BWM

Investment
Guidance

May Markets Review
Case for optimism or caution?
Positive surprises continue

Key Points

- **2009 year to date Total Returns**
  S&P 500 (919) 3% ;
  US 10Yr Bond (3.46%) -21% ;
  NASDAQ (1744) 13% ;
  Foreign (EAFE) Stocks 5%
- U.S. GDP expected contraction = -2.6%
- 2009 earnings expected decline = - 14%
- Stock markets likely have hit bottom as the economy approaches a low point

Executive Overview

Since the March 9 bottom, the S&P 500 index rose an impressive 37% through month end. During a normally quiet May the S&P 500 (5.3%), NASDAQ (3.3%), and EAFE (13.6%) continued their advances. Investors rejoiced (optimistic behavior) due to continued positive news (less bad news than expected) from both the economy and corporate earnings. The 1st Qtr revised GDP (-5.7%) report implied a less deep recession and the seeds of recovery. The global outlook improved and U.S. reflation developed. The price of gold and oil soared 9.4% and 28%, respectively during May and the U.S. dollar fell 7% against the Euro. Other asset classes, including homes, are still bottoming out in price. The 10 yr. Treasury bond (-3.8%) fell again, as the yield rose significantly to 3.46%. Leading Economic Indicators (1.0%) increased more than expected. Many indicators show that credit is priced near normal and the crisis has passed. Government controls continue to expand. Their impact on the auto industry, domestic and international economy, earnings, and investment portfolio ideas in complex times will be discussed.

Themes

Investment markets themes are:

- **Will Obama's GM takeover be more successful than Carter's Chrysler bailout?**
- **Are more U.S. government controls good for the wealth of the country?**
- **Are stock investors over optimistic or does the outlook support higher prices?**

Auto bailouts a generation apart.

The bailout of Chrysler by President Carter's administration in 1980 was far different than the takeover of General Motors and the bailout of Chrysler by President Obama's administration in 2009. The oversight of Congress, the expected impact on the entire auto industry, and the general influence of the rule of law differ considerably between the two cases.

The United States was in a recession in 1980. Chrysler was the smallest of the 3 major U.S. car makers and was led during the crisis by a colorful, no nonsense CEO, Lee Iacocca. Congress, which was heavily controlled by the same Democratic Party as the President, debated any Chrysler assistance at length. Relatively few foreign cars were manufactured in the U.S. at the time. Senators and representatives looked out for their constituents, so Chrysler did not gaining an advantage. They were not using the situation for political gains per Obama Chief of Staff Rahm Emanuel's Rule No. One: Never allow a crisis to go to waste. They were exercising their government responsibility for oversight of legislation and related funding. On January 7, 1980 President Carter signed the Chrysler Corp. Loan Guarantee Act of 1979, which essentially guaranteed a $5B loan co-signed with Chrysler's bankers and required Chrysler to get additional private financing commitments of $1.5B. No government money was printed as part of the bailout. No government dealership shutdowns or union contract negotiation oversight occurred. The process did not setup conflicts of interest between stakeholders. Iacocca drove a harder bargain with the UAW union at the time than the current situation and used his flair in marketing without government financing or warranties to convince Americans and others to buy Chrysler products. In 1983 the co-signed bank notes were paid off, the U.S. government earned a $300M payment for exercised warrants in 1983, union wages were increased as agreed upon, and many savvy investors earned more than 500% profits for stocks purchased below $8 per share in 1980 and sold for more than $40 in 1987.

A generation later the U.S. Congress is again heavily controlled by the same Democratic Party as President Obama. The United States is in the midst of a recession. U.S. car sales have fallen from a bubble peak of 16M in 2007 to 13M in 2008 and 9.5M forecasted in 2009 (3M through April). The Obama administration is running Chrysler and General Motors without

Congressional legislation, while using the Troubled Asset Recovery Program (TARP) funding piggy bank. State congressmen with predominantly Ford and foreign transplant constituents are not effectively protecting their interests. There are many constitutional concerns with the bold political usage of power by the executive branch of government. In running Chrysler and GM through CEO replacements, Board of Director selections, and setting boundaries for company and stakeholder negotiations the U.S. system of laws is being ignored. The simple practical question is: can a benevolent dictator run a productive society better than free negotiations among stakeholders under an established legal system? The implications will follow to universal health care and energy policy.

