



THE FOXHALL GLOBAL OUTLOOK



MARCH 30, 2010

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Dear Paul,

Since the beginning of this year, 2010, through March 15th, the S&P 500 INDEX is up only about 3%. Almost every American knows that the U.S. Economy is not very strong. Are we going to be stuck in a sideways stock market? How long do you think that will last?

Historically, transition periods going from recessions into bull markets are highly volatile and fraught with possible dangers for investors.

Warren Buffett, America's richest and most successful investor has said that in the short run, the stock market's movement can seem as random as a "SLOT MACHINE." But in the long run, the stock market is like a "WEIGHING MACHINE," in that IT ALWAYS TRACKS THE DIRECTION OF THE UNDERLYING ECONOMY.

HERE'S A LITTLE HISTORY

Last year the S&P 500 INDEX bottomed on March 5, 2009. Since that time, the stock market has had a remarkable run up. Although it is still (as of March 15, 2010) over -36% below its last bull market high on October 9, 2007 and still -33% below the last stock market high of March 24, 2000—ten years ago.

The NASDAQ INDEX is even worse. The NASDAQ has declined over -53% in the last 10 years! In order for the NASDAQ to return to breakeven from its March 10, 2000 high, the NASDAQ INDEX would have to go up over +113% from its March 15, 2010 closing price. THAT'S WHY IT IS CALLED THE LOST DECADE!

We've all lost a bet or lost our keys—BUT UNTIL NOW, WE'VE NEVER LOST A DECADE!

This has been the worst U.S. stock market decade in the past 8 decades, starting in the 1930's!

If investors wanted to get back in the black to breakeven over the past decade, stocks would have to regain more than \$5 trillion in value.

THE U.S. STOCK MARKET IS OUT-OF-SYNC WITH THE UNDERLYING U.S. ECONOMY

Despite the rise in the stock market over the past year, everyone in the United States understands that the U.S. economy still has severe problems.

- More than five million homeowners are behind on their mortgages.
- There are over six million Americans who have been unemployed for at least six months, a record 40% of the ranks of the jobless.
- The private capital stock is growing at its slowest rate in nearly two decades.
- Roughly 30% of manufacturing capacity is sitting idle.
- Nearly 19 million residential housing units, or about 15% of the stock, are vacant. Last quarter there were almost 1 million foreclosures. That is 425 foreclosures every hour and 7 per minute.
- One in six Americans is either unemployed or underemployed.
- Commercial real estate values are down 30% over the past year.

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• The average American worker has seen his/her level of wealth plunge \$100,000 over the last two years, even with the recovery in equity markets this past year.

• Bank credit is contracting at an unprecedented 15% annual rate so far this year as lenders sit on a record \$1.3 trillion of cash.

• Unit labor costs are down an unprecedented 4.7% over the past year, and what has replenished household coffers has been the federal government, as **transfer payments from Uncle Sam now make up a record 18% of personal income.** (Source: Gluskin Shef)

IN TIMES LIKE THESE, RISK MANAGEMENT IS EVERYTHING!

Warren Buffett's mentor and Columbia University professor, Benjamin Graham once wrote, "THE ESSENCE OF INVESTMENT MANAGEMENT IS THE MANAGEMENT OF RISKS, NOT THE MANAGEMENT OF RETURNS. WELL-MANAGED PORTFOLIOS START WITH THIS PRECEPT."



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PRESERVE, PROTECT & DEFEND

At FOXHALL CAPITAL, our PRIMARY OBJECTIVE is first and foremost RISK MANAGEMENT. That means that our PRIMARY OBJECTIVE is to try to make sure that none of our clients experience any significant loss of principal in their investment accounts. Our next, but SECONDARY OBJECTIVE, is to increase the value of our client's accounts. BUT RISK MANAGEMENT IS ALWAYS OUR PRIMARY OBJECTIVE.

Our FOXHALL CAPITAL RULE #1 is, "ALWAYS PROTECT THE DOWNSIDE." We always try to "LOOK" DOWN before looking UP in an attempt to manage risk in our client's accounts.

FOR THE REST OF 2010—FOLLOW THE ECONOMY—NOT THE STOCK MARKET

SO WHAT WILL THE U.S. STOCK MARKET LOOK LIKE FOR THE REST OF 2010?

While no one has a CRYSTAL BALL, I expect to see a very choppy U.S. stock market through the end of this year. It is shaping up to be a ROLLER COASTER RIDE where we will see several uptrends like now, FOLLOWED BY SOME HARROWING DOWNSIDE CORRECTIONS. But, at the end of the year, I believe WE WILL END ON THE POSITIVE SIDE.

This year is starting to look like 2004. 2004, like this year, started 3 quarters after the recession of 2000-to-2002 ended. A stock chart of the DOW JONES INDEX for 2004 looks like a roller coaster ride—up and down—but in a sideways direction until December 2004 when it ended the year up almost 11%.

2010 looks like a similar year. As of March 15th, the S&P 500 INDEX is up +3%. But in late January and early February the INDEX dropped over -8% and has now bounced back. I think we are going to see this UP AND DOWN pattern for the rest of the year.

HOW CAN THE U.S. STOCK MARKET GET BACK IN-SYNC WITH THE UNDERLYING ECONOMY?

Many analysts are worried that the housing market could be turning down again after a brief recovery, which could contribute to a decline in U.S. stocks.

Others worry that after last year's run-up in the stock market that U.S. stocks are now extremely overvalued. Many analysts believe the U.S. stock market is 15% to 21% overvalued.

