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With No Apologies to Frank Sinatra: *"It Was a Very Good Year"*

Last year at this time I lamented that 2008 was a Very Bad Year. The S&P 500 Index had lost 38.5%, the Dow Jones Industrial average was off 33.8% and the international index was down 45.1%. Cash was king because it lost no money. Well, the year 2009 was its mirror opposite.

What a difference a year makes! For 2009 these three indexes, as well as just about any others you might choose to examine anywhere in the world, were up and in a big way. Specifically, the S&P was up 23.4%, the Dow was ahead 18.8%, while the international index, the MSCI EAFE Index, was at plus 27.7%.

This was a rubber ball bounce back to a degree that virtually no one predicted. The consensus view going into the beginning of 2009 was for a moderate stock market advance but little more; that view missed the mark by a mile.

In Greek mythology "Cassandra" was so beautiful that Apollo granted her the gift of prophecy; the word is used today as a metaphor to be applied in situations in which valid warnings of future events are nevertheless disbelieved. Do you remember that doomsayer, Nouriel Roubini? He's an economics professor at the NYU Stern School of Business as well as the head of his own economic consulting firm, Roubini Global Economics. In 2005, when no one wanted to listen, he accurately warned of the speculative housing bubble, predicting this "once-in-a-lifetime housing bust" would sink our economy. Boy was he ever on target.

In 2009, *Foreign Policy* magazine listed Roubini as #4 on their list of the "top 100 global thinkers," while *Time* magazine called him one of the 100 most influential people in the world last year.

But this Cassandra wasn't as prescient last year, predicting negative growth through the end of 2009. In fact the third quarter's GDP was positive and the fourth too. Roubini predicted a 24 to 36 month recession while most economists now agree that the recession ended last summer, about 18 months after it began.

So what's my point? First, that it's hard to be consistently right, and second, that we remember the people who take out-of-the-box positions when they happen to be right, but are quick to forget those same out-of-the box prognosticators and their assertions when they are wrong.

I hazard a guess on the economy and stock market for 2010 with great trepidation and fully acknowledge that my prediction, soon to come, will likely be wrong. If it is, I just hope it was too conservative. These general observations weave bond, stock and historical events together in a mosaic for your consideration:

1. The Treasury Market Yield Curve is Signaling a Very Good Year.

"When I was seventeen, it was a very good year ..."

The difference between interest rates (yields) on 2-year and 10-year Treasury notes is called the "yield curve." When the spread between those two interest rates widens (the yield curve "steepens"), it generally suggests that our economy is headed for a recovery.

Here's the Rule: the wider the difference, the better the direction for the economy. It's trending at its highest ever level right now, around 2.85%.

Recently, investors have been selling longer term bonds with the belief that the economy will grow and bring inflation with it, sending those longer term bond prices lower and their yields higher. (Treasury prices and yields move in opposite directions).

The historical average between 2-year and 10-year spreads is 1.5%, and the average over the last year was 2.15%. So with the current spread at an historic high, I think the economy is picking up and will continue to do so this year.

2. The Trend is Your Friend

"When I was twenty-one, it was a very good year ..."

The famous investor Martin Zweig made that phrase about the "trend" famous when I was just starting to develop an interest in this investment business back in the early '70s. I've adhered to it ever since. (*Forbes Magazine* once claimed that

Marty owned the most expensive residence in the United States, so before he retired Mr. Zweig did his thing pretty well).

Here's the GDP trend: Growth in the third and fourth quarters of 2009 was far better than originally predicted. "Growth through October far outpaced our expectations. It's not an aberration that is going to give way to contraction in 2010. It's the beginning of the recovery." So Ben Herzon of Macroeconomic Advisers of St. Louis was quoted in the *Wall Street Journal* in late December.

A consensus of forecasters compiled by Macroeconomic Advisers saw 2% fourth quarter growth in August, but almost double that growth rate at 3.9% for the same quarter when they refined their analysis in December. If realized, Q4 2009 would be the strongest quarter since Q1 of 2006.

T. Rowe Price upped its forecast for Q4 from 2.7% to 3.7%. RBS Securities went from 3.3% to 5%. I could go on but you get my point by now. The Trend is Our Friend.

3. The Brokerage Houses Think the Best is Yet to Come

"When I was thirty-five, it was a very good year ..."

Strategists at Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Oppenheimer, RBC and UBS *all* think the S&P will end up higher than it was at the end of 2009.

The median consensus is around 1250, with JP Morgan and Oppenheimer both predicting 1300. As I write this little ditty the S&P 500 index is at 1146, so the average says we have another 9.0% to add to the gains we've already enjoyed the first part of this year.

So what about those initial gains?

4. The Dow Jones Five-Day Rule is A Good One for Us This Year... Maybe

"But now the days grow short..."

This old wives' tale has been right 32 out of the last 37 years. It posits that as the first 5 business days of the year go for the Dow Jones Industrial average, so will the market be by year's end.

And where was the Dow on Friday, January 8th? Up 1.8% for the year which was also its highest level in more than 15 months. Add that to the 9.0% average of the brokerage house strategists and we have an 11% year. Not bad, not bad.

5. Watch the S&P 500 Index January Barometer

"I'm in the autumn of my years ..."

Barron's recently reported on the research which market historian and author John K. Harris has done. He has calculated how a new year ended when the market's high point for the preceding year was December, as it was for 2009.