The conflicts of interest in the current takeover of GM and bailout of Chrysler are numerous. The rights of lenders, i.e. bond holders, appear to have suffered most. Normally, their rights are superior in a company's capital structure and among stakeholders. The government is forcing irrational losses without negotiations on these parties. Other investors are watching. The government appears to have set criteria for the selection of dealership contract terminations that may not have been based on performance. The setup of government warranties for bailed out car companies will likely cause confusion and add a cost advantage over Ford and others. The new GM/Chrysler finance company will not only add taxpayer costs, but also add another advantage over Ford and others. A large representation of the UAW on the new corporate Boards of Directors will allow the UAW to negotiate with itself. It will also effectively set UAW contracts with Ford. Will cars be manufactured more productively? And will they be the cars that people are willing to buy? Be aware that GM sold 151,000 cars in China and 172,000 cars in the U.S. during April, 2009. Here are a few other questions to think about. Will GM sell more cars in China or the U.S. in 2013? Will Ford (143,000 U.S. cars sold in April, 2009) sell less than 75% as many cars in the U.S. as GM in 2013? Will the U.S. government earn a profit on its $80B 2009 auto industry takeover/bailout, similar to its 1980 Chrysler bailout? If the answer is no to these 3 questions, then the 1980 Carter/Congress policy will have worked better than the 2009 Obama policy.

Are more U.S. government controls good for the wealth of the country?

The increased controls over U.S. citizens through Executive Orders, Department and Agency Directives, and Enacted Laws since January 20, 2009 have been without precedent. Proposed added government controls are even greater. Is this good for the United States of America? How do we measure the increased wealth of the nation? A fundamentals thinker would go back to the founding U.S. of A. documents; the Declaration of Independence; the Constitution, and the process defined to change it. Others may argue for possibly unconstitutional laws, which may or may not be acceptable upon challenge before the Supreme Court justices. In either case, the question of good and increased wealth for both the individual and the country should be discussed and answered. The question is both moral and economic. Adam Smith had a lot to say about both. Here, I simply ponder the issue of increased wealth from the perspective of human capital (spirit and potential of individuals to produce) and economic capital (the economic outputs of individuals).

Controls create disincentives regarding some actions and incentives regarding other actions. Their purpose is often to "level a playing field" or to "spread the wealth". It is important to ask if spreading less future wealth is better than encouraging greater levels of total wealth. The argument for spreading less wealth usually is rooted in the quest to avert a Malthusian catastrophe of some type. Thomas Malthus' 1826 *An Essay on the Principle of Population* saw a forced return to subsistence living, when population growth outpaced agricultural growth. Government attempts to control various activities relate to the idea of limited resources and spreading limited wealth. There are challenges to this thinking based on the 183 years of wealth expansion since Malthus' essay. The standards of living or other measures of wealth in the developed countries are more than an order of magnitude (10 times) greater now than in 1826 without a Malthusian catastrophe. The concept of a controlled society is not in the spirit of U.S. citizens. The idea of spreading less wealth means that children must look forward to a lower standard of living than their parents. At some point within less than 10 years (remember the 1970's), the economic impacts of stagflation and less opportunities will lead to the normal American response: Nonsense! Let's get something accomplished! Increase wealth!

Are stock investors overly optimistic or does the outlook support higher stock prices?

The month of May showed positive developments in credit markets, economic data, investor sentiment, and consumer sentiment.

