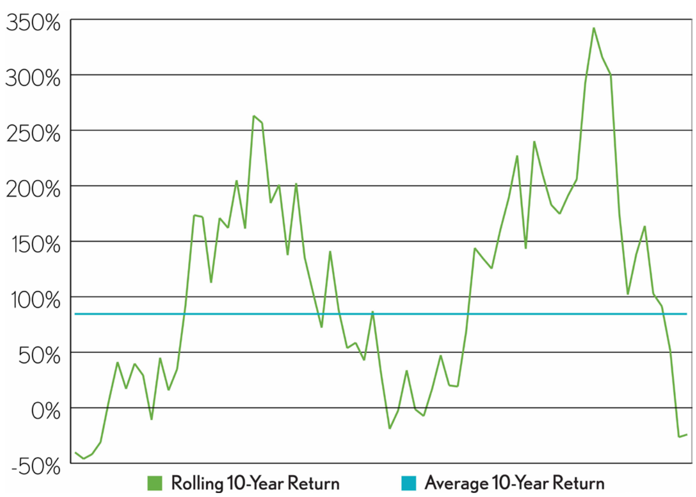
Outlook Report: 2010
Searching for the Afterparty

Introduction

With the first decade of the new millennium behind us we can only hope that this recent period is not any indicator of future periods to come. Stocks lost 9.1%, total returns on bonds were 84.8%, and housing, even after the bubble popped, was the big winner up 162%. More interesting is the 10-year returns by decade over the past 50 years and how this past decade stacks up for risk and return to the prevouis decades. Looking back since 1928, it can be seen that over the long term, markets revert to the mean. Periods when the 10-year return on equities have reached levels greater than 200% of the long term average return (say 8%), have been followed by periods of underperformance and likewise when the average return dips below zero, equity markets have tended to overperform.

Historical 10-Year Market Returns: 1928-2009



Source: Bloomberg, Astor Asset Management

Also of note are the 10-year returns of global indices in countries like China, which have emerged to lead the way and while developed countries like Germany and the U.S. lagged behind. Look no further than those countries' government and trade policies to locate the main boost for such robust equity returns.

A Look at 10-Year Returns

Index	Total Return
S&P 500 Index (Domestic Equity)	-9.10%
MSCI EAFE Index (International Equity)	12.38%
BarCap U.S. Aggregate Index (Fixed Income)	84.75%
FTSE NAREIT Composite Index (Real Estate)	161.71%
SPGS Commodity Index (Commodities)	63.69%
U.S. Dollar Index (Currency)	-23.57%

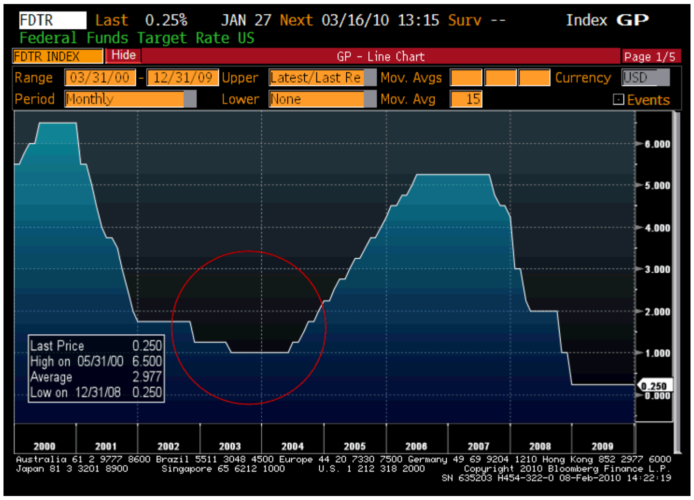
Source: Bloomberg

The Decade in Review

The S&P 500 (the broad-base measure of the largest 500 companies in the U.S.) lost 9.1% for the decade, and that includes dividends. That's almost a 1% loss per year, which is a hard pill to swallow for many when the average annual return for stocks prior to this decade was almost 8.5% annually. The technology-laden NASDAQ 100 Index, which led us into the new millennium with a plethora of promises, lost 48.2% over the same period.

