

CCR Wealth Management Portfolio Strategy & Market Outlook; May, 2009

Review: Dow Jones: 8292 S&P 500: 888 May 21, 2009

The remarkable rise of most broad equity indexes since the March 9th lows (Dow Jones Ind. Avg. +26.68%, S&P 500 +31.61%) catches our collective breath—and even, perhaps, relieves minds immured in the gloom and doom of Q1 ‘09 and Q4 of last year with an air of optimism. We were indeed surprised at the February lunge to even greater depths by the stock market, but feel confident we can call those weeks the cycle lows of this Bear Market.

In this Outlook, CCR Wealth management will outline why we believe many investors should be focusing their attention on the bond market. We continue to subscribe to a “W” and not a “V” shaped stock market return to normalcy. While we don’t think the second “V” in our “W” will have us revisiting the market lows of March 2009, we believe there is less to gain over the longer term for many clients who may be tempted to “play” the market volatility. Rather, we believe in making truly valuable investments in opportunities present within certain sectors of the bond market.

OUTLOOK:

Equities

- The rally of the last 2 months, to some extent, masks the fact that the market(s) remain over one third lower today than they were one year ago! Indeed, the Dow and S&P 500 are barely break-even to where they began the year.

We have written and communicated about pending opportunities to rebalance portfolios, and even revisit investment allocation strategies on market bounces. *We believe the confluence of this “bear market rally”, along with renewed optimism in the recovery of the bond market warrant (for many) such an adjustment now if it has not already been done.*

- We recall the last bear market—2001-2002, and the resultant 26% S&P 500 rally in the equity markets in 2004. The temptation, of course, is to anticipate a repeat performance. While we do not discount the possibility, we do not see it as imminent.

We also recall the comparatively anemic follow-up performances post-2004, and of course, the implosion of 2008. The net result is that the S&P 500 didn’t break-

even until 5 years after the market peak in 2000. The ten year annualized S&P 500 return is now down 2.49%. A true “lost decade”.

Bonds

- We highlight the somewhat depressing statistics above in order to contrast current conditions in the credit markets we believe most investors should be taking advantage of. The chaos in the capital markets in the latter half of 2008 extended well beyond the stock market. Demand for corporate debt evaporated as money moved into either cash, or US Treasuries.

The immutable laws of supply and demand drove high-grade corporate debt to extremely low prices, and historically high yield spreads (a yield comparison to Treasuries—ultimately a risk premium measurement). Corporate bond yields on the lower end of the high-grade credit scale can be as high as 9%, while 6.50%-8% is common, depending on the maturities.

- Most investors have had Wall Street’s narrative of ~9%-10% long term annual stock market return averages drilled into them through mutual fund marketing efforts or stock brokers over the last couple decades.
- Given the lost decade we’ve just experienced (-2.49%, annualized), we view the availability of bond yields in the high single digits (70%-80% of “long term stock market averages”) in a security class with much lower overall risk and volatility metrics as a unique opportunity. Bonds are, in fact, *senior* securities to their equity counterparts, and corporate executives must (and will) mind their credit ratings—and access to the capital markets—above all else.
- CCR Wealth Management firmly believes that it is quite possible many of our clients preparing for, or in retirement right now may never see these credit spreads again.
- We believe current yield spreads in many sectors of the bond market are wide enough to absorb at least some future inflationary pressures.

Non-Correlated Assets

We note that a logical rejoinder to our bullishness on corporate debt revolves around the question of inflation. Indeed, with virtually unprecedented spending programs embarked upon by the Bush administration, and accelerated considerably the Obama administration

and the current Congress, we continue to view inflation pressures as likely in the future. An inflationary environment is obviously a negative for assets which have fixed rates of return (bonds). The reality is, however, that there is virtually no current inflation pressure.

CCR Wealth Management's preferred approach to hedging against this inevitability has been and remains a meaningful allocation to a broad range of commodity elements within a portfolio.

- While commodity prices are rising in general, we view this as global optimism that economic recovery is, at least, on the horizon—not as a response to weak currencies.
- In January, we wrote: “*Oil has nose-dived from \$147/barrel to around \$40/barrel in less than 7 months. While we had no confidence that \$147 reflected economic reality, we are equally skeptical of its current price range.*” Oil currently stands at \$61.00/barrel in an economy that has shed *millions* of jobs since the start of the year. We continue to see even more up-side in this commodity.
- We continue to view Gold favorably, as it once again closes in on \$1000/oz—but at this point Silver also appear quite attractive; Silver has the benefit of considerably more industrial application, and in our view, could gain more from future economic recovery.
- Global Agricultural indexes are rising reflected by increased prices in major grain components, wheat and corn. We note that these rises are concurrent with advances in agribusiness stocks as well. Broad commodity indexes generally have a 20% allocation to agricultural elements.
- We view currency volatility (and disparity) as likely to grow in the years ahead if inflation becomes more of a reality than it is now. Currently, we favor the Australian Dollar based on point and figure *technical* metrics. Currencies, however, distinguish themselves as notoriously difficult to “predict” with much accuracy.

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