The credit market freeze up of the autumn of 2008 appears to be thawing at the same time that subjective judgment accounting is making some questionable money center bank financial statements look surprisingly good. The 3 month London Interbank Offer Rate (LIBOR) has fallen from 4.82% on Oct. 10, 2008 to less than 0.70% currently. International banks are lending to each other relatively freely at less than 0.50% above T bill rates. The TED spread (3 mo. LIBOR – 3 mo US T bill) has narrowed from 4.65% on Oct. 10 to less than 0.50%, which indicates much less credit market stress. The 30 day spread between high quality (AA) and low quality (A2/P2) non financial commercial paper rates has narrowed from greater than 4.0% in November to less than 0.50% now. General short term financing is easily available. Bank tightening on prime mortgages has fallen from 75% in Nov. 2008 to less than 50% presently. Mortgage loan financing is obtainable. Finally the spread between investment grade and high yield credit default insurance has narrowed recently. The overall credit market picture has improved dramatically. Financing for most endeavors is available. This is a necessary condition to do business and earn profits.

The economic data is improving. Durable goods orders were up nearly 2% in April, after being down 2% in March. The ISM Manufacturing Survey was slightly above 40 in April, although the automobile sensitive Chicago May survey reversed lower to 35. Other regional business surveys are mixed. The broader ISM Service Survey was up to nearly 44 in April. Economic expansion in the Purchasing Manager surveys is defined as above 50. The data simply indicates the economy is not currently in a deep recession. The weekly new claims for unemployment insurance are dropping (4 wk. avg. 626,750); although total claims (6,780,000 for a 17th straight weekly record in the 29 year data history) have not started to drop yet. The NABE April Leading Economic Indicators were up a total 1.0% based on interest rate spreads, stock advances, consumption, and new orders. They indicate economic expansion in the second half of 2009. Stocks historically have risen when the LEI has started a positive trend.

Investor sentiment is mixed, which indicates caution. Investment newsletter sentiment is net bullish at 12% with bullish recommendations at 41%. This is about a normal spread and level. Yet, small investors indicated by the American Assoc. of Individual Investors survey are now net bearish at 8% with bearish sentiment at 48%. Sentiment indicators are secondary technical measures. Yet in the midst of a significant stock advance with relative sector strength just starting to develop, greedy behaviors are not yet apparent.

U.S. consumer confidence is the least correlated sentiment with stock prices. If consumers do not have money to spend, they can't act on their feelings. However, the jump from a 40.8 reading in April to 54.9 in May was very large and returned back to the September, 2008 level at the start of the financial system dislocation. Brokerage account cash is at a high level. Of all things, car sales may be worth watching as an indication in the next few months that consumer confidence is translating to consumption, perhaps only a -2% 2nd Qtr. GDP contraction, and 2nd Half GDP growth.

Now the question about stock investors and future stock prices can be discussed. Credit market conditions have improved, which was required to reduce recession uncertainties. Financial stocks led a market advance from depressed levels. The economic data, especially LEI data indicates that the unprecedented level of monetary and fiscal stimulus will result in 2nd Half GDP growth. There are other issues to be discussed shortly that may support international company sales and earnings. Investors and mutual funds have some cash to demand stock prices higher. Their sentiment appears to be cautious, which is what bullish phases are built on. Markets do not show a focus on growth stocks, which often occurs when sentiment gets overly confident and greedy. Yet, the markets need more positive economic surprises to build on. Unexpected consumption translated into car sales or exports based on a weak U.S. dollar (USD) and emerging market demand may provide investors reasons to rationally expect higher 4th Qtr earnings and demand more stocks. I am a careful observer. Scenarios could develop in different ways to tip my thinking in one way or another.

Profits continue to fall; but expectations stable
S&P 500 company 1st Qtr. profits were 32% lower than in the 2008 1st Qtr., but surprisingly 10% better than the most recent analyst reports. In the 2nd Qtr. only the defensive Consumer Staples and Utilities are expected to show better profits than the comparable 2008 Qtr, but total profits are expected to fall 36%. The Technology and Consumer Discretionary Sectors had the best earnings surprises and they are the only sectors with positive 2009 forecasted earnings revisions.

Financial Analyst forecasts are stable.
The current analysts' forecast revision ratio is dramatically improved to 12:11 downgrades/ upgrades for 2009; i.e. a normal range indicating far less than recent uncertainty. Analysts have reduced forecast earnings declines in 2009 to $55 for the weighted S&P 500 shares in the Zacks methodology and to $35 in the strict Standard & Poors methodology. Lower 2009 earnings remain likely. At this time, the S&P 500 trades at 17 to 26 times 2009 earnings based on your choice of forecasts.