THERE ARE TWO POSSIBLE OUTCOMES TO THIS SITUATION. Either we will see a 15% to 20% U.S. stock market correction that would bring the stock market back to "fair value." Or the U.S. stock market could trade in a sideways direction for some time until the underlying U.S. economy rises to a "fair value" level again.

Let's face it, because of the U.S. government's stimulus programs and printing massive amounts of new money, America has been on a "SUGAR HIGH" for the past year. As a result, many investors are growing more risk averse as they question if the good times can last as the government pulls back.



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Angst is also rising as investors price in the longer-term fallout of taking away the so-called GOVERNMENT PUNCH BOWL, leading to higher interest rates and ballooning deficits. Unfortunately, the "SUGAR RUSH" is wearing off and now we may be facing a hangover.

HOW TO MAKE MONEY IN THIS TYPE OF ECONOMY—AND STOCK MARKET!

THE KEY IS TO BE GLOBALLY DIVERSIFIED! AND TO REALLY TRY TO MANAGE "DOWNSIDE PORTFOLIO RISK" EFFECTIVELY!

The HARD REALITY is that emerging markets, not the U.S., will lead the world economy in this recovery over the next few years. Those U.S. companies that can tap into the economic expansion overseas will also benefit and boost American growth in the process. But the key here is to think outside the United States.

ASIA, OTHER EMERGING MARKETS AND HARD ASSET COMMODITIES TO LEAD IN 2010!

Most analysts agree that the United States, Europe and Japan will not be the global leaders in growth over the next few years. The dramatic growth will be in Asia and emerging markets and hard asset commodities for the next five years.

WHAT ABOUT CHINA?

It is true that many analysts believe China has a HOUSING BUBBLE similar to the United States in 2007. But the "BUBBLE" parallels are not the same.

Yes, Chinese and Hong Kong property prices have doubled over the past 4 years. But there are major differences between the bubble in China and the bubble in the U.S.

The Chinese government recognized the problem early and has been slowly tightening credit for over a year. That is a marked contrast to how the Federal Reserve kept pumping money into the real estate market in the U.S.

Unlike the U.S., Chinese home buyers didn't get 125% mortgage loans to buy a house. All Chinese put up 20% of their own money to purchase their main home and if they want to buy an investment property that have to put up 40%. They are less likely to walk away from a property like many U.S. home owners have done.

Lastly, even if many of the government owned banks have increased bad debt, the Chinese government has trillions of dollars in surplus capital. They won't have to print money to bail out the banks like we did here in the U.S.

Last year Asian markets went up faster than the U.S. stock market, but in two weeks in late January Asian and emerging markets saw a -15% sell-off correction AND THOSE MARKETS ARE NOW COMING BACK!

It is very possible that if China restricts credit too much that we could see another small correction, BUT THE LONG-TERM TREND IS UP!



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GLOBAL DIVERSIFICATION!

Investors need to recognize that the regional asset allocation diversification of tomorrow has to be much more global than it was in previous years.

Second, most of us have been very lucky—we haven't had to worry about inflation for a long time. But with our government printing new bail-out money, stimulus money, trillion dollar annual deficits and what many analysts believe will be health care deficits to be funded, it is only a matter of time before we start seeing really serious inflation again. THIS IS WHY HARD ASSET COMMODITIES WILL BECOME SO IMPORTANT IN YOUR INVESTMENT ACCOUNTS.

Developed countries, like the U.S., Europe and Japan, have incurred heavy budget deficits in combating the current global financial crisis, and the International Monetary Fund (IMF) said that the "developed country debt-to-GDP will be 114% by 2014 compared to just 35% for the developing countries."

Most economists believe the U.S. will grow 2.5% in 2010 and 3% in 2011 and unemployment will remain in the 9% to 10% range over the next couple of years. The IMF estimates that China will grow at a 10% rate and other emerging markets will post a 5% expansion next year.

SUMMARY

THE BOTTOM LINE IS WE ARE IN A LONG-TERM BULL MARKET, but in the short-term, the U.S. stock market is out-of-sync with the underlying U.S. economy and the stock market is probably overvalued.

IT IS MORE OF A TIME FOR CAUTION THAN BEARISHNESS!

Managing investment risk in our FOXHALL client's portfolios is hard work, and given the current economy, can be challenging.

While we believe at FOXHALL CAPITAL that a globally diversified investment portfolio is an important risk management tool—it is not, however, in itself sufficient. An investment manager also has to ask, "What mistake can I afford to make if diversification doesn't help me?" And, I assure you, that is a question that unfortunately not enough investment managers ask themselves.

THE FOXHALL CAPITAL PRESERVE DEFEND & PROTECT RISK MANAGEMENT STRATEGY also provides ANOTHER LEVEL OF RISK MANAGEMENT on top of global diversification. When volatility in the stock market goes up, FOXHALL CAPITAL automatically increases the amount of cash and U.S. government bonds in your investment accounts.

VOLATILITY IS USUALLY THE MEASURE OF INSTITUTIONAL FEAR in the stock market by huge institutional investors. These are the big pension funds and hedge funds that can move billions of dollars in or out of the stock market in seconds. That is why the VOLATILITY INDEX (VIX) is often called the FEAR INDEX.



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I believe that BY THE END OF 2010, the U.S. stock market will be modestly up for the year, but the real gains will come from markets in Asia, emerging markets and in hard asset commodities.

In the meantime, we intend to continue to implement our FOXHALL CAPITAL PRESERVE DEFEND & PROTECT RISK MANAGEMENT STRATEGY by increasing the amounts of cash and U.S. government bonds in our client's portfolios when volatility is rising in markets here in the U.S. or abroad.

UNTIL THEN!

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