

# TEAMThink

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By James Dailey

*"It's tough to make predictions, especially about the future."*

- Yogi Berra

## TEAM Financial Asset Management Outlook for 2010

After an uncharacteristic week off, we are happy to be back and share our outlook for 2010. We remain fairly concise in this forum, so clients can expect a more specific and expanded outlook (or sedative for their insomnia for some!) sometime in mid January.

In many respects, financial markets are not tremendously different from where they were in 2007, which is incredible given the amount of economic and market turmoil that has unfolded since then. Stocks are a little cheaper on average than they were in 2007, but have returned to levels that are likely to sentence most buy and hold stock investors to very poor returns over at least the next five to seven years— in our opinion of course.

The same could have been argued, and we did, for much of the 2004-2007 period and stocks did not seem to care! Our challenge for 2010 is to try and assess when what we believe to be very dangerous long term fundamentals begin to matter again. As 2009 ends and we turn over the calendar, we do not yet see imminent signs of a new cyclical downturn in risk assets like stocks and riskier bonds. This can change in relatively short order if conditions evolve in a certain way, but we have not observed significant evidence in this regard to date.

We expect 2010 to involve a building investor focus on a potential “exit strategy” for the US Federal Reserve, as well as central banks around the globe. There has been a vast amount of fiscal stimulus and money printed globally, and it will be a treacherous endeavor for central banks to attempt to extricate themselves, and collectively all of us, from the mess they’ve helped create. They will try to walk a fine line between having a large inflation problem develop and taking away the punch bowl too fast, which could throw us right back into a deflationary spiral.

At this point, TEAM expects the US Fed to remain extremely loose with their monetary policy, though they are likely to get aggressive rhetorically to try and keep markets orderly. We expect markets to eventually force the Fed’s hand at some point in 2010, or possibly 2011, as bond and currency markets may get disorderly.

The leading indicators for the economy from ECRI remain in positive territory, which causes us to remain confident that the economic recovery will endure at a significant pace at least through the first half of 2010. We expressed in recent months that economic growth in the 1st and 2nd quarters of 2010 could surprise many to the upside, and we continue to hold that view. There are building risks that the second half of 2010 could see the economy begin to roll over again, but that is two steps out at this point.

Ironically, TEAM believes that an economy growing faster than expected will end up being very

negative for the broad stock market at some point in the first half of 2010. It is our view that much of the revival in risk appetite amongst investors has been driven by the extremely low interest rate environment and expectation that rates will remain low for a very long time. While we expect the Fed to remain on hold for as long as possible, markets tend to lead the Fed by many months. If economic growth and jobs figures begin to come in stronger than most expect during the 1st half, then markets may adjust violently as an expectation of Fed tightening gets priced into markets. Should this occur, riskier segments of the stock market may suffer from increased risk aversion.

Two market segments we believe are positioned to endure, and possibly even benefit, during the upcoming period are high quality/high dividend blue chip stocks and commodities. There remain a number of high quality blue chip stocks selling at very cheap valuations with dividend yields ranging from 4%-6%. If markets begin to forecast higher interest rates, then these blue chip companies, which rely very little on debt for their capital requirements, may fall into favor for their perceived safety and fat dividends. The average small and mid cap stock is now trading at over twice the valuation of the kinds of blue chip stocks we are referencing, so there is quite a bit of room for this disparity to revert to historical averages.

While we may sound like a broken record to clients, our super duper absolute (our "absolute favorite idea for 2009" was early apparently) favorite theme for 2010 is higher agricultural commodity prices. Our assessment of long term fundamentals across this commodity segment remains explosive. Global inventories remain at generational lows for many of these commodities, with some like wheat trading near 100 year inflation adjusted lows. Rolling waves of parabolic moves have begun in specific ag commodities like sugar, coffee and orange juice. We believe these are likely to be the "first movers", with many others following in the coming months.

TEAM retains a very heavy allocation to commodities in general, with even heavier concentration in agriculture. With all of the portfolios we get to view, we have yet to see a single person or firm allocate any money at all to agriculture, so we are excited that we continue to build positions for clients at the ground floor of what we believe could be a historic bull market. In addition to the commodities, we are also active in identifying those businesses that are likely to benefit if agriculture prices do appreciate as we expect. Fertilizer companies remain well positioned based on this thesis, and we continue to look for opportunities in that market segment.

As we always state in our annual outlook, 2010 is likely to contain several hereto unforeseeable catalysts. This is why we try to ascertain where and when pressures have built up to a degree where explosive price moves may develop. As we've stated, developments like drought or blights could send agriculture prices sky high. Geopolitical risks remain in the forefront. Could 2010 be the year in which some kind of military action by the US or Israel versus Iran unfolds? Will Al Qaeda be able to pull off another large scale attack somewhere in the world? These kinds of developments are always unknowable, which is why we remain focused on risk management given extended valuations and widespread structural economic imbalances.

TEAM keeps these kinds of risks in mind while managing/building portfolios. For example, our general stock exposure in portfolios would obviously be in jeopardy should investors panic over geopolitical or terrorism developments. However, such events have often resulted in higher gold and oil prices, which our clients are exposed to and would help offset potential losses elsewhere. Our continued utilization of various hedging vehicles also serves as intermittent "insurance" against unforeseeable risks.

In summary, TEAM expects the economy to surprise to the upside during the first half of 2010, but for this to eventually be negative for the broader stock market. Another 5%-10% upside in the broader stock market is certainly possible, but from that point we would likely grow extremely cautious on the broader market. We expect significant volatility and fire works in global currency and interest rate markets, as central banks try to navigate the mess they continue to help create/enable. There are likely to be at least a couple of severe shocks to the global market/economic system, with there being a typically large number of potential catalysts.

Ultimately, we remain committed to executing our flexible investment strategy and focus on risk management. After an explosive recovery from the March 2009 lows, we expect dynamic risk management to come back into vogue once again by the end of 2010.

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