The year 2000 began with a 6.35% yield on the 10-Year Treasury Index. The first quarter was the highest reading of the period, with an orderly trend lower over the next ten years. With a recession marking the early 2000's, ten-year yields moved down to 3% in March 2003 as the recession ended. Fed Funds target rates mirrored this move for the most part as the FOMC raised rates 100 basis points to 6.5% to begin 2000. As the equity markets imploded on irrational exuberance, the FOMC cut rates by 550 basis points to 1.00% (see chart below). The Fed Funds rate stayed under 2% for almost 3 years in what many point to as one of the catalysts of the next asset bubble and the credit nightmare that ensued nearly three years later.

Fed Funds Target Rate



Source: Bloomberg

There were some major beneficiaries and casualties resulting from the liquidity crisis of the 2000's. As we know, real estate was cause and effect in 2007 and 2008. Markets around the world were unable to avoid the full-scale collapse of the financial system, due in large part to the credit excesses of the U.S. and Europe, among other places. The liquidity shock saw a large shift in the correlations between asset classes as investors achieved liquidity where they could find it.

While the carnage of the latest recession spread worldwide and everyone had their share of the losses, some countries fared much better over the last 10 years than the U.S. China, who has been credited to some extent in helping to stimulate the world out of this recession, turned in a modest return of 4.8% with dividends over the decade, measured by the Hang Seng Index (Hong Kong). The Shanghai Composite Index, another measure of Chinese stocks, rose a more robust 159%. On another developing continent, the MSCI Australia Index grew by 250% from 12/31/99 to the 12/31/09, despite losses of 63% from 10/07-2/09.

Even investors in the REIT (Real Estate Investment Trust) complex fared much better this past decade than equity investors. Even as the real estate market imploded in 2007-2008, The NAREIT All REIT Index returned 165% for the decade, despite a drop of 67% from 2/07-2/09.

A Brief Look Back

2009 was clearly the recovery year with panic fueling market declines of over 20% during the first quarter as investors ran for cover to raise cash. With many of the previously actively traded market instruments suddenly suffering from lack of liquidity, the stock market offered one of the few investments that would yield cash within three days of selling a stock. That kind of liquidity came at a price (some 20%+) to get your cash. That liquidity panic of Q1 2009 most likely created a level we will not see again, possibly ever. Ironically, it is that panic that helped create the ensuing bull market. Well, that along with improving economic data, easy money and the proverbial wall of worry. Furthermore, that first quarter panic will most likely prevent the market from returning to those multi-year lows as many investors who sold are unlikely to return until it is too late. The amount of selling that occurred in a state of irrationality created an overshoot based on the possibility of the entire financial system crumbling, which we now know is not going to happen anytime soon.

2009 had some economic highlights to go along with the equity headlines. Positive growth returned in the form of higher GDP. Q3 came in at 2.2% and Q4 GDP has been reported over 5%, and those numbers are more reminiscent of past recoveries. Monthly job losses, which once averaged over 700K per month at the height of the panic, showed gains in the November report before slipping back to a mild loss of 84K for December with the average change over the past three months around -30K, which is statistically flat. The trend for revisions to economic data is now established clearly to the upside. Also of note is that the uber-important barometer of economic health and investor confidence, the stock market. The S&P gained over 25% while other broad averages gained anywhere from 20%-40%. So 2009 proved to be a surprise to the upside as the markets outpaced the true economic fundamentals as government intervention and stimulus had its greatest impact on financial markets. Not to toot our own horn, but we said something like that could happen in last year's 2009 Outlook Report.

Where We Are Now

While the job numbers indicate that companies have stopped the mass layoffs, they are still exhibiting a lack of new hiring. In light of the calmer environment, credit is flowing better than a year ago as some of the 'trust' has returned to the system. As with all recessions, one positive is that the weak and weary are wiped out of the system, giving the economy a fresh start. Again, the market produced 25%+ returns for the year, creating over $2.5 Trillion (with a 'T') of new wealth. That is actual money you can get now and it is worth noting that it is actually more then the dollars spent to-date on the stimulus, bail-outs, and healthcare reform combined. This money will find its way into the economy over the following years and act as the best stimulous imaginable.

When asked where we are now (usually in reference to our strategy to identify the current phase of the economic cycle), we must clarify something before answering. The economy has been experiencing two recessions simultaneously: (1) the traditional inventory/employment cycle recession and (2) the rarer credit-bust recession. The inventory employment recession ended some time in 2009 and employment and GDP data have confirmed that. However, the credit bust recession is not over and is not likely to end anytime soon. The credit bust will only trough, like an inventory recession, when the excess credit is drained from the system. Reducing credit from the system occurs in two forms, either its paid down or it ends in default. Either of these solutions will be a drag on the economy.

