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2010 NEWSLETTER

ECONOMIC FORECAST

THE HEALTHCARE DEBATE

Healthcare costs have continued to substantially outpace both inflation and wage growth against a backdrop of corporate greed and insurmountable fraud. The Republicans are correct, the healthcare bill is imperfect and lacks reform, but is both a starting point and socially justified. How can you vote against denying coverage for 30 million people, covering people with pre-existing conditions and assisting small business in absorbing their additional health insurance costs? It is expected that the costs will be revenue neutral and actually decrease the deficit by \$132 billion over the first ten years. Although the budget office claims additional savings of one trillion dollars in the second decade, their beliefs appear to be misfounded. Given the fragile Democratic majority, passage of this historic bill presently in conference committees may be in jeopardy. This rests upon the outcome of the Massachusetts special election to fill Ted Kennedy's seat. It is somewhat ironic that healthcare reform was his lifetime legacy. Although the Senate debated out the public option, it actually exists in both the Senate and House bills. In substance, Medicaid is the public option by virtue of its proposed expansion. The political process involved in the passage of these bills is the epitome of American absurdity. Every Republican Senator voted against the bill based upon its lack of reform and enormous expense. So there is no misunderstanding, the Republicans are clearly in favor of healthcare. In 2003, during the Bush administration, they overcame Democratic objections and added a half-trillion deficit-financed prescription drug benefit to Medicare. While on the other hand, the Democratic Senate majority were unable to unite in their debate efforts. In order to gain the required sixty votes super majority in the Senate, they sank to an all time low and purchased them. Nebraska senator, Ben Nelson accepted what appears to be a bribe consisting of the federal government's coverage of 100% of his states' healthcare for an indefinite amount of time. Nebraska was not the only minority state, Montana, North Dakota and South Dakota received special deals. The actions of both parties demonstrate an unintended loophole in our Democratic process. The sixty votes super majority requirement creates this loophole. The Senate needs to change the rules and revert back to a simple majority of 51% that the Democratic party originally instituted. Otherwise, the power winds up resting in the hands of the minority who may be inclined to hold out for special considerations. As Walter Cronkite once said "And that's the way it is." Although, the bill lacks reform and will become expensive, it is a historic starting point that can and will be amended to resolve its imperfections over

time Had some Senate Republicans contributed to the passage of the bill, the special deals for the minority would never have occurred Reforming healthcare is a monumental task and as such the following should be considered:

- Repeal the health and medical malpractice insurance industries exemptions from Federal Antitrust laws to prevent price fixing, bid-rigging and market allocations
- Create a separate Federal agency to uncover the enormous fraud in the system while increasing civil and criminal penalties
- Although absurd, legalize marijuana to make healthcare costs revenue neutral enabling both the Fed and States to tax it There are a total of fourteen states that allow medicinal-marijuana use. In the State of California there are more marijuana clinics than Starbucks

MID-TERM ELECTION

Given the jobless recovery, the Democrats are in fear of losing their majority status The entire House of Representatives, thirty-seven seats in the Senate and thirty-nine Governorships are up for election this coming fall. Although the Democrats inherited the recessionary crisis, a change in the balance of power normally occurs during times of economic calamity. The Democrats will never be acknowledged for avoiding a global depression because the country will continue to feel as though they remain in recession due to the rising unemployment trend. The Republicans will use both the faltering economy and their obstruction of healthcare to paint the Democrats as fiscally irresponsible and incompetent. Republicans are hoping that their healthcare argument becomes more powerful in the next presidential election Their intent is to politically leverage up their position against the backdrop of a costly health plan that may have failed to produce the intended results. The mid-term election results will be predicated on the path of the economy. Although it is possible for the employment picture to turn positive before the elections, the odds favor the Democrats losing control in the Senate and retaining control in the House. So that there is no misunderstanding, the Government runs better when no party is in control. This creates a political environment of checks and balances that is favorable to the people, the economy and the stock market

DEMOCRACY AND THE NEW WORLD DISORDERS

The world has suffered a severe erosion of freedom and contraction in democracy. The emerging and developing nations are now leaning towards autocratic rule given the spectacular performance by China The belief that liberal Democracy would prevail in the new world disorder after the collapse of the Soviet Union and the fall of Apartheid is misplaced. The Bush foreign-policy objective was promoting Democracy through the world In response to 9/11, we invaded Afghanistan where the corrupt

politicians represent the rule of law. In the name of Democracy we invaded Iraq creating a blood Baath. We promoted Democracy in The Middle East where the Palestinians democratically voted Hamas terrorists into power. To further exacerbate these embarrassments, the world blames the U.S for the most severe global recession since the Great Depression brought on by American corporate greed and governmental deregulation. These nations are led to believe that they can imitate the China model and create a structural self sufficient economy without releasing their grip on political power. The only way to re-promote and advance democracy throughout the world is through debate rather than military action. The emerging and developing countries with all their skepticism must be convinced that political freedoms will set the stage for economic prosperity. The prerequisite for a healthy democracy is clearly not the ballot box but rather having the fundamental institutions in place. These consist of an independent judiciary with equal rights for all including the minority, freedom of the press, government supported by checks and balances and transparency and the ability to compromise. Notwithstanding the evolution of Democracy appears to be taking hold in Iraq, they are completely absent in Afghanistan. **Although Democracy is not perfect, it is clearly the best system in the world to promote personal freedom and economic prosperity**

