Trinity Financial Services, Inc.
A REGISTERED INVESTMENT ADVISER

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To: Valued Clients and Friends

Re: 2nd Quarter 2009 - Markets and Economy in Review
Is Less Bad Good, Or Just Less Bad?
Obstacles Remain – Deficits, Debt and the Dollar
USA - Still the Greatest Country in the World

## 2nd Quarter 2009 - Markets and Economy in Review

The quarter ending June 30 was a very good quarter for the markets, the best since the crisis began. Major market indices are up 30%-45% from the lows recorded March 9, and all but the DJ Industrials are in the plus column year to date. A recap of 2nd quarter and YTD performance is provided in the table below:

| Index | Return % - Qtr End 6/30/09 | YTD Return % |
|---|---|---|
| DJ Industrials | 11.0 | -3.8 |
| S&P 500 | 15.2 | 1.8 |
| Nasdaq | 20.0 | 16.4 |
| Russell 2000 Small Cap | 20.2 | 1.8 |
| S&P 400 Mid Cap | 19.1 | 9.1 |
| DJ World (xUS) | 26.0 | 11.3 |

While the financial markets have recovered nicely from the lows, the economic recession has yet to find a bottom. There is little evidence to support the recovery in the financial markets other than isolated glimpses of improvement in the economy. The rally has been entirely based on a large flow of funds back into equities hoping the end of the recession is near. So far, there are only isolated glimpses of improvement, or "green shoots" as they are being referred to, in some of the economic data. The realities of daily life remain dominated by unemployment and contracting business. Unemployment is rapidly approaching 10% is not expected to subside until early next year.

There is consensus that we have avoided a 2nd great depression. However, this recession is more severe and will linger on more than recent recessions because our entire financial system broke down. The recovery period will be slower and less robust than previous recoveries. Real recovery in terms of increasing payrolls will not occur until sometime next year, and it may take 2-3 years to return to full employment levels. The market rally has already anticipated the initial stages of economic recovery based expectations from the stimulus plan which won't kick in until later this year and into 2010. Consequently, it is questionable whether the markets will advance much further in the near future absent some hard evidence of the recession's end.

## Is Less Bad Good, Or Just Less Bad?

The index of Leading Economic Indicators (LEI), a basket of ten data components, has increased for 2 consecutive months, while Coincident and Lagging indicators remain negative. Seven of the ten LEI components are pointing up including supplier deliveries, interest rate spreads (cheaper borrowing costs), real money supply (massive government intervention), rising stock prices, consumer sentiment (???), building permits (mostly new apartment buildings), and orders for nondefense capital goods. The negative indicators include hours worked and unemployment claims. Coincident Indicators, industrial production and employment are still declining, but at a slower pace. And the main Lagging Indicator, real GDP, fell at a 5.7% annual rate in the 1st quarter, following a contraction of 6.3% in the 4th quarter of 2008.

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From an economist's vantage point, the data does not support a bottom, only a presumption that it is near. From my seat, there is not yet much to latch onto, either. The hype that spins the data and drives the financial markets is not very objective. I don't mean to be negative, but let's face it, less bad is not good, it's just less bad. When the market rallies because we only lost 345,000 jobs versus 539,000 in April it is not good news. It is less bad than before, but unemployment went up to 9.4% and will likely surpass 10% before it subsides. When manufacturing and new orders for goods and services decline at a slower rate, the result is less business, not more business. I'm paying particular attention to employment and housing data which are key elements of the economic recovery.

At the risk of being redundant about the fundamentals, 70% of our economy is based on consumer spending, and people aren't spending. If anything, consumers are saving, holding onto what they have and paying down debt. While this is healthy in the long run, is not a recipe for economic recovery in the short run. When consumers don't consume, business don't make money, and when businesses don't have a potential to increase earnings stock prices won't go higher.

**<u>Obstacles Remain – Deficits, Debt and the Dollar</u>**

At some point, employment and housing will turn around and drive economic recovery. The markets likely will jump higher well in advance the statistical evidence of real economic progress. So why not go "all in" at this point and fully embrace the recovery to come? It is tempting, but there are some serious obstacles standing in the way of economic recovery. First and foremost is deficit spending. Our current total deficit is manageable compared to the rest of the world, but projected deficit spending is off the charts according to the Congressional Budget Office. The projected budget deficit in 2009 will exceed $1.8 trillion, $1.6 trillion in 2010, and just under $1 trillion in 2010. Our total debt outstanding is projected to go from 40% of GDP in 2008 to over $10 trillion, or 70% of GDP by 2011.

