inflation, this fact alone provides little consolation for the buy-and-hold S&P investor during the last 10 years.

In the last 12 months of this decade, however, stocks have bounced back strongly; the DOW was up 18.8%, the S&P 500, 23.5% and the NASDAQ, 43.9%. One important lesson is that neither longer-term trends (50 years or so) or medium-term trends are a certain predictor of how markets will perform the following year or two. Indeed, the DOW low point on March 9th, 2009 (when it was down 53.8% from its all-time high in October, 2007), marked the starting point for 2009’s blistering rally. So, given the potential for a disappointing outcome of a long-term “buy and hold” investing strategy or of simply believing that markets always go up, what can an investor look to in order to give himself or herself the best opportunity to achieve more consistent and better results?

There are at least two good historical statistics to address this question: 1) look to historical patterns which seem to provide specific insight into market behavior, and 2) redefine one’s investment approach; i.e., what investment strategy should be followed. Let’s examine each point separately.

Point 1: There is an article in the Barron’s January 4th edition which provides some very insightful analysis on the first point. The article discusses how a new year progresses immediately following a year in which a market high is reached during the month of December (as was true this past December). The article states in part, “In the 82-year history of the S&P index, a year’s high has occurred in December 25 times Of the 24 years (excluding 2009), 18 were followed by positive Januarys, and the average return for those years was 17.2%.” Implicit in this statement is the well documented fact that most years in which the month of January is positive, the entire year tends to be positive. As the article again points out, “The (January) barometer

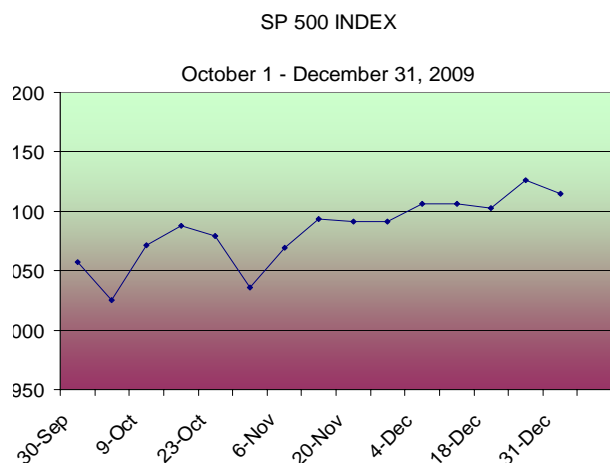
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seems even more reliable following years when the market reached a high in late December.” In 2009, the year’s high was reached after Christmas, in other words, late in December. Therefore, this technical barometer points squarely to a solid January, 2010 and, similarly, a good year for 2010 which provides us with some cause for a positive outlook. However, we should be cautiously reminded that, like all cycles and trends, this one may not always follow the established pattern.

Point 2: Statistics show that investing in high quality, dividend paying stocks helps to produce positive returns, even in poor markets and generates cash for living expenses. Our firm’s centerpiece strategy, Covered Call Writing, provides all the benefits of high quality, dividend paying stocks, plus monthly cash flow from Covered Call Writing, which averages about 1% to 1.5% of assets under management, far better than cash production from high dividend stocks alone.

Over a longer period of time a Covered Call Account would have produced much more cash, leading to a much happier investor than the traditional buy-and-hold investor in times of extended under-performing markets.

THE QUARTER IN REVIEW



The Fourth Quarter of 2009 and December 2009.

The last quarter of the first decade of the 21st century, the quarter just concluded, was a very solid one. The DOW was up 7.3%; the S&P500, +5.48% and the NASDAQ, +7.96%. In modern market history, the year's high has occurred after Christmas 14 times; the most recent case was last month. Indeed, since 1900, the DOW has risen a median of 1% in the last five trading days of December. This last December, however, despite a solid month, the DOW actually fell 0.37% in the final five trading days. As noted on the front page of this Newsletter, December's price movement is considered bullish even though the price action during the last five trading days of December should temper optimism.

Inflation, though edging up, still appears relatively modest, even though some commodities, such as copper, doubled in price during 2009 and crude oil's price has been rising rapidly going into 2010. During December, the dollar strengthened, and it is well recognized that a weak dollar drives up the price of commodities stated in dollars. This trend needs to be watched carefully.

It is anyone's guess when the Fed will commence raising interest rates from the historical lows now in effect — most commentators are estimating June, 2010. Until record high unemployment begins to recede, however, it is unlikely the Fed will raise rates. Although mortgage rates in the United States began to advance slightly during the fourth quarter, the Federal Reserve's policies during 2009 drove mortgage rates to 50 year lows in an attempt to support the decimated housing markets. Thus, both higher interest rates and inflation — perhaps the

most significant obvious threats to strong equity markets — appear in check for now. Serious “dark clouds”, however, are found in the questionable strength of the US currency, which in turn, rests in large part on how the Federal government manages its deficit and its debt. On these last two points, the consensus is very pessimistic; the enormous budget deficit could severely challenge Medicare and Social Security, as we know it, within as little as 10 years. Geo-political matters, such as war or major terrorist attacks, of course, could change everything.

It should be noted that the VIX index, which measures market volatility, has receded sharply during the fourth quarter even while the markets were exceptionally strong. Simply stated, this also, appears to be a good sign as market volatility (a form of risk) recedes, even while markets have been strong. While it is true that Covered Call premiums closely rise with increased market volatility, there still remains sufficient market volatility to support good Covered Call premiums in our projected range of 1% to 1.5% per month on assets under management.

World markets also appear to be stabilizing. The main significance of this lies in the fact that during 2009 the financial/equity markets began moving away from the brink of disaster. In foreign markets, emerging markets (Brazil, China, India) outpaced strong markets in Europe and elsewhere. Indeed, with a 19% gain during 2009, the main laggard in the world was Japan's Nikkei Index.

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