Foreign Economies
Developed economy GDP declines are expected in 2009 after extreme 2008 4th Qtr. and 2009 1st Qtr. declines. Exporters Japan and Germany are hard hit, but 2010 small growth forecasts are firming up. Emerging countries China and India have solid 2009 forecasted positive growth. Inflation is still an issue in Russia. Key forecasts according to the *Economist* follow.

Table 1. Economic Forecasts

Economic Market	2009 GDP	2010 GDP	2009 CPI
United States	-2.9	1.4	0
Japan	-6.4	0.6	-1.0
China	6.5	7.3	0
Great Britain	-3.7	0.3	1.5
Euro Common Mkt ECM	-3.7	0.3	0.5
Russia	-3.0	2.0	13.0
India	5.0	6.4	5.0
Brazil	-1.5	2.7	4.4

The total global economy is likely to show 2009 contraction. In Table 2 the U.S. highly positive sloped yield curve continues to be the most stimulative monetary policy. U.S. reflation may be causing the recent sharp fall in the USD. With increased global protectionism, trade will suffer. Most countries are increasing their stimulative positively sloped yield curves.

Table 2. Current Global Yields

Economic Market	3 month	10 Year
United States	0.2	3.5
Japan	0.5	1.5
China	1.2	3.4
Great Britain	1.4	3.5
Euro Common Mkt ECM	1.3	3.3
Russia	12.0	10.9
India	3.1	7.5
Brazil	10.2	6.1

Economic Sectors and Investment Outlooks
A Technical Overview (BPNYSE, etc) indicates recent strong U.S. and very strong foreign stock demand. Money supply growth is supporting demand. The continued May strong advance defied the probability of a pause. **Suggestion: If you have been a bit defensive, as recently discussed, review equity assets with an open mind. Oil, gold, and foreign stocks advanced strongly as the USD fell. If asset groups form tight price range bases for a few weeks that may indicate few sellers and opportunities to make diversified purchases.**

Economic Sector Analysis and Outlook
Telecom sector stock demand is good. Hold current positions. **Utility** Sector forecasted 2009 earnings are stable. Dividends are around 4%, but sector Relative Strength (RS) has been weak. No opinion. **Consumer Staples** sector 2009 earnings growth is forecast to be flat (and above all other sectors), while RS is weak. No opinion. A sizeable **Energy** sector earnings fall is forecast in 2009. Yet stock demand has been very strong as oil surged above $65 per barrel. OPEC is holding output at current levels and a weak USD could help push prices higher. Hold energy stocks. The above sectors have dividend growth candidates for value investors. **Healthcare** sector 2009 earnings look stable. Stocks are performing in line with the market. No opinion on the sector. Be aware of potential legislation uncertainties and volatility. **Technology** Sector stocks continue to participate in the advance. Positive earnings surprises are possible. Selective buying is suggested. The **Consumer Discretionary** sector remains a cyclical area. Selective buying of steady earnings companies is suggested. While some firms are going bankrupt, some of the remaining stocks may be good opportunities. The cyclical **Materials** sector is performing in line with the market. No opinion. **Industrial** sector exports (and earnings) to developing countries are slowing, but a weak

USD may support increased sales to emerging markets (China & India). No opinion. The **Financial Services** sector remains very volatile. No opinion. **Earnings are weak in total.** Stocks are priced very much higher than 12 weeks ago. **Summary Considerations**: cautiously purchase only stock sectors with stable earnings and technically tight bases after recent advances.

International Markets Are Advancing
Foreign stock markets rose more dramatically than U.S. markets, while the USD (1.41 Euro) weakened. Holding developed economy stocks is reasonable. Emerging market stocks rose more than 50% since the March bottom. Normal weights may be considered if you can withstand large declines (-50% in 2008) and high volatility.