> <u>How much is a trillion dollars?</u>
> *If you earned $1/second or $31,536,000/year, it would take 31,710 years to earn $1 trillion.*

We may have reached our limits on leverage. The yield on long term Treasuries has doubled in the last few months and the dollar has depreciated. Our credibility is being questioned. Many in industrialized world are calling for a new global reserve currency to replace the US dollar. The world is choking on our debt. China, the most vocal and the biggest holder US debt obligations ($763 trillion), has actually reduced its holdings of US debt in recent months. You can't really blame them. The value of their US bond portfolio is depreciating with every tick up in interest rates and tick down in the value of the US dollar. It's a real catch-22 for our trading partners like China. They need the US economy to recover and resume buying their goods. They don't want any more of our debt, but boycotting additional purchases will only stifle our recovery.

Fed Chairman Bernanke went to Capitol Hill last week and squarely laid the responsibility for managing our deficits on the Congress and the Administration. Politics aside, the urgency of dealing with the deficit is not so much the current spending as it is initiatives that will add to structural deficits in the future - on top of the existing liabilities for Social Security and Medicare down the road. These new initiatives, plus looming local and state budget crises, and underfunded public pensions (which have yet to receive any press) are real concerns and can't be presumed to be funded with more government debt. We need to get our fiscal house in order.

In the private sector, it appears that the massive spending and efforts to stabilize the financial system and ease the credit crisis are working. It is easy to criticize what has been done, but on balance, the various regulatory actions are working and the credit crisis is easing. Lending is resuming, yield spreads have normalized, and there are consistently more new debt and stock offerings coming to market. Problems do remain here and abroad. Changes in accounting rules have postponed the recognition of real losses at many financial entities. And losses in certain asset classes such as commercial real estate are just starting to surface. Problems are most severe in foreign banks where leverage was much higher than in US banking institutions, but hundreds of billions of dollars of overvalued assets remain on US bank balance sheets.

Regarding the global markets, emerging markets have produced, and likely will continue to provide superior opportunities and returns versus US equities. There is simply much stronger demand for products and growth potential overseas. That said, what is going in certain emerging markets right now is a lot of speculation and leverage (i.e. China +62.5% YTD). China, in particular, lacks transparency in its financial markets, its economic numbers are not reliable, and it is a well known fact that the government is encouraging bad lending practices in its banking system. It is trying to create internal demand and consumption to fill the void left by the US and other trading partners. But buyer beware! Speculative bubbles burst. International markets will remain very risky and are not a cure all. You just never know what's going to happen in politically immature and unstable markets. Take Russia or example. A huge country, and just a year ago a major emerging market, but now a low rated market struggling to maintain any credibility at all in the investment community. The same thing could happen in any of the lesser-developed markets. Protectionist legislation can also be a dagger in the heart of global economic recovery if countries begin yield to internal pressures and restrict international trade. Terrorism also remains a cause for concern.

In summary, economic recovery is inevitable, but there is too little evidence and too much risk to jump on the recovery boat without a life preserver. Believe it or not, I do look at the current market as an opportunity. It is just going to take some time to sort out the issues and make sure another crisis doesn't impede progress. I still believe the stock market will end of year in the plus column, and depending on what transpires, there could be a significant year-end rally. Economic recovery measured by rising employment probably happen until next year, and the recovery process will be long and slow. So for the time being, cash, caution and patience remain valuable investment tools.

**USA - Still the Greatest Country in the World**

This past Sunday, my church was blessed with a visit from a college singing troupe directed by a very talented young woman, Marissa. Marissa formerly led my church praise team and is now earning her master's degree at a small college in California. She left Wichita to spend 10 months in China teaching English and covertly spreading the Good News. She shared some of her experiences while in China. She commented that while she did not experience any personal danger, there were plenty of firsthand accounts of government reprisals against people who did not follow strict guidelines on speech and personal expressions of religion. Before going to China, received safety training including the need to encrypt email communications, and being very intentional not to use Christian slang or even refer to God in public to avoid triggering investigation by government officials surveying her communications.

I can't imagine trying to live this way. Nor can I can for one moment wear the shoes of a protestor in Iran, a citizen of N. Korea, or a woman in a Muslim nation. Newspapers are constantly filled with international headlines of the oppression of liberty and crimes against humanity. We go to extraordinary lengths to preserve our individual liberties in the USA. Freedom of speech and the presumption of innocence remain hallmarks of this great country. We have true freedom to say and do what we want each and every day. The USA is the greatest country in the world to live. I am proud to be an American and extremely grateful live here. And even though we don't deserve it, I pray God will continue to bless America. Happy Independence Day!

Please call me if you have any concerns or if you want to discuss any of these comments. Thank you for your continued trust and confidence.

Sincerely,

*Jeffrey L. Noyes*

***God grant me the serenity to accept the things I cannot change; the courage to change the things I can; and the wisdom to know the difference...Amen***