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Quarterly Newsletter

First Quarter 2010

Summary- After the crash of '08 and the vigorous rebound of '09, we expect the economy and financial markets to spend most of 2010 moving sideways as they adjust to a slow "grind out" recovery. Jobs will be the key, as there can be little CPI inflation, rent growth, gain in consumer spending or main street improvements until unemployment is below 8% and falling. That is unlikely until well into 2011. Like the USC football team, it will be a building year, necessary before a healthy future economy can emerge.

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Fixed income, absolute return stock management, foreign markets, commodity buys on dips, selective real estate and patience will be rewarded this year.

U.S. Economy- The US Gross Domestic Production (GDP), the key indicator of the country's combined economic health, grew a revised 2% in the third quarter and a preliminary 5.7% in the fourth quarter of 2009. This followed four quarters of deep losses, our worst drop since WWII. Our temporary government stimulus programs helped jump start the economy, but real business growth is needed soon to address unemployment, personal income drops, housing, state/local budgets and credit availability.

Our US Dollar appears to have bottomed vs. the Euro and Yen late last year, which has caused a pause in the rise of commodities. The US Treasury rate curve has steepened dramatically with 30-day rates near 0% and 30-year rates at over 4.5%, suggesting expectations of economic growth and inflation in the years ahead. Credit spreads (the difference in interest rates between risky and safe debt) have shrunken from all time highs to above average spreads, as investors' appetite for risk returned. Unemployment remains high at 10%, and the 65% labor participation rate is the lowest in 25 years. Unfortunately, many jobs in finance and construction may be lost for several more years.

Economic Forecast- While the consensus is for GDP to grow at over 3% this year, we are more conservative and see only about 2.5% growth. Furthermore, we think the third and fourth quarters will be only 2% as the stimulus programs end before the underlying economy picks up. We believe this will cause the stock market to dip 10-15% before recovering in the fourth quarter in anticipation of a better 2011. This should keep interest rates only marginally higher as inflation should be held to about 2%, with a good chance of a deflationary scare at some point in the year. This in turn should provide a dip in commodity prices before they rise again toward the end of the year. We expect unemployment to stubbornly stay around 10% for all of 2010 (but I hope we are wrong).

In this environment, the Dollar should hold relative to the Euro, but lose ground to Canada, Australia and other natural resource based economies. Europe and the G3 "rich countries" will likewise have muted growth, while the BRIC countries (Brazil, Russia, India & China) and EM (Emerging Markets) countries expand more rapidly.

Stock Markets- While the correlations of the world stock markets were remarkably in sync last year, we believe a divergence will occur in 2010. We expect the US markets to consolidate, with a 10-15% drop in prices at some point this year, as every similar "V" bottom recovery has done in the past. While we expect world markets to follow, BRIC and EM should fair better with shallower dips and a larger recovery. Our target for the S&P 500 is about 1225 at year-end, up from a possible bottom mid-year at 950-1050.

Fixed Income- Investors have bid up the price of gold and silver in expectation of much higher inflation, but we think they are early. True CPI inflation will stay low this year due to high unemployment, stable dollar, weak economic growth and the inability of companies to increase prices of goods and services. We believe this environment will produce relatively stable interest rates and good returns for all levels of fixed income. We particularly like tax-free municipal bonds with long-term yields between 5-7%, as expectations of higher future taxes and scarcity of bonds will offset risks in defaults and rising interest rates. California long-term G.O. bonds have been under pressure due to expected budget shortfalls and mismanagement. While the prices may fall further as we approach the June budget deadline, these prices should appear cheap in the years ahead. However, we do expect inflation and rates to rise in 2011 and beyond, so active management or laddered portfolios are recommended.

In addition, we like high-yield bonds, but only in hedged programs as we believe they will have a dip similar to equities this year (but payout 8-10% yields in the meantime), foreign bonds (particularly in Emerging Markets) and Australia and Canada should do well this year as well.

Real Estate- The looming commercial real estate debt maturity program is a race against time. Banks are ignoring values and extending loans (extend and pretend) if borrowers can continue to service the loans. However, many cannot and distressed debt deals and REO sales will keep prices from rising until at least next year. Buyers of these properties should be handsomely rewarded in the years ahead as bad loans run their course, the economy improves and very limited new inventory combine to eventually lift prices. While housing pricing is localized, we expect a gradual rise in housing, held in check by continued high bank inventory selling.

Politics- The election of Republican Scott Brown to the Senate may be viewed in the years ahead as the turning point of a national, state and local shift toward the center/right. In turn, policies should become more balanced and business friendly than earlier feared. Tax increases, higher spending and some health care reform will take place, but the run away deficits should be tempered by thinking that is more conservative. Our political system (corruption aside) still works because when the politicians stray too far (either way) from the needs of the people they will be voted out.

Investment Strategies for 2010- After the huge investment losses of '08 and the sharp recovery in '09, 2010 will seem boring. We believe both the stock and bond markets will be range bound this year. In this environment, bonds should have moderate volatility and produce returns based mainly on their coupon. Stocks will be frustrating to trade with industry rotation and lack of momentum prevalent. We recommend "absolute return" or "market neutral long/short" hedged management for this type of sideways environment. We sold our commodity exposure at the end of 2009 and await a dip in prices for a reentry at still lower levels. Similarly, we recommend buying both debt and equity, for appropriate accounts, in BRIC countries on dips this year. Investment real estate will stabilize location by location and ultimately only gain upward momentum when local job growth returns.

2010 should be a base building year, bringing the stability and consolidation necessary for healthy future growth. Proper risk management, realistic expectations and patience will help you make the most of this coming year.

Mark Van Mourick
CEO

Please join us for our Educational Series, presented by key industry leaders.

March 17, 2010 – Mark Percy, Managing Director of "Excellence in Giving," will lead a discussion of philanthropy as a tool to teach accountability and responsibility to our beneficiaries and heirs.
4pm – 6pm in the Optivest Conference Room.

April 7, 2010 – Matt Brown, J.D. and partner of Brown & Streza, will speak on "Exiting your business without taxing yourself", a must for anyone considering a large business or asset sale in the future.
4pm – 6pm in the Optivest Conference Room.

You are welcome to come to any or all of these meetings and we encourage you to bring others that might also benefit from hearing these topics. Space is limited to the first 15 people to sign up. Kindly RSVP to Traci Crays at 949-363-8686 or email traci@optivestinc.com.

We encourage your feedback on these meetings and strive to bring you value added education in the areas that are most meaningful to you. If you have other topics or speakers, you would like to hear, please let us know.