The quest for peace and freedom will continue in the year of living perhaps more dangerously than in the past. On the upside, we are witnessing a fragile success in Iraq. Their institutions are taking hold especially their judiciary. Elections are scheduled for March with our scheduled withdrawal expected by the end of 2011. Bush's coalition of the willing has ended leaving only our forces on their soil. Given the idealistic and nationalist differences between the Shiites, Sunnis and Kurds, a civil war, although remote cannot be ruled out. **Afghanistan** remains in a downward spiral. All we control is Kabul, the Taliban have the rest. The Persians, Alexander the Great and the British Empire all conquered but could not control this country. The Soviet Empire actually went bankrupt in their unsuccessful attempt. What makes our military believe they can reverse this historic trend? The new world disorders are all rising rather than abating in Iran, Palestine/Israel, Somalia, Yemen, Sudan, Syria, Libya, Pakistan, North Korea and Venezuela. Demographic trends dictate continued political instability, tribal feuding, civil wars and terrorism in the Islamic world. As we are all aware, no border and no country are immune from terrorism. These new world disorders give rise to both the climate and environment for future crisis, chaos and conflict. The cost of controlling these disorders depletes our global economic resources and impairs our living standards. **There is no prosperity without world peace.** In this information age where borders are less important, we need an international fundamental change in philosophy: **we are one world, one people.** Let us pray to shed our differences whether it be religion, race, nationality or otherwise and recognize that we are all human beings.

THE STATE OF THE U.S. ECONOMY

The most severe recession in post World War II history that began in late 2008 has come to an end in the third quarter of 2009 against a backdrop of unprecedented and warranted government intervention. Global economic fundamentals have surprised on the upside. Domestically it is more probable the recovery will be a long and protracted but sustainable moderate economic expansion. This is based on an environment consisting of rising unemployment, continued contraction in real estate, curtailment of credit and exploding federal deficits. On a cyclical standpoint, unemployment continues to rise as a recovery takes hold. The economic expansion will pick up steam along with the global recovery and improve, creating new jobs possibly by the end of 2010. Either way, the global economies can no longer rely on the American consumer to finance a world-wide recovery. What makes this cycle different from all others is that it will continue to feel as though we are still in a recession until the rising unemployment trend reverses.

The catalysts to the severe recession was the Feds monetary error on the side of restraint and allowing the collapse in September 2008 of investment giant Lehman Brothers. This triggered the greatest implosion in global activity not seen since the Great Depression. As such, we had witnessed the complete financial meltdown, the availability of credit froze, demand fell off the planet, world trade was cut by more than half and with all these implications both consumer and business confidence imploded.

Yes, Ben Bernanke is the man of the year. The Feds ultimate and unprecedented monetary and fiscal intervention has, in substance, prevented a global depression. The Feds actions are showing continuing signs of stabilization reversing the negative GDP of the first half of the year to growth in the second half. These improved fundamentals surpassed most expectations. The stock market had demonstrated a strong comeback. While the unemployment rate will continue to rise, this negative trend will abate. Consumers will have a bias towards savings rather than taking on more debt which will impair consumption. The corporate sector will continue to downsize in order to maintain profitability placing additional pressure on the unemployment rate. The housing sector has been the beneficiaries of the government's first-time home buyer's credit. However, these credits expire on July 1, 2010 and therefore the limited benefits are temporary in nature. The housing downturn will continue to persist on the downside in the long-term. The commercial real estate sector will be subject to a sharp rise in mortgage foreclosures against rising vacancy rates and their inability to refinance placing greater stress on our banking sector. The year 2010 will mark the greatest regional and community bank failures since the Great Depression. While on the upside, our nation's largest banks and other institutions deemed too large to fail will continue to raise capital in the public markets in order to repay the government's bailouts and purchase other banks. These banks will only lend to the most qualified credit worthy entities while small businesses and households will find it difficult to obtain the credit to meet their needs. **Only government loan guarantees will unfreeze and stabilize the credit crisis**

In an environment of abundant excess capacity throughout the world and with the Feds discount rate targeted near zero, the deflationary risks in the economy clearly outweighs the inflationary risks. Deflation is defined as a broad based general decline in prices. It is always the by-product of a collapse of aggregate demand forcing producers to cut prices on a continuing basis in order to find buyers. The economic cycle of life runs eighty years comprised of four stages. The first being rising inflation, the second falling inflation, the third stable inflation and finally, the deflationary stage. As I have previously written, if you take 1929, the year of the Great Depression and add to it the eighty year economic cycle of life, you arrive at 2009. This is exactly where we are today entering the deflationary stage of the cycle which could last for a long protracted period. The banking sector recognizes that the collateral it may take to secure debts today may be worth much less in the future. As such, credit intermediation will remain impaired until the government intervenes in the capacity as a guarantor to relieve the crisis. The government's main line of defense has converted from prevention to containment. **Deflation is in fact the most destructive underlying force in a modern day economy. The best way to fight deflation is to create inflation. The Feds response is consistent with this approach.**

GOVERNMENT SECTOR:

