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Asset Allocation for the Global Client January 2010

Outlook Q1 2010

Yikes ! They are building the world's tallest building !

The next time you see someone announce that they are breaking ground on the next tallest building in the world, find out the completion date and mark it on your calendar as the end of the economic expansion. The odds are high, as the completion of 9 out of the last 10 tallest buildings punctuated the peak of the business cycle (see table on page 2). The skyscraper Index ,aply named by Andrew Lawrence when he did the research, shows a high correlation between these massive buildings and business cycles. This makes some sense when you consider that the only time people can get the money to build a "tallest building" is during the easy money times of an expansion. The buildings take years to build and by the time they are finished so is the business cycle. The dates for the expansions peak and the tallest building completions for the last 100 years can be found on page 2.

We have been through many business cycles and the cycles appear to be driven by human nature . Our economy leaps forward as companies grow and add jobs and people have more money to spend and on goes the expansion. Then we get over extended, assets deflate and credit dries up, so down we go. We know the drill and yet each cycle, everybody seems surprised.

Why is it important to know that these trophy buildings correlate with business cycles? It is interesting from the timing standpoint, but more importantly, it is a very tall reminder that our economy booms and busts. We tend to forget the busts during the boom times and we think things will never get better during the recessions, like we are right now. We need these tall reminders now more than ever as it appears the expansions are getting longer (see page 3).



New skyscrapers are a good indicator of the end of an economic expansion!

So while we don't know exactly when, the one thing we can be sure of is that this recession will end and an expansion is on the way! Then you know what to do when they announce that next really tall building is under construction.

T. Rehberger

What's ahead for 2010

The U.S. economy is expected to grow by a respectable 3% in 2010, according to a consensus of economists who are polled on a regular basis by *The Wall Street Journal*.¹What else do experts think will happen in 2010? Here's a roundup of what's scheduled, expected, and predicted.

The Recession

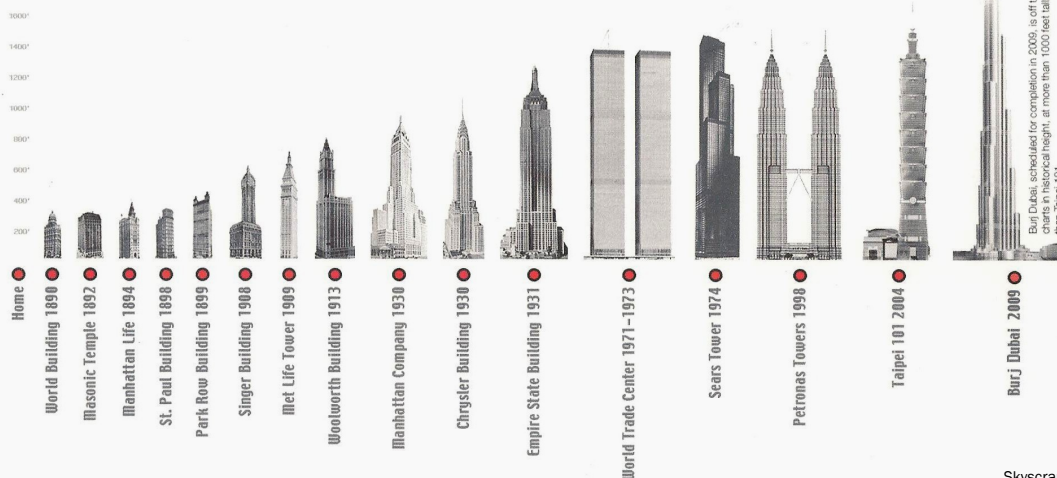
Something most people will be looking for in 2010 is the end of the economic recession that began in December 2007. The average duration of each U.S. recession that has ended since 1945 was about 10 months, although the longest was 16 months.² That would make the end of the current recession long overdue by historical standards.

But don't hold your breath waiting to hear that the recession is over: In the past, the National Bureau of Economic Research, the nation's official recession timekeeper, has taken an average of 15 months after a recession is over before it makes a pronouncement to that effect.³

Unemployment

Few economic indicators are more important or more visible to Americans than the unemployment rate. As long as it remains above the 5% to 6% range, any economic recovery might not feel like much of a recovery at all. And yet, the job market is expected to remain bleak.

WORLD'S TALLEST TOWERS: TIMELINE OF ALL SKYSCRAPERS HOLDING THE TITLE OF TALLEST BUILDING IN THE WORLD FROM 1890 TO THE PRESENT



Skyscraper.org



The Burj Dubai now the world's tallest building just completed in a recession!

Table 1 tallest buildings completion date and the end of the expansion

Building	Year Finished	Expansion Ended*	Building—continued	Year Finished	Expansion Ended*
World Building	1890	1890	Manhattan Co	1930	1929
Masonic Temple	1892	1893	Chrysler Bldg	1930	1929
Manhattan Life	1894	1895	Empire state	1931	1929
St. Paul Building	1898	1899	World Trade Center	1973	1973
Park Row Building	1899	1899	Sears Tower	1974	1973
Singer Building	1908	1910	Petronas Towers	1998**off	2001
Met Life Tower	1909	1910	Taipei 101	2004	2001
Woolworth building	1913	1913	Burj Dubai	2010	2007

What's ahead—continued from page 1

*source NBER

In *The Wall Street Journal's* December 2009 economic forecasting survey of 51 economists, the average forecast was for a 9.6% national unemployment rate by December 2010. Just four of the 51 economists surveyed expected the unemployment rate to dip below 9% by then.⁵

Taxes: Income, Capital Gains, Dividends, Inheritances

A bundle of favorable federal tax laws that were passed in 2001 and 2003 are scheduled to expire after December 31, 2010. If Congress takes no action to extend these tax laws, we can expect higher tax rates on income (up to 39.6% from the current top rate of 35%), long-term capital gains (up to 20% from the current 15% rate), dividends (up to 39.6% from the current 15% rate), and inheritances (0% in 2010 but then up to 55% in 2011 on estates larger than \$1 million).

