



# The Centurion Counselor

Fourth Quarter 2009

## UNDERVALUED SECTORS

(CONSIDER!)

- CONSUMER DEFENSIVE
- MEDICAL DEVICES
- MEDICAL DIAGNOSTICS
- TIPS

## OVERVALUED SECTORS

(AVOID!)

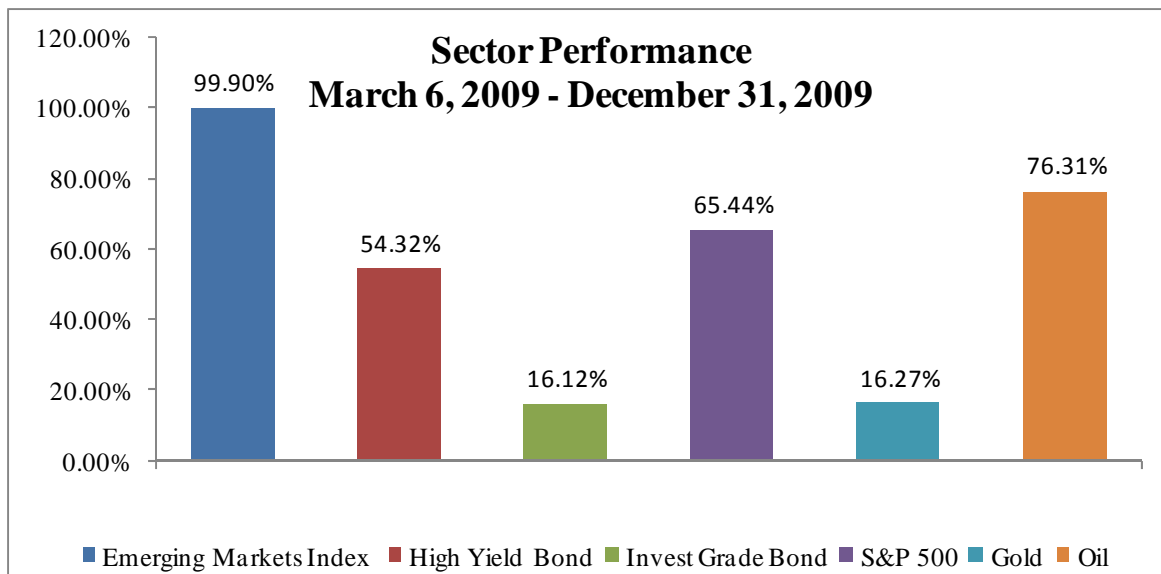
- JUNK BONDS
- EMERGING MARKETS
- TREASURIES
- BIG BOX RETAIL
- REITS

## Annual Crystal Ball

In last year's Counselor we discussed the violent rallies that often occur in bear markets. 2009 proved that to be true. From the low point in March, it seems that the market went straight up. It is now obvious that the fear discount in March was huge.

During this universal recovery, as in most post-recessionary periods, the time comes to sell as the rally gets at least temporarily ahead of itself. The problem is that the yield on cash is zero. Cash is trash right now, and promises to continue to be in the near future.

In the bigger picture, there's a major disconnect between stocks and treasuries. Stocks are predicting a V-shaped recovery, while bonds are forecasting a more subdued U-shaped recovery-maybe even the dreaded W brand of a double-dip recession. It is a toss-up which one is right, but our guess is the bond market. As James Carville, Former President Clinton's 1992 campaign strategist stated " I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everyone".





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Yes, there is euphoria baked into the price of gold and oil, and the money is pouring into the Asian markets, creating another bubble. Behind all the combustible elements that could trigger inflation, are still sizable deflationary forces, like the potential disasters lurking in commercial U.S. real estate. Stock market bulls do not see the bearish signals being sent by the vulnerable part of the credit markets. Is there a trillion-dollar meltdown coming in commercial real estate, or has it already been discounted? There's also the peril of prolonged U.S. budget deficits. We're talking about the long-term financial deterioration of the United States. Look at the Fed's total net borrowing and lending in credit markets. The numbers of the domestic nonfinancial sector are down by over a trillion dollars; while the private sector is deleveraging. Meanwhile, the public sector, state, local and national governments are adding debt. What does it mean if the U.S. loses its triple-A credit rating next year? Or if its \$12 trillion in outstanding government securities become rated "junk bonds?"