The era of fiscal irresponsibility that started during the Reagan administration remains intact. The Keynesian economic theories advocate that governments during periods of economic expansion should be able to set aside enough revenue in order to support the periods of downturns. President Reagan entered office during a recession and appropriately employed supply side economics and deficit financing. Once the crisis had been rectified, Reagan failed to turn off the spigot and remove the excessive liquidity from the system. This set the stage for the fiscally irresponsible Republican mandate to borrow and spend which has created the **Great American Debt Society**. This combined with the Democratic deregulation of the banking sector during the Clinton administration and corporate greed led to our severe recession and current deflationary imbalances of today. The Bush administration alone nearly doubled the national debt ending his term at \$10.5 trillion. Yet the congressional Republican minority continues to ostracize President Obama's fiscal stimulus plans against the backdrop of an enormous national debt trajectory. Our national debt now exceeds \$12 trillion and is increasing by almost \$4 billion per day. In more understandable terms, this represents almost \$40,000 of debt for every U.S. citizen. As of September 30, 2009, our deficit, which represents the excess of the annual expenditures over revenues, was \$1.4 trillion. This is the highest post World War II level and is three times more than the prior year. However, our geniuses at the Office of Management of Budget have noted the deficit is 24% less than originally projected. The U.S. government utilizes the cash-basis method of accounting which is not a generally accepted accounting method as promulgated by the A.I.C.P.A. If the government used the accrual method of accounting, an acceptable method, they would be required to record the unfunded entitlement accrued liabilities consisting of Social Security, Medicare, Medicaid and Prescription Drug liabilities. These accrued liabilities equal \$107 trillion. Restated, this would equal almost \$350,000 of debt for every U.S. citizen. If these were added to our existing national debt the problem would be almost tenfold. **Yes, the U.S. government is bankrupt.**

However, a governmental bankruptcy differs from an individual or business since governments have the power to tax and print money. This is precisely what they will do.

Ben Bernanke will be reappointed as the Feds chairman and for good reason. The Feds unprecedented monetary intervention, although to some degree unorthodox and some I did not agree with, were clearly warranted and in sum avoided a 1930's type depression. Bernanke, an expert on the Great Depression, has learned valuable lessons from Milton Friedman. Milton Friedman maintained that the Great Depression could have been avoided had the government acted as a lender of last resort and purchase government bonds to increase the money supply. The debt super cycle, which represents the buildup of leverage to finance economic expansion, has gone through a metamorphosis from the private sector to that of the government sector. In reality, the government's fiscal policies have replaced the private sectors contraction in spending in order to reflate demand to counter the deflationary risks in the economy. The Fed will continue to do whatever it takes to reflate demand and smooth out the business cycle. However, we must avoid at all costs the point of no return of leveraging up the government to the extent of creating an unsustainable fiscal crisis in the long-term. If the debt super cycle comes to an end, the markets will act violently creating deflationary repercussions that will spread as a contaminant throughout the world. Congress needs to create a plan addressing our long-term imbalances that will be acceptable to the global markets. The plan will be painful given the fact that taxes were decreased and spending dramatically increased during the Bush administration. Future government expenditures will be required to be cut, the social security retirement age will probably be raised in line with life expectancy and taxes will probably go through the roof. **Either way, against a backdrop of a sluggish recovery, the government deficit spending to reflate demand and their monetary support of our financial sector are a prerequisite to a sustainable recovery.** Our national debt will probably exceed \$14 trillion by next year with huge future negative implications on both the U.S. dollar and interest rates.

FINANCIAL SECTOR:

Another key to a sustainable recovery is restoring health to the financial sector. The government's unprecedented actions in substance privatized profits and socialized losses. Credit fuels the wheels of economic activity. While there has been major progress in providing solvency to the largest banks, this may be in part delusory given the possibility of enormous hidden toxic assets remaining on their balance sheets. On the upside, these large institutions have been able to raise private investment to add to their capital requirements. While some of these banks actually repaid government bailouts, others retained the capital in anticipation of rising loss reserves and/or paying executive bonuses. Either way, obtaining credit by small businesses and households remains a difficult task. Banks of all sizes remain cautious with respect to the value of any collateral in this deflationary environment and the effects of the proposed Obama's administration banking regulations. Both the regional and community banks are under extreme pressure against the looming commercial real estate and existing residential foreclosures. These issues will contribute to banking failures in 2010. In 2009, 133 U.S. banks and thrifts failed costing \$252 million. It is more probable than remote that more than 150 banks will fail in

2010. The FDIC intends to levy a 25% premium on the banking industry's pre-tax income which will decimate the sectors profits and their related market share value. It may take up to two years for this sector to fully recover and for the credit crisis to thaw out. **In recognition that regional and community bank lending correlates to 60% of job creation in America, the Fed will intercede probably as a guarantor on small business loans. The Fed has learned from their prior mistakes and will not allow any major institutions to fail.**

CORPORATE SECTOR:

Non-financial margins have improved against a backdrop of the deflationary impact on material and labor costs. Corporate America will continue to cut jobs in the near-term adding additional pressures to the unemployment rate. On the upside, jobs will be replaced with both temporary and part-time workers to avoid pension and healthcare costs. This sector has continued to benefit from enhanced productivity by investing in IT which bodes well for the technology sector. Our exports have risen by more than 30% given the depreciating dollars. However, there is a limitation on how much more cost cutting will occur and productivity gains that can be squeezed out in this economic cycle. Profit growth has to rely on increased revenue which is contingent upon positive improvement in both consumer and business demand. It is more probable that we may witness an enhanced rebalancing in global demand as emerging economies support our export industries. The financial sector profits have surprisingly demonstrated strong growth. However, this trend will not continue against a backdrop of rising loss reserves, restrictive federal regulations and increased FDIC premium costs. Either way, as the economic recovery progresses there will be the corporate survivors and the ones that fall from grace. There were 207 corporate bankruptcies filed in 2009 representing the third largest total on record. **CIT Group** charged their way into bankruptcy. This 101 year-old commercial lender primarily servicing small and midsize companies left bankruptcy shedding \$10 billion in debts and possibly leaving \$2.3 billion taxpayer dollars uncollectable. **GM**, once the world's largest company, an American icon, exited bankruptcy with a full tank but got siphoned from the DOW Jones industrial index. **Chrysler** served wagon wheel pasta at an event after Italian auto maker Fiat took control after it emerged from the same place. **Six Flags** were lowered to half-mast after losing all their shareholders in bankruptcy. **Extended Stay**, a long-term lodging facility, had their sheets stripped from beneath them and got dislodged in court. **Black Angus Steakhouse** got carved to the bone after filing Chapter 11 for the second time. Retailers lost their shirts while restaurants lost their spice. Although this bankruptcy trend is destined to continue, most of Corporate America rebuilt their balance sheets retaining enormous amounts of cash. **Given the resiliency of Corporate America's profits, it is more probable that they may surprise on the upside.**