So the economy improved and so did the markets as one recession ended and another lingered. Let us look ahead and see how things shape up for 2010.

Outlook 2010: Searching for the Afterparty

While we said 2009 would surprise on the upside, 2010, if you are not in the right sectors and markets, will likely bore you to tears. It will be like watching paint dry. We think it will be an up year for the market but only in the high single digits as volatility decreases. However, as Churchill once said, "if things change I may change my mind." It is possible to have a small down year with little meaning to the overall economy or the longer-term outlook for the markets. The relatively low return we are looking for this year after 2009's explosive rally could easily slip into negative territory as part of normal market fluctuations but we would be surprised if declines were deep or long-lasting. Although the economy is improving it is doing so at a very muted pace, and we have come a long way in a short time and a pause year would not seem so unlikely. The headwinds will eventually cap the rally of 2009 at least until the economy goes from recovery mode to full on expansion. This ying and yang will cause brief periods of market weakness to scare investors to run for cover but will most likely not amount to much. There will also be periods of euphoria and the fear of missing another rally like 2009 but those will eventually be capped by the reality of the deleveraging of the credit cycle and the head winds hat will create. The result will be a boring year of déjà vu each month as price levels will tend to repeat. Every price will most likely trade twice, if not three times.

Its a Mad, Mad World

As we travel around and discuss the issues of the day and how they affect our outlook, the anger level of those out there is remarkable. Yes, anger. Investors are angry, at everyone. It is possible they are angry at themselves, but we will leave that to the therapists. Most of the outlooks are incredibly pessimistic, and while some are encouraging, they are definitely in the minority (probably another good reason to be positive).

More notable are the concerns of the angry people and how their view of the economy do not line up with reality. The things that they are worried about are not the things that will cause the outcome they fear. To quote another one of the world's gifted linguists, Mark Twain, "today is the tomorrow we worried about yesterday," certainly applies here. Amidst all this worry, however, there is one correlation we do see. The more damaged from the credit crises and recession the more pessimistic is one's outlook. Those that made the 'halftime adjustments' survived and even profited on the market's landscape, and they are the ones most optimistic.

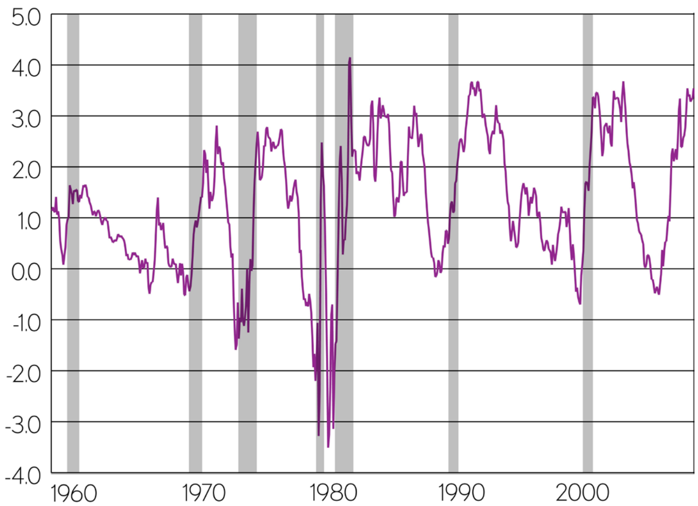
Yes, there are problems out there and we need to be realistic as many will be headwinds on the economy and the market. But we need to be rational and drill into the data and get to the root cause and eventual effect. For example, we stated last year that the markets are likely to outperform the economy. The reason is that the markets anticipate a recovery and that intervention in these markets was likely going to support the market regardless of the fundamentals. For 2010 we think the markets will mirror the economy if not slightly underperform. The question then is: how much additional acceleration does the economy need to propel the market from these levels? Fortunately, our analysis of economic cycles (expansion, peak, contraction, trough) gives us great tools to identify the areas of potential growth. We feel confident that we will be able to identify the areas that are accelerating and continuing to grow, and thus be able to create portfolios that will thrive regardless of overall market direction. We will continue to watch employment trends and out put trends of individual sectors for clues.