In the 82-year history of the S&P 500 index, the year's high has occurred in December 24 times, excluding 2009's. For eighteen of those occasions the S&P 500 index ended positively the last day of January of the following year, while six times it didn't. In the positive years the market averaged plus 17.2% for the entire year, while in the negative years it was down 3.5% on average. Let's hope we're up come January 31st.

If so it will have been a very good year.

What's Missing In Washington?

When I was a young man, I was inspired by John Kennedy's *Profiles in Courage*. This Pulitzer Prize winner recounted examples of eight United States Senators who put the good of the country ahead of their narrow and partisan interests, showing bravery and integrity by crossing party lines or by defying public opinion to do what they felt was the right thing to do for the country. As a consequence, each suffered serious condemnation as well as the loss of popularity because of the actions they took.

Compare Kennedy's political leaders with our Congressional members in Washington today. As they address issues of concern to all Americans, no matter the issue -- health care, the stimulus, tax or monetary policy -- Democrats and Republicans alike prove themselves consistently incapable of working together in a trusting and mutually beneficial relationship for the good of our country.

Their mutual ill will and enmity leaves me disgusted with both parties and the political process. If I were a judge, I'd find them guilty of putting their self-interest before the common good, and sentence all 535 of them to a mandatory counseling session where, after reading *Profiles in Courage*, they would consider the application of the lessons of three individuals on the sports field, each of whom demonstrated a selflessness rarely evidenced today in the corridors of Congress:

Case 1: Darius McNeal and the Right Thing to Do

On February 7, 2009 a Madison, Wisconsin and DeKalb, Illinois basketball game was held. Earlier that day, the captain of the Wisconsin team lost his mother to cancer. His coach planned to cancel the game, but Johntel Franklin, the player in question, insisted it continue. Young Franklin left the hospital and went directly to the gym, arriving after play had started in the second quarter.

His coach asked the referees if Johntel could play but, since he had not been entered in the official's scorebook as a player, the only way to permit him to play was to call a technical foul on his team, thereby awarding the Illinois team two free throws.

DeKalb, the opposing team, asked the officials to ignore that rule but the refs refused, insisting on "going by the book." The DeKalb coach then asked for a volunteer to take the unwanted free throws awarded his team. Darius McNeal was the first to raise his hand and step forward.

Standing on the free throw line, *his first free throw went two feet; his second less than that.* The Madison players and crowd stood and applauded.

Once the game resumed Johntel Franklin scored 10 points, helping Madison to a 62-47 win. "I did it for the guy who lost his mom. It was the right thing to do," McNeal told the *Milwaukee Journal Sentinel* after the game.

Case 2: Adam Van Houten and the Lesson of Integrity

This Ohio high school sophomore shot a 144 over two rounds to win the fall 2005 Ohio Division II golf tournament by six strokes. After signing his scorecard he realized that he had recorded the 10th hole on the second round as one stroke lower than he in fact had actually scored on it. This meant he had defeated the field by five strokes rather than six. The stroke had no bearing on his triumph, but his conscience told him otherwise.

Accordingly he *self-reported the error* even though he knew that a card signed with an incorrect score would disqualify him from the tournament. Thus Adam lost the tournament and his state title. But in my mind he reaffirmed the importance of something much larger. (Adam is presently playing for the George Mason golf team).

Case 3: Esther Kim and "The Other Man First."

When I was a youngster, I attended a boys' camp on Lake Champlain in upstate New York called Camp Dudley. Its motto was "the other man first." This story captures that motto perfectly.

Ms. Kim and her training partner Kay Poe were best friends. In May 2000 they were scheduled to meet in the finals of the flyweight division at the U.S. Olympic taekwondo trials, with the winner going to the Sydney Olympics later that year. Kim was ranked No. 2 in the U.S. while Poe was the heavy favorite and world-ranked No. 1.

Unfortunately, Ms. Poe dislocated the patella in her left knee during the last seconds of her previous match. In the hour

before their final Ms. Kim helped to ice her friend's knee. Nevertheless it was apparent that Ms. Poe would not be able to compete.

Accordingly, Ms. Kim *forfeited the match* thereby giving up her chance at an Olympic bid so that her friend could go instead. Kim never qualified for another Olympics.

Is it too much to expect that our politicians adhere to the same standards of decency, honesty and compassion as were exemplified by these sports heroes? Wouldn't we all feel more kindly toward the system if they did?

Listen to the Music

Last year at this time I asked for a prediction of the Dow Jones Industrial Average number at the end of December 2009. The Dow ended the year at 10,428. The winner is a wonderful Connecticut widow and client, one who is an inspiration to me every day as she has supported me through personal tribulations, including when my mother died this past July.

Anne Dennean attends Mass every day and prays that, among other matters, we safeguard her accounts. She's one reason Westover's tag line reads, "Your capital's preservation and its appreciation is our only focus."

Anne freely admits that financial markets are not her cup of tea. In her own words, her guess that the DJIA would end at 10,776 "was based purely on the fact that I like those numbers." Anne, you had some divine guidance here. Congratulations!

The quiz for this first quarter of 2010 will award the victor a \$100 gift certificate to the restaurant of the winner's choice. I have to believe that every reader has listened to the Beatles over the last 45 years.

Here is your no Internet sleuthing, two-part quiz: Correctly associate these Beatles' songs with the individual Beatle who sang them (easy) and also place them in order, with the oldest song first and the most recent last (harder, but not all that difficult).

Songs:

Yesterday (recognized as the most covered song in history; sung by over 3,500 artists)

Something (the second most covered Beatles song)

Yellow Submarine, and

Please Please Me

Good luck, and as always we wish you the best for 2010.

January 14, 2010