CONSUMER SECTOR:

The deflationary repercussions associated with the profound retrenchment in consumer spending is slowly reversing. In 2009, 141 million Americans filed for personal bankruptcy. There were eight million jobs lost during the recession bringing the unemployment rate to 10.6%. There are fifteen million unemployed competing to fill three million jobs. As the global recovery gains momentum primarily precipitated by the emerging countries and more specifically the Asian Pacific Basin, the unemployment trend will slowly reverse. However, in the near-term it is more likely to rise to 12% rather than fall. Notwithstanding the enormous amount of jobs lost in the auto industry, in 2009 corporate America downsized their labor force in unprecedented numbers to improve their bottom lines. Twenty thousand jobs got caught in the spider web and never returned to work at **Caterpillar**. **NEC** laid-off the same amount and sent them to the chiropractor. Eighteen thousand employees involuntarily seceded from **United Technologies**. Fifteen thousand jobs got foiled at **Alcoa** but may possibly be aluminated given the comeback in commodities. Ten thousand jobs were deplaned at **Boeing** while 6,700 jobs were decaffeinated at **Starbucks**. **King Pharmaceuticals** dethroned 22% of their labor force while 18% of **Eastman Kodak's** workforce faded into oblivion. **Pioneer** loaded 16% of their labor force on a wagon train and sent them to the unemployment line. **Texas Instrument** cut 12% and sent them to Mexico. **Goodyear** Tire deflated 7% of their jobs while **Black & Decker** hammered out 5%. Thirty-four thousand jobs were short-circuited at **Circuit City** representing 100% of their workforce due to their closure in a bankruptcy liquidation. Either way, it may be several years before we reach full employment which is defined as a 5% unemployment rate. Consumers have been clearly biased towards saving as evidenced by the savings rate finally reaching positive territory for the first time in seven years. The private sector debt super cycle is clearly something of the past. On the upside, consumer confidence has benefited from the stock markets' performance, stabilization in the bank sector and optimism fueled from the global recovery. On the downside, we continue to feel the negative impact of the corporate bankruptcies, rising unemployment, rising tide of foreclosures and the gradual and continuing decline in real estate values. **In sum, the consumer sector is divided into two categories; the haves and the have nots.** The haves consist of the group that is fully employed and whose balance sheets have lost value but remain healthy. The have nots are the group that are either in fear of losing their jobs or unemployed. They have over extended themselves and their balance sheets are subject to debt derailment that is evidenced by the mortgage foreclosure crisis and rising credit card debt delinquencies. On the upside, the haves represent the majority of consumers whose severe retrenchment in spending is primarily related to the fear factor associated with the severe recession. **Against the backdrop of rising confidence amongst this group, the odds favor a better than moderate increase in domestic demand which may provide the prerequisite momentum to a sustainable recovery.**

IN SUM: There are those that are predicting a V-shaped recovery. This is where a recovery in GDP growth equals or exceeds its contraction after the severity of a recession. This will not be the case in the current cycle given the broad based deflationary impairment in the global economy. I also do not expect a W-type recession, also known as a double-dip back into recession. Furthermore, I'm not expecting a Japanese style deflationary stagnation. Considering the unprecedented government intervention, these could only occur in the unlikely event of a major financial shock such as a run on the U.S. dollar or other major geo-political shock such as a terrorist attack.

The path and sustainability of the recovery and ultimate prosperity will be effected on the upside by any of the following:

- The rebalancing of global demand continues to take hold and expand in emerging countries which will enhance our export sector
- China revalues their currency
- The U.S. dollar's depreciation is both gradual and orderly
- The government continues to reflate demand notwithstanding our national debt issues
- The Fed continues to maintain an easy monetary stance and provides the prerequisite support to both large and small banks for the appropriate pricing of their toxic assets and unwinding of the credit crisis
- The government appropriately removes the massive liquidity in the system and shrinks the Federal Reserve's balance sheet in order to prevent asset inflation if they act too late and a W-type recession if they act too early
- The pent-up demand associated with the majority of the American consumers who are not subject to debt derailment starts spending as their economic fears dissipate
- The continued inflow of foreign investment into the U.S. manufacturing sector and China's acquisition of bankrupt companies will both enhance employment

The risks that remain an obstacle lie primarily on the inability to reflate both consumer and business demand and will be effected on the downside by any of the following:

- Unrelenting unemployment
- Household deleveraging
- Rising commercial and residential foreclosures
- Regional and community bank failures

- Rising corporate bankruptcies
- Failure of the government to reform their fiscal irresponsibility
- Although unlikely, a run on the U.S. dollar
- Deflation
- Geo-political issues