For 2010, the direction of the economy is no longer down and neither is that the direction for the markets. The $14.5 Trillion economy and $12 Trillion equity markets have reestablished upside momentum and will generally stay in the same direction until something like an economic cycle shift occurs, aside from some late market-cycle volatility. Of course markets fluctuate and down periods will occur, it just seems that they will be more normalized declines that you can sit through. After all, a scraped knee feels better than a gunshot wound.

While we are focused on the encouraging signs, our data has not fully turned positive, meaning that this is not an all-out expansion yet, just a recovery from some really dark economic times. Therefore, we do remain cautious for 2010. The recovery can, and we expect will, turn into an expansion, but it can also turn back unto a contraction. Until the new cycle becomes evidently clear we will have some defensive and non-correlating positions in the portfolio.

The Yield Curve

Treasury Spread and Recession Dates
10-Year Treasury Bond vs 3-Month Treasury Bill



Source: Bloomberg, NBER

A positive note for 2010 is the shape of the yield curve. Positive yield curves generally point to better economic times ahead and inverted ones precede trouble. Look no further than our two most recent examples: in 2000 and 2001 the yield curve was inverted and was a precursor to the NASDAQ-led recession, and, once again, for most of 2006 and 2007 the curve stayed inverted and led us into the financial collapse. Most recently in that last period, it got to the point where we wrote that the yield curve phenomena either does not exist anymore or we were in for a really wicked downturn. Clearly, we got the latter of the two. Now the yield curve is positive and the spread between the 2-year and 10-year is as wide as it has ever been. Once again, we will state that either this does not matter anymore, as we are just regressing to the mean, or that we are going to have one very big expansion. We are banking on the latter, we just don't know when.

So the test will be to see if the so-called artificially, supported markets and economy eventually catch on to the private sector who can then carry the torch. That will be the big question for 2010 (and beyond). As we have stated many times its all about growth: if we grow out of this we will be okay and if we do not grow, we will not. It looks apparent that the 'artificial' stimuli will be around until we do start to grow, which appears to be the right policy to be following.

Unemployment

One of the most devastating bi-products of any recession are job losses. As we mentioned, recessions occur when businesses become overly optimistic about the future and hire too many workers and build too much inventory, resulting in surpluses that are reduced by laying-off workers and reducing inventory levels. In fact, companies will continue to reduce their payrolls and inventories until they either become profitable or go out of business. At the inflection point, the profitability per worker becomes positive and companies are incentivized to hire more workers with the profits. But at this inflection point worker productivity is very high and so is profitability per worker. With the Q4 2009 GDP report showing huge gains and the payroll numbers stabilizing, it is clear that the economy produced more output with fewer workers. That is a very productive situation and very good for the long-term outlook of the economy. In fact, trying to force more jobs and hiring without letting the new profits add up might not be the best idea for a sustainable economic recovery, but we will keep that politically incorrect view to ourselves for now.

