

Newsletter – January 2011

2010 Market Summary

Global equities finished 2010 on a very strong note led by US stocks which generally outperformed international stocks for both the quarter and the year. US mid cap and small cap stocks outpaced large cap stocks for the quarter and year. However, the S&P 500 Index returned 10.8% in the fourth quarter and 15.1% for 2010 – reaching a two year high. Emerging markets continued to surpass international developed markets. Commodities, especially gold, and REITs (real estate investment trusts) also excelled and topped global equity returns for the year. As for fixed income, major bond indices experienced a volatile year but still finished in positive territory after a fourth quarter pullback. Last December, we saw the first net redemption from bond funds after two years of significant inflows. US Treasuries suffered one of their worst selloffs in decades, driving interest rates abruptly higher.

Commentary

As we look back at 2010, we chose to do something we hadn't necessarily expected to do when we founded Shorepoint Capital Partners. We made a market call to substantially increase equity holdings at the end of June, when fears flamed about a possible second dip into recession. Please see our June newsletter, ***"Is this a repeat of 2008? We don't think so! This is a time to increase equities."*** Since then, equities (S&P 500 Index) rallied over **23%** while bonds (Barclay's Aggregate Bond Index) were up a meager **0.8%** through year-end. Although this type of call is unusual for us, we recognize the need to look beyond current market gyrations to identify what we believe are true opportunities based on valuations. In this quarter's newsletter, we will explain the thinking behind this accurate call and more importantly to share our view for 2011 and beyond.

Outlook

As we pointed out in the June 2010 newsletter, we attempt to remain maddeningly moderate in the face of tumultuous market activity. In our opinion, our steadfast approach and cold view of markets is what makes us hireable and able to add value to clients. Ironically, it is at times when markets are correcting and portfolios may be decreasing in value that we try to add the most value. Back in June, the sentiment got very dim very quickly based on the following factors: ***European debt crisis, slowing Chinese economic growth, lack of US job growth/persistent high unemployment, and weak investor sentiment still tainted by the 2008 market meltdown.*** We balanced these headwinds with what we saw as tailwinds: ***attractive valuation for the S&P 500 Index after 10 years of anemic returns, the acceleration of economic growth, strong corporate profit growth and low interest rates.***

Given the historical precedent of the modest valuations, and the rapid increase in overall fear which is a counter-indicator in our view, we believed the odds for robust returns in stocks were among the most attractive that we had seen in recent history. Despite the market's quick turnaround back to a positive trend, we reiterated this opinion again in the September 2010 newsletter, ***"We believe this is an opportunity to own stocks at levels...not seen since the early 1980's"***. We got this one right (twice), but we are ever-humble when it comes to the markets. There are no finish lines – just horizon lines and the perpetual process of guiding clients on their journey. We present this detail not to congratulate ourselves but to reiterate and explain our current thesis and to provide you with an understanding of how we see the current investment environment.

MARKET TRENDS 12/31/2010

	Total Return	
	Q4	2010
US Stock Markets		
S&P 500 Index	10.8%	15.1%
S&P MidCap 400 Index	13.5%	26.6%
S&P SmallCap 600 Index	16.2%	26.3%
Int'l Stock Markets		
EAFE Index	6.6%	7.8%
Emerging Mkts Index	7.2%	16.5%
Fixed Income		
Barclays Intermediate Gov't/Credit Bond Index	-1.4%	5.9%
Barclays Capital Muni Bond 3 Year Index	-0.7%	1.8%
Commodities		
SPDR Gold Shares	8.5%	29.3%
Goldman Sachs Commodities	13.4%	9.0%
Real Estate		
Dow Jones US Real Estate Index	7.0%	26.9%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

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As we revisit many of the headwinds and tailwinds of the June 2010 newsletter, we find further improvement. For example:

Federal Estate Tax

The estate tax expired temporarily in 2010, but Congress reinstated it for 2011 and 2012.

ESTATE TAX

	<u>Highest Rate</u>	<u>Exemption</u>
2011	35%	\$5,000,000
2012	35%	\$5,000,000
2013	55%	\$1,000,000

The tax bill increases the lifetime gift exemption to \$5,000,000.

GIFT TAX

	<u>Highest Rate</u>	<u>Exemption</u>
2011	35%	\$5,000,000
2012	35%	\$5,000,000
2013	55%	\$1,000,000

These new rules are only effective through 2012. Unless Congress acts again, the exemptions will revert to \$1,000,000 and the top tax rate to 55%.

