



NOVEMBER 2010 INVESTMENT UPDATE

Dear Friends and Clients,

We are sending this special update because we felt that financial and tax planning is vitally important during 2010 and we wanted to encourage you to review your particular situation in time for you to act before the end of the year. Before we get into the investment portion of our update, let's take this opportunity to go over some administrative policies and procedures regarding our wealth management services. By way of background, we created Farmand Investment Services, Inc. on December 14, 2001 but we have been providing investment management services since 1997 and we have made an intensive effort to provide you the best level of service that generates value beyond what the financial indexes give us.

Also, in early 2010, we undertook an effort to improve and enhance the Farmand, Farmand & Farmand, PA, CPA website, including adding more information related to our wealth management services. In the future, we intend to establish a link to our website for our investment newsletter. We welcome any suggestions you have for how the site could be more useful and easier to use. Please send your suggestions to mike@farmandcpa.com.

Now, let's go over the investment portion of our update by going over the current investment climate in general as well as to discuss our strategy for the remainder of 2010 and 2011.

Since 2000, we have endured two horrendous bear markets. The first, from 2000 to 2002, let the air out of a wildly inflated speculative mania pumped up by the arrival of the Internet. The second, and more sinister, bear struck in 2007-2009, when valuations seemed much more reasonable than in 2000. However, excessive debt-mortgage debt in particular - trumped all other factors. The deleveraging process among households continues to this day, throwing a wet blanket on the U. S. economic recovery. To stop the economy and financial system from imploding, Washington took off on an unprecedented deficit – spending spree.

Global stock markets, most definitely including our own, have enjoyed a strong recovery since March 2009, despite the recent unsettling “correction”. But the bull will not run forever. Consumers may be reducing debt, but the federal government's debt has soared more than 4 trillion dollars in the past three years, to \$13.3 trillion dollars at last glance. To date, Uncle Sam has had no difficulty selling bonds at rock-bottom interest rates. By 2012, though, the government will face a greater fiscal crunch as the number of baby boomers reaching 65 (the age for Medicare eligibility) spikes. Washington's debt-to-GDP ratio will soar to 100% - typically, the level at which a country's creditors begin to rebel. In short, there is a serious risk of another deep bear market in 2012, perhaps extending into 2013.

Given this outlook, you might be tempted to head for the hills! But, if the U.S. Government's budget woes are not adequately addressed before 2012, the economic recovery has built up enough momentum to probably lift share prices up another 12 to 15% or more. Yes, the housing sector is still in dreadful shape. But manufacturing is steadily improving, with industrial production up 7.7% in the past year. Many export-oriented technology companies are booming. Service industries, for the most part are doing OK. Retail sales, while still below the 2007 peak, have gained 5.5% from a year ago. Barring an external shock, the European situation looks a lot healthier today than it did a few months back.

Election fever is running high as politicians blitz the airwaves and their posters swarm the streets ahead of the November 2nd climax. Clearly the makeup of the next Congress will have a significant impact, for better or worse, on taxes, regulation and government spending. However, America urgently needs to address the long-term fiscal problems created by the retiring Baby Boomers. But the financial markets aren't a simple, one-button machine. Numerous factors influence stock prices. The truth is, investors are always faced with uncertainty, even in what may seem to be the best of times. Asset allocation is a strategy used to reduce the risk of that uncertain world to a manageable minimum. What that means, in plain English, is that we never put all our eggs in one basket. We own a globally diversified mix of stocks, bonds and cash, with dozens of individual securities to provide an extra layer of protection.

As you know, all of our portfolio reports are now set up where each account has its own targeted asset allocation mix formulation between "equity" and "fixed" investments, based on the Family Portfolio Management agreement, unless it was revised. What percentage would I place in a new client's portfolio (over time)? Even though each client has their own individual goals, my own personal current portfolio is earmarked 60% for stocks and 40% for fixed income investments. That's very close to the norm I have followed for the past 20 years. For most investors a 60/40 allocation delivers enough upside participation to keep most of us happy in good markets, with enough of a cushion to let most of us sleep soundly in tough markets. These percentages should be adjusted to fit each one's particular own situation. People in their 20s, 30s and 40s may feel comfortable with a larger weighting in equities. Folks approaching or already in, retirement might shade the equity percentage lower. One helpful rule of thumb: To compute the percentage of your portfolio that should be in risk assets (those that don't offer a guaranteed payback), take 115 minus your age. Thus, a 60 year-old would shoot for a 55% "normal" weighting in stocks and other risk assets. The actual percentage at any given time might vary with market conditions and personal circumstances.

As the current stock market cycle matures, our strategy is to take more profits on equities and increase our weighting in fixed income. The next bear market is probably some distance off, but we will want to move gradually into a more defensive position as the final peak for the cycle comes into view.

In the fixed-income area, speculation over the Federal Reserve's next quantitative-easing (bond-buying) move dropped the 10-year Treasury yield to a new 2010 low of 2.33% on October 8th. But long-dated Treasuries didn't follow suit; the 30-year yield held above its August low. This type of divergence points to a rebound soon in bond yields, which could raise the 10-year

Treasury yield back up to the 3% range by year- end. Our strategy in the fixed income area has been and will continue to be to keep our maturities short (generally under five years) until we see how strong the next bounce in yields turns out to be.

As we head down the home stretch, it's beginning to look as if 2010 may turn out to be a pretty good year after all! For equity investors, especially, it's nice to see the DOW within striking distance of its second winning year in a row. This is quite a change from the dark days of October 2008, when the financial world came perilously close to breaking apart at the seams.

As always, of course, we are more interested in the future than in the past. And here, we must inject a note of caution. The powerful run-up in global stock markets since late August will be a tough act to follow. Granted, the Federal Reserve and other Central banks are pushing hard to "stimulate" business activity through near-zero interest rates, quantitative easing and related gimmicks. In the end, though, the U.S. economy is likely to keep growing at a subdued pace in 2011, bringing a much more modest growth rate for corporate earnings (probably 10% or less) than we have had this year.

We want to thank all of you for giving our firm the opportunity to serve you. We thank you very much for the trust and confidence you have placed in our firm as it is always appreciated. Please contact me should you have any questions or comments.