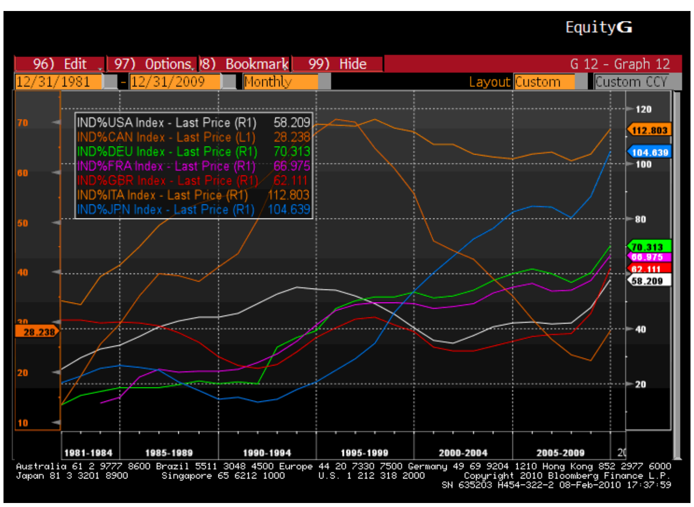
The Foundation is Set

We believe the economy is self correcting and periods of exceptional growth are followed by periods of lower growth. However, even in the midst of the darkest recession, economic activity still exists. It is this activity that eventually becomes the foundation for the next recovery. From home purchases to business expansions, the deals that are getting done these days (and most of last year) are the ones with real economic value. Imagine buying a house today. You are probably getting a very good deal and feel confident that the value will appreciate from these levels in the future. The lender probably feels good about your loan and your ability to repay the loan at these levels of interest. Your financial state and down payment are probably in good shape if you are buying a house today and getting a loan. The result is a good deal for all involved. The same is true for businesses that are expanding in this environment. They probably support their expansion from internal growth and if they are expanding in this environment they will most likely be able to thrive. These examples are how a very strong foundation is being built, one that will most likely survive the next contraction, but more importantly will thrive in the next expansion. This will be a jumping off point for future growth.

The Big Scary Numbers: Debt, Deficits and GDP

The debt numbers, while quite large, are not the problem one might think at first look. The interest payments are a mere 1.3% of GDP, the lowest in 50 years. Although it must be acknowledged that interest rates are as low as they have been in 50 years and the average maturity is less than 5 years. Furthermore, I am aware that interest rate will most likely rise when the debt is rolled over. But in the meantime we can afford the debt. If we can grow, the rise in the interest rate might be offset by the growth. While the most recently submitted budget hit a record of $1.9 Trillion you need to realize that GDP increased by almost $1 Trillion (annualized) to $14.5 Trillion and the stock market appreciated $2.5 Trillion last year alone. If we are going to worry about the debt we need to also consider the equity. A comparison of net federal debt as a percentage of national GDP across countries (see the chart below) shows that the ratio in the U.S. of debt to GDP is hardly one of the worst among other developed nations, and in an historical context is not widely beyond what we have seen before. Also, it is important to keep in mind that GDP has declined for six quarters, making the denominator smaller when calculating this ratio. That is unlikely to continue.

Government Debt as Percent of GDP



Source: Bloomberg

Also of note are the largest holders of U.S. debt. As you can see from the chart below, we primarily owe this debt to ourselves. That's right to ourselves not foreigners. It is true that foreigners, especially China and Japan own U.S. debt and a growing percentage at that, but the vast majority of the debt is owed to domestic investors, equaling over $8 Trillion of the total U.S. Treasury debt, making U.S. citizens and institutions the largest holder of our own debt by far.

Largest Holders of U.S. Debt

Holder	Billions
Federal Reserve and U.S. Intragovernmental Holdings	$5,127
Other Investors	$1,114
China (Mainland)	$789.6
Japan	$757.3
Mutual Funds	$694.5
State and Local Governments	$528.3
Pension Funds	$490.2
United Kingdom	$277.5
Oil Exporters	$187.7
Caribbean Banking Centers	$179.8
Insurance Companies	$162.2
Brazil	$157.1
Hong Kong	$146.2
Depository Institutions	$145.4
Russia	$128.1

Source: CNBC.com (U.S. Treasury, U.S. Federal Reserve, U.S. Office of Debt Management)

The Headwinds

The true headwind is the private sector debt. Private sector debt hit a high of $43 Trillion while the Federal Reserve's balance sheet has ballooned to $3 Trillion dollars and the national debt increased to $11.5 Trillion. But that all pales in comparison to the private debt of 10 times the Federal Reserve's balance sheet and 4 times the national debt. To put this in perspective, GDP is $14.5 Trillion and that is for one year. Consumer spending accounts for 70% of GDP and much of the $14.5 Trillion GDP comes from the borrowed money in the private sector. While the solution to the credit bubble is a reduction in debt (mostly private sector debt) it will clearly be a drag on GDP. Wiping out the entire national debt (the debt we currently can afford) would be only a 20% reduction in private sector debt. To get to sustainable levels where we can have above-trend growth, we estimate that private debt levels need to be reduced by 50%. This will be a drag on the economy and markets for the next few years. Fortunately, the growth over these years will be strong enough to prevail over the headwinds of the reduction in debt.

This all sounds scary and a picture can be painted to connect the dots to forecast the end of the financial system, but as we remember the teachings of the great economist Adam Smith we can be certain that the financial system and the economy will endure.

Adam Smith Revisited

The necessary tenants that support a positively sloped growing capitalist economy have been damaged, but they do still exist. And when we summon the great economist and philosopher of the 18th century we are encouraged that we will eventually get the great recession of 2008 behind us and that what we learn and how we behave will be different and productive for the future. To paraphrase Mr. Smith, if the following three principals exist a capitalist economy can thrive:

(1) Division of Labor: You can milk the cow and I can grow the corn or someone makes the engine and someone else makes the chassis.