On a long-term prospective, we will face enormous financial imbalances consisting of the Twenty-First Century Social Security and Medicare Panic, Health Insurance crisis and the demographic issues associated with the retirement of 78 million baby boomers. Our budget office has estimated our national debt to be 110% of our GDP by 2015. Without the political courage to address these long-term issues, the unwinding of these imbalances will be both horrendous and painful. **The recession has ended and the recovery will be longer and more gradual as compared to historical standards. The U.S. economy may surprise on the upside demonstrating 3% GDP in 2010. It is possible that the Feds inflationary injection will counter balance the destructive deflationary forces and possibly create a floor in both the housing and commercial real estate sectors. So that there is no misunderstanding, the Fed will do whatever it takes to promote perpetual prosperity.**

THE GLOBAL ECONOMY

THE FEARS OF A GLOBAL DEPRESSION HAVE ABATED. Against a backdrop of the deepest global recession during our lifetime, governments around the world intervened with unprecedented monetary and fiscal policies that supported demand and substantially reduced the uncertainty and risk in the financial markets. Many of the economic fundamentals in support of the recovery are temporary in nature. These include the enormous fiscal stimulus to reflate demand, central banks' monetary support to unwind the credit crisis and inventory replacement to enhance production. Although the benefits from these driving forces will contract during 2010, the global economies will continue to expand. The recovery has been precipitated by the rebalancing of global demand in the emerging and other developing economies. The world can no longer rely on the American consumer on the demand side of the equation. The rebalancing of consumer demand is occurring in Asia and to the greatest extent in China and India. These emerging countries are starting to benefit from a self-feeding domestic economic progression even though the evolution of these economies are in their infancy stages. **Free trade is the evolution of economic progress.** Any deviation from this progression will place the delicate recovery in severe jeopardy. However, free trade must be fair trade which is the reason why there are surmounting global imbalances as evidence by our trade deficit, especially with China. The prerequisite to sustainable global growth lies in the process of rebalancing global demand which will evolve over a long-protracted period against a backdrop of the need for flexibility in exchange rates. On the upside,

the surmounting deficits in the industrialized world is partly cyclical and will reverse as the economic recovery expands. On the downside, the enormous deficits in countries such as the U.S. and U.K. are structural in nature and will have negative long-term implications on their economies and in the markets in years to come. It may take three to five years to restore the global economy to pre-crisis levels before reaching full employment. **The odds favor global GDP will exceed 3% with emerging and developing countries growth substantially surpassing that of the industrialized nations.** The structural fundamentals of the emerging economies clearly support the argument that their equity markets will outperform the United States in the long-run.

ASIA AND THE CHINA SYNDROME: China, India and Indonesia averted a severe recession as a direct result of their enormous policy stimulus. The remaining Asian export driven economies severe contraction followed the Lehman Brothers bankruptcy. They have demonstrated a moderate comeback resulting from both enhanced domestic demands and exports sourced from trading amongst themselves. China, with the best demographics in the world, will continue to be biased towards an easy monetary stance which will continue to reflate domestic demand on the upside and create enormous global imbalances on the downside. By pegging their currency to the U.S. dollar they have in essence adopted the U.S. monetary policy which is clearly destructive to an economy expanding at such a strong pace. Their current over stimulative monetary policy is destined to be the catalyst to excessive speculation. **Yes, China's authorities have become hooked on the debt super cycle process and probably won't let go until a bust down the road in either their housing sector or stock market.** The severe undervaluation of their currency and enormous foreign investment inflows are causing excess liquidity in the system which will trigger asset inflation. China is benefiting from a self-feeding domestic economic evolution that enables it to rely less on its export sector. This is the substance of global demand rebalancing. China, with its enormous U.S. dollar surplus, will become the largest buyer of both U.S. companies and other assets at bargain based prices whether from the bankruptcy court or direct purchases. This country's economic prosperity is producing a growing middle class and a new wealthy class and with this, the possibility of a democratic political change. **Yes, the seeds of political change are maturing and we may live to see democracy in China.** On the upside, China is becoming more capitalistic while the United States is becoming more socialistic. The odds favored a 9% growth rate and a 5% appreciation of their currency even though 12% would be appropriate to unwind the existing global imbalances. This region may produce the equity markets star performers in 2010 and thereafter.

INDIA, the world's second largest democracy, has overcome all of their recessionary implications demonstrating growth in excess of 5%. What makes this impressive is the fact that their growth covered all sectors of their economy especially IT and real estate. Their economy is resilient, reliable and stable supported by enormous inflows of capital. Their middle class is expanding and, with it, disposal income available for consumption. **All of their economic fundamentals are establishing their economy as one of the largest and fastest growing in the world.** The odds favor a 6% plus growth rate in 2010 and with this, strong investment appeal.