Fixed Income - Less Volatile
U.S. Treasury bond year to date returns (-21%) may not improve as increased supply to finance huge deficits is partly offset by FRB buying. Investment grade corporate and GNMA bonds should provide single digit 2009 returns. A small portfolio weight in a TIPS fund is suggested. Muni bonds are also suggested for taxpayers in high tax states, who research good general obligations bonds. High single digit after-tax returns at modest risk are possible. Inflation helps a government pay back huge debts with lower purchasing power money. When inflation eventually returns, longer maturity (and duration) bond prices will suffer.

Alternative Investments – Diversification
The Real Estate Investment Trusts (REITs) index has improved significantly after plunging in the 1st Qtr. 2009 based on financing concerns. Commercial and retail vacancies remain an issue. Private equity or knowledgeable partnerships may be a more effective way to profit from income producing real estate. Gold funds are diversifiers, which surged in May with the USD fall. A 5% to 10% weight in a less volatile direct gold exchange traded fund (GLD) is suggested, instead of the gold mining companies.

Portfolio Management
Funds have less cash (4.9%) to boost stock prices higher. The S&P 500 index is trading above a normal P/E based on uncertain earnings forecasts. Yet be open to positive economic surprises, which may boost asset class demand.

Current portfolio themes are:
Normal Investment Weights
- U.S. large stock funds normal weight
- U.S. small stock funds normal weight
- Foreign EAFE funds normal weight; Emerging stock funds normal weight
- Fixed income – TIPS and possibly Muni
- Gold – Entry Positions
- Only hold stocks in suggested sectors

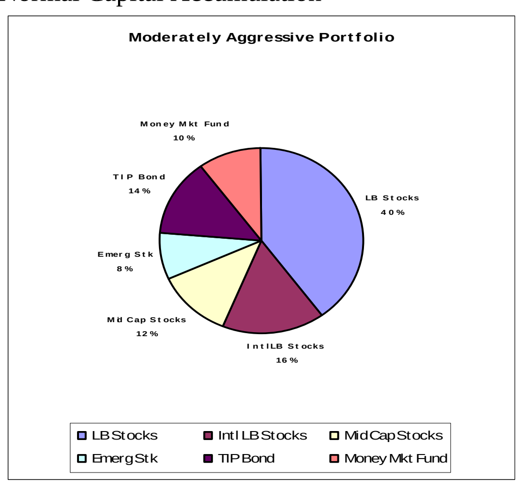
Disclosure: Personal holdings:
33% Domestic & Intl Large Cap stock funds, (15% Total International funds)
42% Small/ Mid Cap funds,
25% short term bonds and cash
Changes are bold faced.

Some June purchases are probable in personal account and possible in client accounts.

Sample Portfolios are models
Not Client Recommendations

Sample Portfolio A - **Moderately Aggressive**
Example 45 year old college educated parents with 1 high school child and 1 college child.
- 40% Large Blend Stock Index Funds
- 16% Large Blend International Fund
- 12% Mid or Small Cap Stock Fund
- 8% Emerging Market Stock Fund
- 14% TIP Bonds
- 10% Money market cash

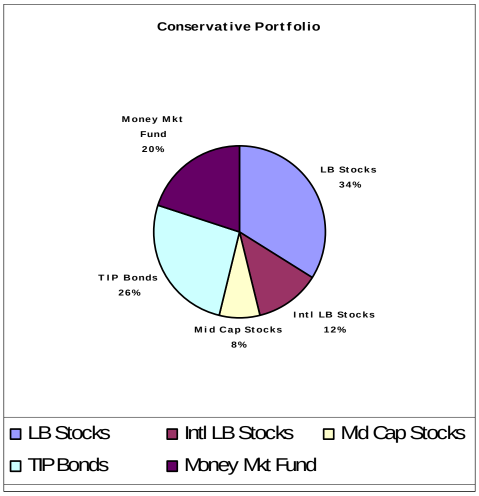
Normal Capital Accumulation –



Sample Portfolio B - **Conservative**
Example 65 year old couple with Social Security Income (20% of spending needs) and Retirement 401K or Pension Plans converted to IRA's

- 34% Large Blend Stock Index Funds;
- 12% Large Blend International Fund;
- 8% Mid or Small Cap Stock Fund
- 26% TIPS Bonds
- 20% Money market cash

Normal Capital Preservation –



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