

After enormously volatile—though ultimately stellar returns in 2009, we began 2010 on somewhat shaky footing. Investor concerns ran the gamut. Would we experience high US inflation as a result of massive infusions of cash by the Fed? Or would the Fed's action fail to stimulate the economy resulting in further deflation of asset prices? Would we EVER see anything close to full employment in our life times? How would we possibly repay our soaring domestic government debt? Could the weakness of European governments lead to a second liquidity crisis? Would emerging countries find a way to temper their own economies as the developed countries tried to stoke a fire under theirs? The possible surprises were as unpleasant as they were numerous.



However, the biggest surprise of 2010 is that *none* of these lurking dangers kept the economy from continuing its gradual improvement. We concede that the progress has been modest and has a long way to go before its effects are broadly felt, but the trend is solidly in place. We view the market's strength in the face of such uncertainty as very positive and are adjusting portfolios to take advantage of it. Nonetheless, we have not forgotten the lessons of 2008. So, as we shift asset allocations to increase growth opportunities, we will keep an eye on sources of risk and the fragility of global financial landscape. This means continued emphasis on quality stocks with strong fundamentals, selective exposure to emerging markets through stocks and bonds, and decreasing exposure to US bonds especially longer term maturities.

The US stock market, which always moves in fits and starts, was undecided as to the implications of our country's economic progress until the first week of September. The market's return to that point had been zero for the year. After that, with a bit of confidence in economic stability and a boost up from the Fed, investors finally became comfortable with risk again. Thus, in the ensuing three and a half months, the market booked all of its gains for the year. Oddly, despite their experiences in 2008, investors went right for higher risk stocks causing this asset class to outpace the market as a whole. Bonds, on the other hand, lost a fair amount of ground. Investment grade corporate bonds, either in protest to Quantitative Easing or in recognition of a stronger economy, lost about three percent. Municipals, amid worries of deteriorating state finances and an onslaught of new supply, dropped twice that much, giving up all their gains from earlier in the year. We are just now beginning to see buying in municipals swing back toward the center as the overreaction begins to correct itself.



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## SEASCAPE NAVIGATOR *January 2011*

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Our clients' portfolios by and large met their overriding goal of achieving competitive risk-adjusted returns. We accomplished this while providing a steady stream of income to enhance portfolio values when growth was scarce.

If you wish to examine your own portfolio to insure you are meeting your critical personal goals, we invite you to contact us.

Warmest regards,

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