



Dear Friends of Atlas Brown,

We began the prior decade with what investors will recall as the bursting of the “dot com” bubble in March 2000. The catalyst, in hindsight, seemed obvious: equity price multiples were bid up to extravagant levels never before seen as speculators kept buying stocks on the expectation that the house of cards would never collapse. The result was quite sobering however as a substantial portion of the investment gains from the prior decade were wiped out in only a few short months.

That contagion which started here quickly spread around the world. Before the year was out, what started as a localized sell-off primarily in US-based technology companies ended up being a global phenomenon that quickly enveloped most equity markets around the world.

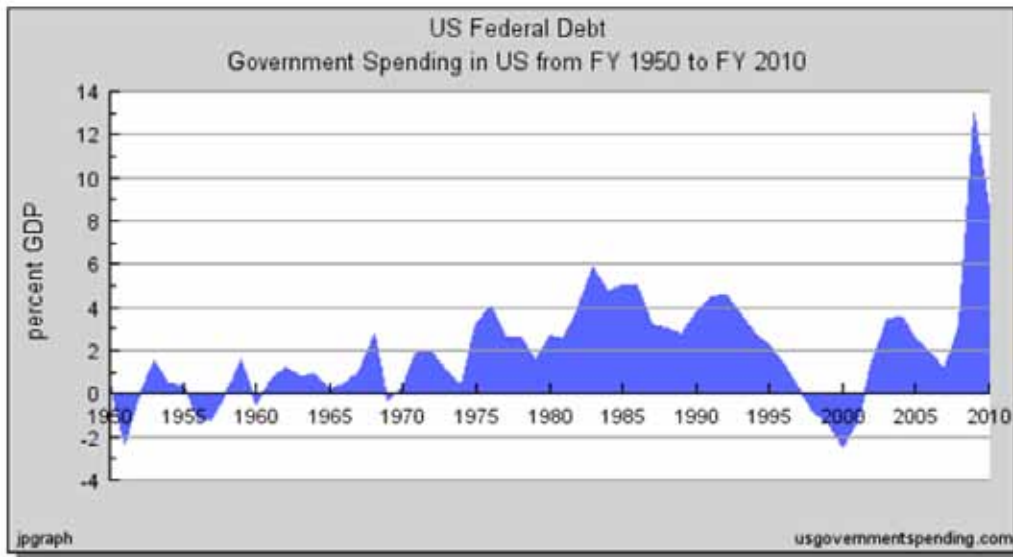
But the pain was short lived, as were many investor memories, and within the year markets had already started to form a base from which to start their resurgence. Although investment results were somewhat choppy, and returns varied widely from country to country, the results were nevertheless positive for most global markets from mid-2002 through mid-2007.

By the end of 2007, many financial indicators began to give clues that we were once again headed for heartache in the equity markets. By mid-2007, the dollar began to deteriorate in anticipation of rate cuts, and foreign investments in US securities dampened with the expectation of slower US growth rates. Concurrently, sharp increases in commodity prices, namely oil and food, diminished real incomes. Lastly, the subprime mortgage market deterioration led to a full blown liquidity crisis which sent financial markets across the board into a tailspin reminiscent of the 1970’s market crash, most sharply felt in the last quarter of 2008 through the first quarter of 2009.

So where does that leave us today? We had a decade of modest, consistent performance in the middle years which was bookended by gut-wrenching volatility in 2000 and 2009. To be frank, the roller coaster ride wasn’t that fun for anyone. Many investors lost substantial sums of money. Others, unable to endure any more pain, simply cut their losses and have been content to sit and watch from the sidelines. The end result has been an investor psyche that has been so damaged, that many investors are content to focus their energies on bonds, annuities, or even bank CD’s. But is this wise?

We don’t think so. We feel that while what happened between mid-2007 and early 2009 can’t be discounted, the principal factors which contributed to the large selloff have been or are in the process of being mitigated. Wall Street excess has been exposed for what it was, the use of toxic borrowing and lending facilities, and has been essentially eliminated. There has been enough light shed on the lapse in regulatory oversight that such shortcomings are not likely to be repeated, at least not anytime soon. But what has also happened, and this is very important paradigm shift, is that there has been a marked decline in over-leverage as the financial system has begun to rid itself of the excess and reduce its internal appetite for risk. We see this as an essential, necessary change. In doing so, we are eventually going to arrive at a place where the value of things bought and sold more clearly represents their true worth. For example, housing prices appear to be reverting to their pre-expansion cost bases. The same goes for commercial real estate and even undeveloped land. Closer to home, the equine industry appears to be adjusting (though not easily) to lower prices at the annual yearling sales and more noticeably, in purses made available to stakes’ winners.

However, when it comes to credit expansion, the one entity that has no trouble borrowing whatsoever is our own United States Treasury. One look at the chart below from usgovernmentspending.com and it is easy to see that the recent, more moderate spending patterns by the government have taken a significant turn for worse in the past year. We can argue whether the wars in Afghanistan and Iraq are prudent and appropriate. We can also challenge the merits of the Economic Recovery Act of 2009, Cash for Clunkers, TARP, and TALF, and that's before we even begin to think about the costs for Medicare, Medicaid, and the running of the Federal Government.



At its current level, government spending will place tremendous pressure on our financial system. Many paint a gloomy picture of soaring interest rates, inflation and taxes which will stifle economic growth in the near term future. Based on the current level of US Government spending, additional tax increases will be unavoidable. With debt levels in their current range, higher interest rates are also likely. **This is potentially problematic, as history and logic both tell us that tax increases and interest rate hikes are anything but stimulative to economic growth.** Many fear inflation will be a byproduct of our government stimulus program. While we see rate hikes and inflation as real possibilities, we believe these factors will be less pervasive than many. Rate hikes should be gradual, with the Fed cautious about stifling growth in our economy. In order for inflation to become a real problem for investors, the consumer will have to lead the recovery by reverting to old spending habits. We are skeptical about this as consumers, at least in the near term, are cautious in their spending habits due to tight credit markets and high levels of unemployment.