JAPAN'S fragile economy has turned the corner and is emerging from its' worst recession since its asset bubble burst in 1989. They have the worst demographics in the entire world consisting of the oldest population. Their long-term structural problems consist of enormous government debt and increasing pension costs. The 6% contraction in their economy was so pervasive that consumer prices fell an additional 2 ½%. Notwithstanding a potential 2% growth rate for 2010, their economy remains in a long protracted period of deflationary stagnation. While their economy was crashing, the yen remained strong and at mid-year their stock market dropped to an all time low. Japan will clearly benefit from the China and emerging economies dividends. **In the event that the yen falls during 2010, their stock market could surprise on the upside suggesting a contrarian investment play.**

EUROLAND AND THE U.K.: Euroland's central banks were the only ones to fail to recognize any economic downside in July 2008 and actually raised their interest rates. The sudden collapse in real estate values in the U.K., Ireland and Spain brought their severe contraction in economic activity. Given the regions aggressive monetary and fiscal policy stimulus, the pace of their economic contraction is abating. Although both Germany and France are on the road to recovery, many of the other EU members and the U.K. have reached the maximum limit of their fiscal stimulus responses. On a monetary standpoint, the ECB will probably not raise rates given their ailing banking sector and the environment of benign inflation, rising unemployment, retrenching consumer spending and declining exports. The U.K. is probably the most vulnerable. Both parties in the upcoming U.K. election are demanding aggressive fiscal restraint which will translate into increased taxes and severe reduction in governmental spending. This will have a negative impact on consumer spending, the prerequisite for a sustainable recovery. **It is more probable than remote that the EUROLAND and the U.K. will demonstrates the slowest growth than anywhere in the world.**

RUSSIA'S devaluation of their currency in January 2009 resulted from the abrupt reversal of their oil-boom related capital inflows triggered by a drop in commodity prices. The economy suffered a severe contraction representing almost a 10% reduction in GDP in the first half of the year and with it the loss of both consumer confidence and spending. Given the retrenchment in domestic demand, the economic revival is relying on their export sector against a backdrop of enormous reserves of natural resources and rising commodity prices. With their aging population, they have the worst demographics in Euro-Asia. Notwithstanding the long-term economic implications, they will do whatever it takes to reassert themselves as the former Soviet Union to include all their former geopolitical satellites rich in natural resources. **Given their huge 2009 run up, Russia may still outperform this year with the odds favoring a 3% growth rate. However, Russia is and remains corrupt and, therefore, carries much greater investment consideration risks.**

LATIN AMERICA: Most of the countries were able to employ timely monetary and fiscal policy in response to the crisis in order to reflate demand. Although the region is primarily comprised of commodity export nations, their financial sectors were sound and they were willing to use currency exchange rates as shock absorbers. One exception is Chavez's Bolivian Revolution, Venezuela. This corrupt oil based restricted currency country, suffering from rampant inflation currently at 25%, has just devalued their currency on an export basis. Against the backdrop of the global recovery and for many countries that had the fiscal ability to mitigate the shock effects of the crisis, by mid-year the region was stabilizing and turning around. Brazil, the largest economy and Latin America's greatest success story, will lead the way to recovery. This country has the best economic fundamental with the largest and healthiest consumer sector and will also benefit from the China dividend. On the other hand, Mexico's recovery will be at a much slower pace given its reliance on the American market for its exports. Either way, the entire region will benefit from rising commodity prices. **Although the region will show a 2.5% contraction for 2009 it more likely will show 3% growth in 2010 with Brazil substantially passing this rate. The Brazilian equity markets may duplicate their economic success.**

AUSTRALIA'S pre-crisis prolonged period of prosperity enabled them to maintain sound economic fundamentals and implement appropriate regulatory regulations. The accrued leverage in both their fiscal and monetary arsenals has given them the weapons to combat the severity of the recession. Commodity based Australia is the only country that showed positive growth in 2009. No country was immune to the crisis, but Australia was never down under demonstrating positive GDP throughout 2009. This nation has been going through a transformation which has evolved industrial production and a healthy and confident consumer sector. **Australia will continue to reap the benefits of rising commodity prices and will probably show 3% plus growth in 2010. It would be difficult to duplicate the equity market's recovery but investment opportunity may still exist.**

IN SUM, the world is on the road to recovery against the backdrop of the most unprecedented recession in the post-World War II era. The recovery is expected to be sluggish, possibly at a 3% growth rate resulting from the massive government fiscal and monetary intervention that started in the United States and spread throughout the world. This recovery will be uneven. Emerging countries performances, especially China, India and Brazil will expand by more than twice the rate of the developed nations, such as the U.K, U.S. and Euroland. The expected slow growth in the developed economies will continue to be impaired by the weakness in their financial systems, the contracting benefits from fiscal stimulus programs and continued retrenchment in consumer spending since those who suffered asset deflation will be biased towards savings.

The path to a sustainable global recovery and ultimate prosperity will be effected on the upside from any of the following:

- Strengthening and reforming the financial systems which is a prerequisite to international trade
- Continued and proper employment of short-term monetary and fiscal support to continue reflating demand where needed
- A near-term commitment to fiscal reform and restraint in order to enhance credibility and confidence in the global markets
- Exchange rate flexibility and adjustment to unwind the global trade imbalances with China and other current account surplus nations

The risks that remain an obstacle lie primarily in the developed economies inability to reflate demand and will be effected on the downside by any of the following:

- A premature withdrawal from both accommodative monetary and fiscal policies could trigger a W- type dip back into recession
- On the other hand, failure to exit from the accommodative policies to late will create global imbalances and asset inflation
- The contraction in credit intermediation
- A substantial rise in the price of oil
- Resurgence of protectionism
- Geo-political issues

Thanks to Ben Bernanke the recession has ended and it is more probable than remote the global recovery will take momentum and surprise on the upside given the fears of a global depression are now misplaced.

The Rise and Fall of both civilizations and economic cycles are directly associated with demographic trends. The Ottomans, Spaniards, French, and the British had their times as the global economic leaders. Although America remains at the helm, it will eventually succumb its position to emerging countries. Specifically China, who has the best demographics in the world, will become the super economic power driving the world to prosperity within the next fifty years.