(2) Work for Profit: We can hire someone to install the tires or build the barn who can be compensated and motivated by profit.

(3) Free Exchange/Trade: I can trade the milk for the corn that we can complete projects by exchanging resources, goods, and services.

So even though Mario has fallen back a few levels (whaa whaa wahh) the game is still on. We will survive, then grow, and maybe even reach a warp zone where we can make up some lost ground in a hurry.

The comments ahead break down some of the sectors in 2010 and address some of the economic data points that seem to be of concern and see what they are really saying.

Gold

Many find it hard to believe that the S&P and NASDAQ returned more to investors then gold during 2009, even after the year many investors were seeking safer harbors than stocks, even after inflation fears ran rampant. As an inflation hedge gold has historically underperformed inflation. It is funny to note that this past decade was one of the lowest decades for inflation but one of the better decades for gold in recent memory. Historically, stocks have a much better record for beating inflation than gold, the past decade not withstanding. It is hard to poke fun as gold has done well the past few years and we were fortunate enough to have gold overweighted in the portfolio for most of the past three years. However, we are mindful of the long-range returns of gold and its role in the global economy. When gold has a low or no correlation to equities, we can rationalize adding to a portfolio. But on its own merits, with the exception of momentum-based speculation, it is very hard to get behind a meaningful position in gold. It is not the world currency and we suggest that if we ever had a meaningful global currency meltdown gold would get clobbered. It would be the classic "buy the rumor sell the fact." Central banks, who own a nice chunk of the shiny yellow metal, would be selling gold, so would the gold bugs because they would need things like oil, food, and real "money" to sustain. The fool could even be the one who is left holding gold as no one is set up to accept gold for payments. It can be argued it would be a hedge until the day arrived, but head for the door if it does. All that said, we don't think gold catches up over the next few years, in fact it probably loses ground. Maybe when you can pay your rent or mortgage with gold or when the ATM asks if you want $10's, $20's, or gold bars we might rethink this. But for now, when the movement of gold correlates this highly with stocks, we would rather own stocks. Also, there are plenty of metals with intrinsic value due to their specific uses with regards to economic relevance that we would rather own, like copper or silver. These metals are likely to appreciate if gold appreciates as well, and they have a more attractive correlation to equities.

Bonds

Believe it or not, U.S. Treasury notes and bonds have been in a 25-year bull market, dating back to when the Federal Reserve chairman Paul Volcker began unwinding the massive rate hikes that were instituted to combat inflation.

It is safe to say that run is over. However, we would not be too fast to jump on the higher rate/lower bond bandwagon just yet, much beyond what we call a more normalized interest rate environment.

Although many believe the Fed controls rates, the reality is they only (sort of) control the Fed Funds Rate and the discount rate. Most rates are determined by the marketplace and the demand for money. Interest rates are like prices for people wanting to borrow or loan money. Demand for money currently is actually quite low these days, supporting the notion of low rates and any move up we see in the 10 or 30-year have been a more normalizing of the curve after muddling through a credit panic.

The yield curve is the steepest it has been in years, and this is usually evident during the early stages of a recovery. The yield curve is set up to favor banks right now (borrow cheap and lend higher) and help them shore up their balance sheets. As many consumers have seen also, credit card lenders have begun to raise the APR charged on most/all client balances. This will curb over-borrowing, force consumers to pay down debt, but unfortunately it will hurt those that are without jobs at this point as their monthly payments have just gone up.

As the credit markets thawed during 2009, the U.S. high yield market saw the largest issuance of bonds in over a decade at over $157 Billion as pent up demand hit the market early in the year. As the economy stabilized throughout the year and the hint of rising rates passed through the markets, issuers hit the windows at the highest rate in Q4 since Q3 of 2007. Banks issued the largest amount of debt since 1998. While rates are expected to say somewhat tame for a while, further issuances are expected in the corporate market early this year. Investors have taken advantage of this market for yield as savings and interest bearing accounts have paid next to nothing. More supply and a sudden jump in short-term rates would no doubt put pressure on this market. Until this occurs, the attractive yields of 5%+ in the high grade markets and 10%+ in the high yield markets will keep investors' attention, especially for those not willing to commit further down the capital structure to equities.