It is with this back-drop that we fearlessly make our predictions for 2010.

1. Cap and Trade is dead for this year! After the battle over health care and with 2010 an election year, it is finished for at least one year.
2. "Crowding out" will become part of the national discussion again. Governments borrow money by issuing debt to fund additional spending. "Crowding out" occurs when government debt "crowds out" private companies and individuals from the lending market. U.S. and foreign governments are on tap to borrow record amounts this year to fund deficits. When you add in state and local debt, we believe that, short of printing money, government borrowing will overwhelm the system. This last happened for a short period during the Carter administration.
3. Increased borrowing (see #2) will cause interest rates to rise. The current yield on the 10-year Treasury is 3.75%; we believe that it will be at least 4.74% by the end of the year.
4. Several Governments (Greece, Spain, Ireland, Iceland, Italy, California, Argentina, and Venezuela) are on the edge of economic collapse due to years of uncontrolled spending. One or more will fail sparking a global economic crisis.
5. The Euro will face a crisis as its weaker members struggle. (see #4)
6. The dollar will be stronger in spite of the large deficit, due to international turmoil (see #4).

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7. We will have a double dip recession; the bond market is right! However, it will feel like “stagflation” another relic from the Carter era when low or no growth is accompanied by inflation. Consumers represent 70% of the economy; they will not be able to help as the underemployment rate of the U.S. is in excess of 17%.
8. Gold, currently just above \$1,100 per ounce, will hit \$1,300 or more during the year.
9. George Clooney will retire from Hollywood to become President for Life of a small South American country.
10. Equity markets in the U.S. will be flat to slightly down for the year.
11. Emerging Markets will drop, some by over 30% (see #4)

## How did we do last year?

We will divide **Our 2009 Predictions**, of one year ago into three categories (1) Those “dead on;” (2) Those that were “partially correct” or in the opinion of the judges (us) not yet fully played out; (3) Those that frankly just “missed the mark.”

### “Dead On”

- “The S& P 500 will close over 980.” In early March when the index hit a low of 666, we thought that this prediction was out of the pennant race, at the same time as the San Diego Padres. However, the S&P came back (the Padres never did) to close the year at 1126.
- “The personal savings rate may well exceed 3%.” It hit a high of 6.4% in the second quarter but ended the year well over 4%. This is the highest number in a decade, even though the rate paid on savings plummeted.
- “Gold will finish the year over \$1,000 per ounce.” Gold skyrocketed on a weak dollar and inflation fears to finish the year over \$1,100.

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- “The recession will end.” It appears, although not yet formally announced, that the recession ended sometime in the 3<sup>rd</sup> quarter. Remember, we said it would end, not that the economy would get better!
- “Commercial real estate will continue to suffer, while housing will start to recover.” Home prices continued to slip for the first 6 months of the year but then held firm or rose slightly in most parts of the country. Commercial real estate continued its drop with prices falling below 2003 levels.
- We stated that long treasury bonds were over-priced and the yield would “climb over 4%.” The yield on long dated treasuries did increase and closed the year at 4.64%
- “Tiger Woods will fall from grace”...O.K. we did not predict this!

## “Partially Correct”

- “California will not declare bankruptcy” but will continue to have budget woes, it will get on the federal dole. California is, and will be for quite a long time, a fiscal mess, but it is not yet a ward of Washington.
- “Inflation will pick up in the fourth quarter but will be less than 2% for the year.” It picked up in the fourth quarter even more than we expected causing the CPI for the year to rise 2.7%.

## “Missed the Mark”

- We went out on a limb and predicted that the “Obama administration would give serious consideration to corporate tax reform. The branch broke!
- We believed that “China would fall “into recession.” They continued to pump up their economy avoiding what we believe will be the inevitable day of reckoning.
- We stated “the dollar will retain its gains made in 2008.” The dollar finished the year down about 10% against most major currencies, as investors seemed to forget about 2008.

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