July 1, 2010

Client
Address
City

Dear;

After four strongly positive quarters in a row, the global stock markets suffered a lousy one. This market action did not come as a surprise, and I had expressed concerns that the optimism regarding stock prices had run ahead of economic reality. Even the catalyst, European debt problems, was understood and I had the ability to sell some equity holdings in advance of the downturn in prices. That said, because I rarely take extreme positions, my accounts surrendered the advances made in the first quarter of the year and a bit more.

Market participants continue to flock to the perceived safety of bonds and were rewarded with positive outcomes in the short run, but I do not feel comfortable with that approach over the longer-term. I did not add to my short-term treasury holdings in the quarter because there was no opportunity to do so at attractive prices. However, my portfolios did benefit from purchases made in this area during the first quarter of the year.

I continue to add to high quality, dividend paying, large capitalization U.S. companies, however sales early in the quarter dwarfed purchases later on, so equity exposure was reduced. I still feel that big, U.S. stocks are the best place to be in terms of return versus risk over the long-term, but with concerns about the strength of the economic recovery taking hold, it will most likely be a rough ride. Please keep in mind that these companies have growing earnings and dividends and have the best balance of cash to debt in history. What they are not doing is hiring new employees but instead are getting more output from existing workers. This is good for investors but not so good for employees or the U.S. economy.

Many stocks are inexpensive at this point, the question is why? My guess is that investors have sworn off the equity markets as too uncertain, and the most recent volatility just adds to that belief. It could also be a function of investor’s long-term concerns related to the basic functioning of our political and economic system. Whatever the case is, stocks are not without risk, but by my judgment, are the only asset class that will provide an attractive return and one that compensates for the risk undertaken.

To revisit the idea of investing in bonds, I can sum up my opinion very clearly; the expected returns do not compensate for the potential risks. Said another way, the amount that can be lost is much greater than the amount likely to be gained. This explains why I sold out of a municipal bond fund during the quarter that had provided a great return and why I expect to sell the other municipal bond fund held in accounts soon. The finances of state and local governments are a mess, with declining tax receipts and growing pension expenses combining to increase the risk that these entities will not be able to meet the promises made to bond holders.

Enclosed please find your portfolio review for the periods including the second quarter on 2010. Please feel free to contact me with questions or concerns if they arise before I have a chance to contact you. Have a great summer.

Best regards,

Peter V. Hedberg