



What's New?

January 6, 2010

KEYS TO THE BEGINNING OF A RECOVERY:

1. *The Real Estate market must stabilize. If not reversing, at least not continuing to fall. **NEW HOUSING STARTS UP** this past Spring and Summer because of seasonal factors but inventory still huge! The Nationwide COMMERCIAL COLLAPSE IS JUST BEGINNING!*
2. *Unemployment must stabilize. If not reversing, at least not continuing to rise. Last report was lower! IT'S ACTUALLY WORSE as a "%," Back to near 10% - BUT IT CONTINUES TO MOUNT @ OVER 250,000+ weekly.*
3. *Corporate Earnings (profits) must stabilize. If not reversing, at least not continuing to fall. **SOME POSITIVE SIGNS** but mainly in **TECHNOLOGY.***
4. *Banks must begin to make loans again (especially to small businesses and potential home owners...albeit under ancient premises of buyers being qualified and of all things, a down-payment! Lots of "hoopla" from the mega banks, but it appears that there's no real progress. They're "hoarding" any cash they can get their hands on. And now here comes the Regional problems compounded by PRIME loan problems, Credit Card defaults and Alt-A resets!*
5. *The DOLLAR has to decline. It's started for REAL but now shows signs of strength!*
6. *Auto sales must stabilize at some NEW level. Maybe started!...but at a really low level.*
7. *The consumer must get "back in the game of consumin'" **NO WAY!***

ANALYSIS OF THE ABOVE: No Real Hope YET! -1/6/2010

2010 Outlook

Keep your Eye on the Dollar From: Lon Witter

The 2008-2009 recession was not a normal, business led recession and the recovery from this recession will not be normal either. Statistics on past recoveries from normal, business led recessions are irrelevant and misleading;

they give a false sense of security. Witter & Westlake believes the rally in world stock markets and commodities since July is the result of a dollar carry trade and the illusion of economic recovery brought about by massive stimulus programs. The current rallies in stock and commodity markets will be severely tested by the following four events that we believe are likely to occur in 2010:

1. The dollar index will rally to 78-82 causing the dollar carry trade to unwind, resulting in a 10-25% drop in world stock and commodity markets in 1-5 days (see previous update "Riding the Wave").
2. There will be at least one sovereign default. If the sovereign default is one of the financially stressed European Union countries, then markets can turn down very quickly. Treat Dubai World as the canary in the coal mine, only there will not be the United Arab Emirates to bail out the next default. No western country can risk bailing out a defaulting country; it would be political suicide for any leader to do so.
3. Unemployment will remain above 10% throughout the year. Practically all sustainable jobs are created by new small businesses less than five years old. In a recent Barrons' survey, two-thirds of small business owners said they were concerned or extremely concerned about their firms surviving for another two years. Small business bankruptcies were up 44% in the third quarter of 2009 from the same quarter in 2008. Things may look better on Wall Street, but they are not better on Main Street.
4. Almost every state will suffer a 10-20% shortfall in revenues. One of the following will be required for fiscal 2011:
 - a. Large tax increase
 - b. A substantial reduction in services resulting in the loss of at least 1,000,000 jobs nationwide (affecting teachers, policemen, firemen, utilities, garbage men, etc.).
 - c. A new federal stimulus package to bail out the states

In light of the likely occurrence of the above four events, we believe the stock market will experience below average returns in 2010.

INVESTMENT STRATEGIES

After several years of study and three years of actual trading, we are convinced that practicing daily mean reversion on a balanced portfolio (Original program), individual funds/ETF's, or a long/short combination of funds will increase returns and substantially reduce risk over a market cycle. The following is Witter & Westlake's investment strategy for 2010:

1. **Original Program**
We expect our original program to earn double digit returns if the S&P 500 is up less than 14%. Even if we are wrong and the S&P 500 is up as much

as 28%, we expect to break even or lose very little. We will practice daily mean reversion on the following funds at ProFunds to accomplish our investment goals and keep risk low:

Long Funds: Ultra Bull, Precious Metals, Oil and Gas, Emerging Market, Rising Dollar

Short Funds: Ultra Bear, China, Real Estate, International

2. Long / Short Combinations

Do the long/short combinations earn more than the Original program with less risk? Unfortunately, we still do not have a definitive answer. Most of the long/short combinations began in June. Some did better than the Original program (long/short China, long emerging market/short China) and some did slightly worse. I believe the risk is less, but can they earn double digit returns? We think so, but only time will tell.

3. Individual Funds

Investors practicing daily mean reversion on individual funds should include the rising dollar fund at ProFunds. Investors using the precious metals fund should include the short precious metals fund until the dollar carry trade has unwound or been proven to be of little consequence. Make sure short funds are included in your portfolio.

Daily mean reversion works best in average or less than average stock market years. In years with above average stock market returns, other investment styles will outperform daily mean reversion. We expect daily mean reversion programs to do well in 2010.

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All of our past Newsletters are available on our Website at:

www.fedderngroup.com

We continue to receive more and more inquiries about our Down-side Risk Management disciplines along with our group of recommended money managers. We appreciate your “referrals.” It’s the main way we continue to build our business.

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