THE ECONOMIC FORECAST 2010

EQUITIES:

The 2009 market should be called the year of the comeback kid. The DOW closed the year at 10,428 showing an 18.8% annual increase in value. Notwithstanding the DOW lost 33.8% in value in 2008, its spectacular performance from its 6,470 low on March 6, 2009 produced a 61% rate of return in what was otherwise one of the most volatile trading years in history. The S & P 500 closed at 1,115 generating an enormous 23.5% annual return while the NASDAQ closed at 2,269 producing a spectacular return of 43.8% on the year. In the prior year I forecasted the DOW would trade in a volatile range of 7,000 to 10,000 and close the year at 8,500. The market actually traded between 6,476 and 10,580. The markets' spectacular performance was fueled by both optimism and liquidity and not based upon economic fundamentals. **In 2010, liquidity will remain intact, but optimism will be mitigated by economic fundamental realities setting the markets' direction.** Over the past 10 year period, U.S. Treasury bonds actually outperformed stocks demonstrating a compound average return of 8.6% per annum. Continuation of the 2009 volatility in the marketplace is not in the cards but expect turbulence along the way in an otherwise multi-year bull market that may exceed five years. United States equities and to a greater extent emerging equities appear to be over bought on a short-term perspective. As such, they are overdue for a correction/contraction possibly within the first quarter. The market will rise against a backdrop of both the sustainable global recovery, corporate profits continuing to surprise on the upside, enhanced consumer confidence and spending and a reversal in the unemployment trend. The continued contraction in the real estate sector combined with both rising commercial and residential foreclosures, bank failures and corporate bankruptcies will continue to be kind of a drag on the market for the entire year. The odds favor a continued rally as the market transcends from a liquidity/optimistic driven phase to one that is based upon the economic fundamental of earnings. **Yes, a new bull market is on the horizon. Although returns may be moderate, emerging markets may produce substantially greater returns.**

IN SUM: So that there is no misunderstanding any advice provided herewith must be discussed with your broker/investment advisor as it relates to your personal investment objectives. Reflation trade strategies, ones that favor stocks over bonds, will out-perform in this slow growth recovery economic cycle. During a recovery stage, both mid and small caps historically out-perform large caps. On a global standpoint, Euroland should be avoided, however, an underweight position in Germany and France may be appropriate. On both a structural and long-term perspective, emerging markets will continue to outperform Wall Street. The star performers will be India, China, Brazil, Indonesia, Australia and Canada. Given the strength in commodities and the potential upside in their currency, Canada represents an investment opportunity. An overweight exposure should be considered for these star performers after the anticipated first quarter correction/contraction. A contrarian play should be considered for uninspiring industrialized Japan who suffered the greatest decline in value during the recession. Many Japanese medium sized companies are trading at 75% of their 1989 value

With respect to sectors, consider overweight positions in energy, technology, industrials and healthcare and underweight positions in real estate, consumer discretionary and financials. The financial sector faces the headwinds of government regulation that will be less intrusive than most predict. Their profits, especially the commercial banks, will further contract due to the anticipatory loan write-offs, taxes and assessments. This sector that demonstrated a comeback in 2009 carries the greatest risks in 2010. However, the investment banks will profit from an upswing in both new issues and merger and acquisition activity and therefore will carry limited risks. On a long-term perspective, it may take possibly four years to reach the DOW's all time high of 14,164 that occurred on October 9, 2007. This will represent an 8% compounded return. Notwithstanding we expect moderate returns over this period, the U.S. market could surprise on the upside. **Emerging markets and commodities will outperform any other investment in this slow growth economic recovery environment.**

Absent any geo-political and/or natural disasters and assuming the Fed maintains an easy monetary stance, removes the excess liquidity from the system in a timely and orderly manner, allowing a slow depreciation of the dollar, and is successful in combating deflation with their inflationary injection, the Dow may trade between a range of 9500 and 11500 and close the year at 11200. The NASDAQ and the S & P 500 may close the year at 2500 and 1220 respectively. The trading year will be one of turbulence where the market will rise on good news and fall on bad. Although the market may be vulnerable to a near-term correction/contraction in the first quarter. The second quarter may outperform the rest of the year.

INTEREST RATES: Although U.S. Treasury bonds outperformed stocks over the past 10 years, this will not continue in 2010 since stocks have one thing that bonds do not have: earnings. Given the slight improvement in financial conditions, interest rates may rise slightly in the fourth quarter, but remain low by historical standards. Contrary to most other economists belief, the Fed is more likely to error on the side of ease and the Fed's rate should remain at .25% or at best increase 25 basis points by year end. The ten year treasury yield currently at 3.61% may rise to 4% by year end. However, on a long-term perspective, possibly as early as 2011, the yields will be biased to an up-swing against a backdrop of our fiscal deterioration trends and a better than expected improvement in private sector credit demands. Mortgage rates will average between 5% and 6%. The Fed clearly recognizes it needs an inflationary injection to combat the deflationary implications in the economy. As such, investors should consider investment-grade high yield emerging debt rather than developed country's sovereign and short-term duration debt instruments.

THE U.S. DOLLAR: The long-term bear market remains well entrenched. The path of least resistance by our government will be clearly biased toward a continued downward trend supported by low interest rates. In 2009, the dollar had lost an average of 7%. The continued process of devaluation of the U S dollar will remain relatively benign and will not create any crisis in our financial markets given the continued intervention by Asian central banks in support of our currency. The belief that we will be subject to a run on our currency is clearly misplaced since this will propel the world into recession.