Source: Charles Schwab

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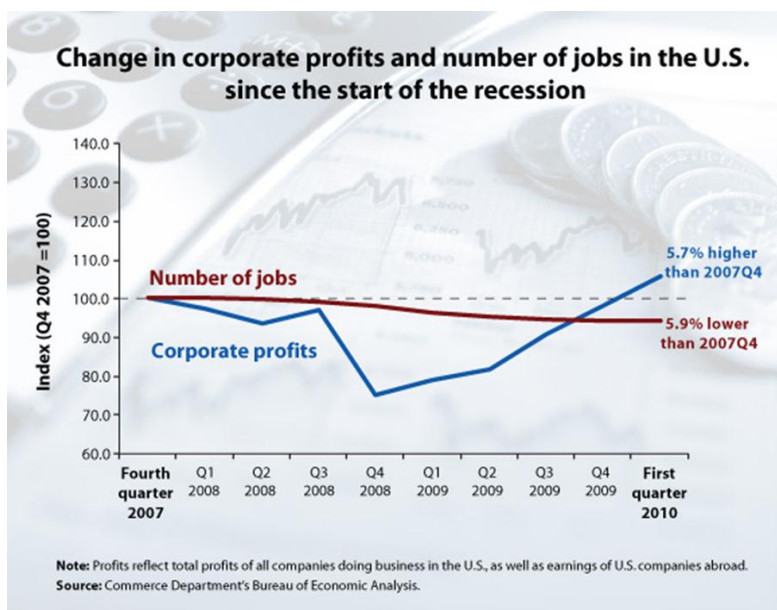
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- **Chinese Economic Growth** - The dramatic economic slowdown in China has not materialized. GDP growth for 2010 was 10.3% and according to Chinese government researchers, 2011 GDP growth is projected to be ~9.5% - strong by any measure especially compared to economic growth in developed markets.
- **European Debt Crises** - Although still not "resolved". The European Central Bank and the International Monetary Fund provided loans to Greece, Eurozone countries are instituting fiscal austerity programs and are refinancing their debt albeit at high interest rates (e.g. recent Portugal auction). Overall, the concern of a possible "contagion" impact has lessened.
- **Washington, D.C.** - The November elections resulted in a divided Congress, which historically has been positive for financial markets. The extension of current tax policies will add to economic growth and afford investors with some clarity, even if only for the next two years. Also, this year's social security withholding tax decrease provides another stimulus for the economy. The table on the left contains a summary of estate and gift tax rates while capital gains and dividend tax rates remain at 15%.

Even with these improvements, we are monitoring the following concerns:

- **Unemployment** - is still stubbornly high but unemployment claims are down from peak levels and job growth is starting to pick up with employers planning additional hiring in the near future.
- **Housing** - prolonged weakness in the US housing and construction market continues to be a drag on the US economy.
- **Fiscal Deficits** - large budget gaps are being faced by individual states and the federal government.
- **Healthcare Reform** - impact of reform and the continued rise in healthcare costs for individuals and businesses.
- **Commodity Prices** - increase in commodity prices leading to high inflation.



“Economic Growth - five months of positive growth and economic leading indicators are accelerating .”

“Even with the recent equity rally, sentiment towards equities are still negative.”

“Earnings growth & dividends should still result in returns that exceed other asset classes such as bonds, real estate and cash.”

“We are overdue for a correction...would use any equity market pull back as a buying opportunity.”

Major positives are:

- **Economic Growth** - five months of positive growth and economic leading indicators are accelerating with steady gains in the manufacturing sector, renewed corporate spending and a strong holiday retail shopping season.
- **Revenue and Profit Growth** – strong results with companies using excess cash balances on capital spending, increasing dividends, acquisitions and buying back their stock.
- **Low Interest Rates** – even with the recent increase, interest rates are still historically low which has enabled corporations and households to repair their balance sheets.
- **Investor Sentiment** – even with the recent equity rally, sentiment towards equities are still negative which may provide fuel for further gains as demand for equities increases.
- **Valuation** - the S&P 500 Index is trading below its historical average. The combination of strong expected earnings growth with low interest rates and inflation has historically led to higher valuation and stock prices. However, even without any valuation expansion, earnings growth and dividends should still result in returns that exceed other asset classes such as bonds, real estate and cash. Based on our own research, we are still identifying companies with attractive valuation characteristics.



Conclusion

We are not pulling the plug on our overweight position in equities. At some point in the future, we will take profits in equities, even if we are early. **For now, the general tenor of our advice to overweight stocks versus other asset classes, especially bonds, remains in force. That being said, after the most recent 20% run on the S&P 500 Index, we are overdue for a correction as the equity market does not only go up! However, we would use any equity market pull back as a buying opportunity as appropriate for clients' individual situation and as long as the macro forces we listed remain in place.** We base our advice on equal parts science, art, and experience. Being engaged and attentive also helps us when we, like everyone, invariably are wrong. We remain vigilant, on watch, stewards for our clients' assets in these interesting times.

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