Inflation

Many people we talk to are expecting inflation as a matter of fact as a result of all the liquidity that has been injected into the financial system. We get asked all the time, when is inflation going to arrive? As if once we proclaim it coming, it will be here. One of the biggest misconceptions of the government spending plans and liquidity injections into the market is that it will result in runaway inflation. When we have needed the liquidity to shore up bank balance sheets and stop the bleeding economic wounds, the easy money will not have the same effect as it has other times. Furthermore, looking at the velocity of money supports this theory even more, where in 'normalized' periods of economic growth, for every dollar lent, five dollars typically gets spent. Nowadays, for every dollar lent only 60 cents gets spent. Another issue regarding the onset of inflation pertains to the weak employment numbers and the productivity/capacity utilization numbers that corporations are currently enjoying. Monthly wage growth stands at just over 2.0%, the weakest in five years. With less money making it to consumers' pockets, there is little chance the pricing power is even close to being where we need to be concerned about having portfolio inflation hedges in 2010.

The Dollar

Longtime the subject of pundits concerned about the government's efforts, or oftentimes the butt of currency jokes, the greenback appears to be turning a corner. With sizeable deficits (and growing) and rates as low as possible to stimulate growth, it was clear why investors wanted to have little to do with the dollar. But as it is still the world's reserve currency (no revisiting of the gold standard is coming soon), the dollar gets flows in times of weakness and worry. As we see 2010 being the year where volatility returns and equity markets suffer at times, the dollar will be a nice safe haven for those who are looking to diversify away from some of the risky sovereign debt that exists overseas. Politically speaking (and we try not to take any sides when it comes to Washington), the massive stimulus spending looks to be wound down this year and the Fed's balance sheet should contract towards year-end. Mix in some higher market interest rates and you have a recipe for the dollar to appreciate in 2010.

Additionally, a strong economy has often been associated with a strong currency. Lastly, we are a net importer, hence the trade deficit of $40.2 Billion, meaning that the net effect of a weak dollar will hurt, rather than help, the economy overall. Therefore, a stronger economy and a stronger dollar go hand-in-hand...eventually.

Real Estate

As we mentioned earlier, real estate had once been the hottest thing to hit the investment world and quickly has become the ghost town for investment dollars as defaults and tight budgets dried up the thirst for risky asset plays. As with most asset bubbles, once real estate became too economically relevant – whether it was putting just a few percent down on a secondary purchase that once rates reset one could not possibly afford, or chopping off a piece of your house to get cash at the bank (yes, there were commercials that illustrated this), the mass exit from this sector became not a question of "if" but "when." While it may be soothing to learn that even our smartest economic minds did not foresee such a real estate collapse being possible, one could look within the employment and output numbers of the sector to see how over the last few years real estate hit its peak and slide down the steep side of the mountain. While we have been able to participate in the real estate "boom" via some focused ETFs in the sector, the most important thing for us was to miss the "bust." With so much negativity surrounding the sector in the near future, whether it is commercial real estate (which is a problem, but not one the size of residential housing), or the option-arm resets that accelerate in a rising rate environment in the next two years, there could actually be an opportunity to gather real estate yet again in a portfolio. The trick this time will be that due to more responsible lending (and borrowing), the expectations of any upswing that the sector participates in will have to be somewhat tempered. However, real estate has always been a game of patience, and you will need a lot of it this time around.

Financials

Typically in the real estate section we could address financial conditions and cover our thoughts on the banks, etc., but certainly after all that this sector has been through, it deserves its own section this year. After a wild plunge down in the credit crisis of 2008, financials went mini-boom in 2009 as government intervention, less competition, and really a forestalling of economic panic allowed cooler heads to prevail and dispel any notions of major bank nationalization, which would have wiped out common equity shareholders. Now in 2010, just as the financials began hiring again for the first time since mid-2007, we have seen the sector itself in flux again, with Washington's "war on the banks" (not our label, but one we have heard many times) putting some of the recent gains in financials very much in jeopardy. This has to do with several things, but mostly in the form of additional regulation and taxes that will be imposed, which will change their businesses with respect to profitability. There also seems to be a lack of lending in the system, whether it is loan demand or loan availability, which impacts future profits. A normalizing yield curve will help, as banks borrow short and lend long, but one has to wonder which banks will exactly be the ones lucky enough to lend. The candidates for this actually seem to be the regional banks, with fewer effects from the derivatives blowup and from the commercial real estate slump, their balance sheets are cleaner and they will be rewarded for this by being allowed to do what they do best – run their businesses to turn a profit.