So yes, there is much to consider, and to be fair, for every point or argument to be made, there is a valid counterpoint to be made as well. But that said, we believe we have done our homework and have outlined some key points which we believe will frame the investment landscape for the coming year. We certainly can't predict the future, but we can be diligent in our research, thoughtful in our reasoning, and open-minded in our forward-looking assessment. To that end, we hope you, too, find these observations to be insightful.

Based upon recent history, the current state of the economy, the dynamic and evolving nature of geo-political affairs, our own investment and market research, and that of others whom we respect, we offer our Investment Perspectives for 2010:

- Massive deficit spending in the US will increase the supply of money and ultimately lead to higher interest rates. Right now the US Treasury is auctioning off over \$100 billion of debt securities every month. The bulk of these recent auctions are being underwritten by the world's largest Central Banks and Sovereign Wealth Funds, including the Monetary Authority of Singapore, the Abu Dhabi Investment Authority, the Saudi Arabian Monetary Authority, the Norwegian Central Bank, and the People's Bank of China to name just a handful. So what happens when they become fully invested or are otherwise tired of supporting the US public debt? Well that is the crux of the problem. Our view is that when current investor appetite is diminished, the only thing that will likely bring additional investors to the table is something enticing and attractive: higher rates.
- Fixed income returns will likely be unspectacular after what we consider a 25-year bull market in bonds. If you happened to own a large bond portfolio throughout the entire last decade, you probably did pretty well if only because you were able to maintain your principal value. But the fact is that interest rates have been globally orchestrated to record low levels in order to assist in the global economic recovery. As we all know, bond prices and bond yields move inversely, and with the Fed poised to exit its current accommodation phase, we expect to see short and intermediate term interest rates rising as we approach the back half of 2010. This will bode poorly for bondholders as financial markets will begin to anticipate the Fed's policy directives, meaning that bond prices should start to fall before mid-year. We do hold out some hope however that when the Fed begins to raise interest rates toward the end of 2010 or early 2011, higher rates will likewise result in a stronger dollar. By exactly how much is anybody's guess. In theory, higher rates will make US treasuries more attractive to foreign investors and in order to buy treasury securities, these investors will need to buy dollars to facilitate the transaction.
- Domestic companies with significant overseas revenue should benefit from a weak dollar scenario. We are therefore strategically assessing specific sectors of the market that have significant exposure to overseas markets, such as energy, consumer staples and technology.
- Opportunities may occur in other fixed income investment markets outside the US. So while we are not encouraged by the prospect of owning US dollar denominated bonds in late 2010, we do feel that certain international markets will present bondholders with opportunities to outpace inflation and be somewhat currency protected.
- Demand for technology will come primarily from two segments of this all important and broad category. First, we would anticipate that replacement cycle demand (for new equipment, hardware, and software) in the developed economies would increase as many mid to large sized corporations have already had technology upgrades on hold for several years. Many have already risked business-model or market share impairment which may not easily be recovered. For them, the waiting game is over. Second, we see perhaps the largest growth coming from the chip and semi-conductor segment. As companies become more global and as requirements for processing, data storage, and record retention continue to multiply, the need for faster and more technologically efficient computing power becomes critical for any enterprise to remain on the cutting edge of its market base.

- Bank lending will remain constrained due to increased capital requirements, regulation and ongoing balance sheet repairs. What does not appear to be widely chronicled in the financial press is that for each dollar of credit that a bank is willing to make, a certain percentage of that amount must be held in abeyance and put in reserve at the lending bank's account with the Fed. So while it is true that bank lending is necessary to fuel the economic resurgence, it is equally true that the risk-based capital requirements which banks face is also a disincentive to make credit available. Our view is that much of the new lending and credit extension (for corporate lending and M & A) in the coming year will be made not by banks but by private equity and venture capital financiers who are free from bank regulatory constraints and are accountable chiefly to their investors and stockholders. And by the way, there are record amounts of uninvested capital at these private equity firms actively seeking out double-digit investment opportunities as we speak.
- There will be increasing demand for commodities and materials as the global recovery takes place. We're already seeing increased demand from investors who want continued exposure to oil and gas, precious metals, and coffee. We also see ongoing demand from those who continue to believe in real estate, specifically the significant amount of real estate and undeveloped land being purchased at distressed prices from banks forced to liquidate.
- On the equity side, certain global economies will continue to outpace both the US and many other established and developed economies. We believe that the trends we saw in 2009 will continue throughout the coming year. Investors in emerging markets and in what is now called the BRIC economy (Brazil, Russia, India, China) will continue to benefit handsomely primarily due to a weak US dollar, robust export scenarios, more stable domestic economies, and the continued cost of cheap labor relative to the US.

We hope this perspective has been of some value to you. Perhaps if there is one broad theme here, it is that through the development and proliferation of telecommunications and the elimination of tariffs and trade barriers, the world is truly becoming a smaller place. As we have all come to realize, the happenings in faraway places such as Indonesia and Ireland can and do have a direct impact on the investments we make here at home. So as we open the New Year and begin to contemplate the myriad of socio-economic, cross-border and multi-cultural variables which drive the world's economies, knowing how to be properly positioned has clearly become more challenging than any time in our past.

We at Atlas Brown hope you find our views for the coming year to be both informational and relevant. As always, we would welcome your thoughts and suggestions to this or any other related matter. We also want to take this opportunity to thank you for your relationship with Atlas Brown and wish each of you a very prosperous New Year.