Orderly depreciation of the U.S. dollar will assist to reverse our trade deficit, enhance our exports and provide stimulus to counter the deflationary impact of our housing crisis. It may decline between 5% and 10% in 2010, falling against Emerging and EURO currencies but rising against the YEN. **2010 could be the year the Canadian dollar surpasses the U.S. dollar.** The U.S. bear market has further to run but still is the world's equivalent of gold. **Its position as the global reserve currency of choice remains intact.**

GROSS DOMESTIC PRODUCT (GDP): The slow growth economic recovery will pick-up with moderate steam throughout the year producing GDP of 3% which is consistent with the global trend.

INFLATION/DEFLATION: The world appears to be clearly deflationary given the global excess capacity. We have entered the deflationary stage of the 80 year economic cycle of life. The best defense against deflation is the creation of inflation. The unprecedented massive global intervention of both monetary and fiscal policies was both warranted and appropriate and clearly inflationary by definition. However, the emerging economies, especially China, are in the process of absorbing their excess capacity. Their deflationary implications may totally reverse creating asset inflation primarily in real estate and other risk assets. **Yes, many of the emerging countries will become addicted to the debt super cycle phenomena.** It is possible that in 2010 core inflation may remain at the low end of the range but should not exceed 1% to 2%.

GOLD: As I predicted in 2009, gold hit \$1,200 an ounce only to recede to about \$1,000 at year end producing a shining return of almost 14%. Although gold does not normally keep its luster in a deflationary environment, it clearly has an upside in an environment of positive liquidity, a depreciating dollar and low interest rates. **Given the Fed's inflationary injection and considering gold is a safe haven, it is possible that gold could hit \$1,300 per ounce.** I probably should buy my wife jewelry now rather than later.

OIL: The turmoil in oil has abated against the backdrop of OPEC nations cleaning house and the supply and demand forces in the market becoming more aligned. The price of oil will rise in 2010 and trade between \$80 and \$100 per barrel based upon two factors. The first being oil is traded in U.S. dollars which is expected to depreciate against Asian emerging countries. The second lies in the expanding global recovery. Especially China, with its insatiable appetite for the black gold, placing immense pressure on the demand side of the equation. **The long-term perspectives remain extremely bullish.** Consider the fact that car ownership is the social symbol of joining the middle class in both China and India. One billion new cars will bode well for both oil and the automobile industry.

OTHER COMMODITIES: The commodities bull market remains intact and will persist for many more years. Commodities will continue to benefit from existing generous liquidity, the depreciating dollar and low interest rates. Demand will accelerate with the global recovery. It will be enhanced by China's transformation from an export economy to one driven by infrastructure development. However on the supply side, there are many commodities that are in short supply due to lack of investment in facilities,

exploration and production. **It is more probable than remote silver will outperform gold given its supply constraints and its use as an industrial commodity.** In the event the U.S. dollar starts to rise rather than fall, the commodities bull market will contract. **There is clearly a long-term upside and this bull market may very well turn into a stampede to renewed mania conditions.**

REAL ESTATE: The deflationary implication of the real estate downturn will continue to persist in the long-term. There were 2.8 million foreclosures in 2009. This year will surpass the prior year. The remaining residential mortgage resets are due to occur over the next two years which will generate additional toxic loans and with it foreclosures. In addition, the banks have accrued a large inventory of properties in 2009 that will be foreclosed in 2010. The commercial market has been subject to continued rising vacancy rates and rent reduction and renegotiations with their tenants causing further downward pressure on values. Given the credit crisis, although moderately abating, the landlord's inability to refinance as their mortgages come due places them at risk of foreclosure. To further exacerbate the problem, the 78 million baby-boomers, which have become empty nesters will be adding their homes to the existing housing inventory glut. The demographic consequences are devastating and will persist in the long-run. On the upside, the rate of decline is slowly abating. The banking programs consisting of modifications, short sales and lease for keys will reduce the number of foreclosures. **The only way to offset the deflationary pressures in the marketplace and create a bottom is with the inflationary injection.** The government may very well be successful in its objective, as long as, monetary policy remains easy, liquidity remains intact and the dollar is allowed to depreciate in an orderly manner.

Notwithstanding all the risks and global imbalances, I remain optimistic to the outlook.

Thank you Ben Bernanke.

DISCLAIMER

THE ECONOMIC FORECAST AND GENERALIZATIONS CONSTITUTES MY VIEWS AND SHOULD NOT BE REGARDED AS PERSONALIZED INVESTMENT ADVICE. FOR INDIVIDUAL APPLICATION, SEVERAL VARIABLES MAY APPLY WHICH REQUIRE REVIEW OF YOUR PARTICULAR FACTUAL CIRCUMSTANCES WHEN DETERMINING WHETHER THE GENERALIZATION RULES WOULD BE APPROPRIATE. I DISCLAIM THAT ANY AND ALL OF THE ADVICE AND RECOMMENDATIONS CONTAINED HEREIN ARE APPLICABLE TO ANY USER. THEREFORE, ANY ADVICE WITHOUT MY REVIEW ON AN INDIVIDUAL BASIS IS TAKEN AT YOUR OWN RISK. ANY FINANCIAL, INVESTMENT ANALYSIS OR SPECIFIC INVESTMENT RECOMMENDATIONS PROVIDED HEREIN MUST BE PRESENTED TO AND DISCUSSED WITH YOUR PERSONAL FINANCIAL ADVISORS.

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