Emerging Markets

If one question has been brought to the forefront over the past 24 months, it is whether the developing nations can independently operate from the global economy and the larger, developed nations. As the financial markets raced to their lows in 2008 and again in early 2009, the emerging markets, specifically Brazil, Russia, India and China (the BRICs) toppled further than the developing nations, and were highly correlated. Much of this was, however, due to the deterioration of commodity prices across the globe. China, as a major consumer, and Brazil and Russia, as major producers, were all hurt by the global slowdown. As we saw in 2009, China held the torch for the global stabilization, which may not have happened without their efforts. Equity indices in Brazil quietly tacked on 113% in 2009 and ended the two year span positive. With banking systems much less advanced than Europe and the US, they fortuitously avoided much of the overhang that brought down the giants.

Heading into 2010, the big question is, will China act to slow down its growth too much and hamper a global economy that struggles to get back to health? The housing market in China appears to be a looming bubble by many accounts, but the nation continues on its path. China is creating a new middle class the size of France every year, therefore, an actually bubble is a long way off, if it even ever happens. Brazil and other developing nations maintain healthier government balance sheets than the developed markets, which should benefit the country in the event of a staggering global recovery. The effects of the commodity price run-up on Chinese stimulus will need to be observed carefully, as in all resource consuming nations. Much of the run-up in stock prices was on a reflationary bet to the economy, but like the prospects and diversification of these markets. The sensitivity to commodity prices and inflationary aspects will present volatility as we move deeper into the year.

Conclusion

We titled the 2010 outlook "Searching for the Afterparty" because we do feel that one will exist, but not at the same scene as 2009, and with expectations that gains both domestically and abroad will be harder to find in the new year than they were just a year ago. The market's sickening panic and robust recovery more than suggest a normalizing of return percentages closer to historical norms (which are still single digit positive) with certain areas outperforming others. We also caution those who did not learn the valuable lesson of the early 2000's, where those stocks, sectors, and styles that were nearly obliterated in the recession did not come back with much gusto in the next expansion. While some areas that 'survived' the last recession have thrived, those that needed little survival skills in the last recession appear most ready to continue to move forward. As we have discussed, finding those specific areas and strategies will be somewhat politically influenced, but ultimately will lie within the economic data as it pertains to the prevailing economic cycle. We will continue to drift portfolio positioning to areas that are showing hiring and above-average output, with close attention paid to return profiles via standard deviation and correlation.

ABOUT THE MANAGERS

Robert N. Stein, Senior Portfolio Manager

Rob Stein began his career in 1983 as a project analyst for the Federal Reserve, at that time under the chairmanship of Paul Volker. From there, he went on to hold senior trading or portfolio management positions with Bank of America, Harris Bank and Continental Bank. Mr. Stein also served as the Managing Director of Proprietary Trading at Barclay's Bank PLC in 1991. Mr. Stein formed Astor Financial, Inc., an investment and brokerage firm, in 1994, and formed Astor Asset Management, LLC, a division of Astor Financial, in 2001. Mr. Stein is the author of several books including the recently released The Bull Inside the Bear: Finding New Investment Opportunities in Today's Fast-Changing Financial Markets (John Wiley & Sons).

Scott D. Martin, Co-Portfolio Manager

Scott Martin is integral to the management and investment decisions of Astor's fee-based investment portfolios, and also handles new advisory relationships. He is a contributor to Fox Business Network and a former columnist with TheStreet.com. Mr. Martin graduated in Economics and French from Denison University, and began his career in the financial industry with TD Waterhouse. He holds the series 3, 7, 63, 65, as well as life and health insurance licenses.

Bryan M. Novak, Co-Portfolio Manager

Bryan Novak is responsible for assisting in all money management decisions made by Astor and oversees the trading operations for Astor Partners, LLC. He was formerly a trader for Second City Trading, LLC, an equity option market-making firm, at the Chicago Board Options Exchange. Mr. Novak graduated in Financial Management from Ohio State University. He holds the series 3 and 65 licenses and is a Level II CFA candidate.