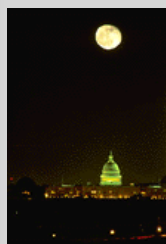
Given that 2010 is an election year, taxes are going to be a touchy topic. Because tax rates are slated to rise automatically in 2011, the debate could take an unusual direction. Proponents of higher taxes will need only to scuttle any new legislation to extend the lower rates, while low-tax proponents will have to muster the political will to pass tax cuts despite the fact that the federal government is facing a huge national debt and growing obligations to entitlement programs such as Social Security, Medicare, and federal employee pensions.

1, 4) *The Wall Street Journal* Economic Forecasting Survey, December 2009 2, 3) National Bureau of Economic Research, 2008 5) *The Wall Street Journal*, December 11, 2009 6, 7) Yahoo! Finance, 2009. Dow Jones Industrial Average for the period 10/1/2008 to 12/14/2009. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is no guarantee of future results.

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“The best way to predict the future is to create it!”

- Peter Drucker



Taxes are going to be a touchy topic

Current Allocations

The stimulus, tarp and monetary policy have done a great job of blunting the downward force of the recession. The stock market has snapped back to an overbought, overvalued position which puts us at a very low exposure to equities.

Low interest rates and deflation concerns have weakened the dollar and caused people to move to the short term maturities. Low interest rates make bond funds a bad investment with concerns over rising rates in the future. The recovery remains fragile and increases asset risk.

Yet even with deflation concerns gold and oil remain

strong. This sounds like a developing problem if inflation kicks in. See managed futures.

In the last letter, I stressed that small business problems would need to be addressed and while the rhetoric is high little is being done.

The investment landscape is very difficult, so remain defensive. Short term traders may take positions, medium to long term investors should lower exposure to equities. There is a chance that equities are forming a bubble.

Here are the allocations

Equities
US low exposure

T. Rehberger

Foreign low exposure
Fixed Income
Short maturities high exposure
Long maturities low exposure
Commodities
Average exposure
Real Estate
Low exposure
Macro plays -increase exposure
Energy
Water
Short the interest rates
Tax advantaged
Managed Futures

“The average economic expansion is now about 6 times as long as the average recession!”

Are the longer expansions making us forget the busts ?

If we are stuck with these cycles of boom and bust, what can we learn from past cycles ? Are they changing? How should we deal with them?

We know from our research that business cycles have been changing over the last 150 years. The chart on the right shows that the business cycle, starting in the early 1900's, has changed dramatically in length. The chart compares the number of months of expansion in light grey followed by the number of months of recession in dark grey. You can clearly see that the expansions have become longer, and the last expansion after this chart was made has set a new record of 120 months. I added the upward sloping line to show the general increase over the years. The recessions, on the other hand, have slowly decreased in length. In fact, if you look at the data in Table 2 below the chart, you can see that the recessions from peak to trough have fallen from a 22 month average in the late 1800's to a 10 month average in the late 1900's. This means that the average recession has been cut in half over the last 100 years. The next column shows that the average expansion has increased from 27 months to 57 months during the same period or the expansions have doubled in length. You can also see that in the late 1800's, expansions and recessions were about equal, 22 and 27 months. By the late 1900s expansions were almost 6 times as long as recessions, 10 months and 57 months respectively. The most staggering statistic of all was at this last peak in 2007, which was when less than 12 of the approximate 15,000 economists* in this country predicted a downturn in the economy. It's almost as if the entire financial community had forgotten that the business cycle exists. We have become mesmerized by the Goldilocks economy—not too hot and not too cold. Will we forget this lesson as the next long expansion takes hold? Let's hope not! Be prepared for the next cycle up, and down. By T. Rehberger

*John K. Galbraith

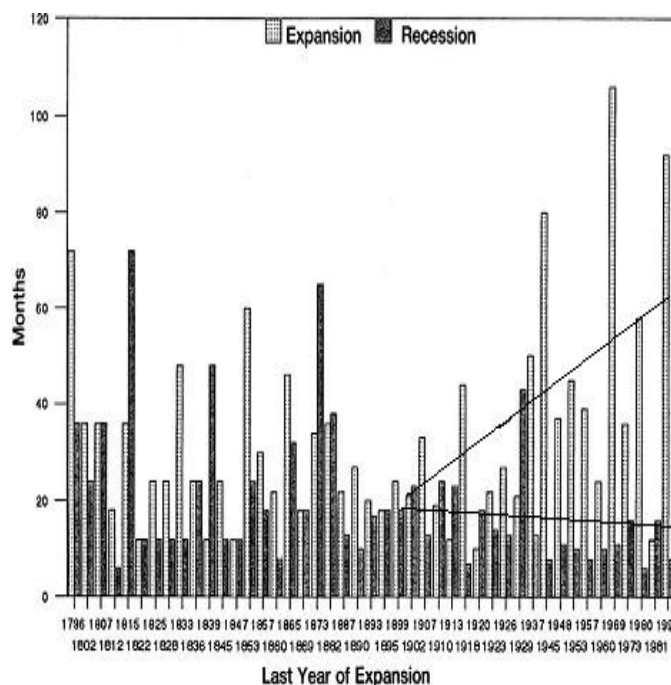


Chart 1. Length of Business Recessions and Expansions United States, 1790-1991

SOURCE: Compiled from data supplied by the National Bureau of Economic Research Center for International Business Cycle Research, January 1993.

Dates	Peak to trough	Last trough to this peak	Trough from last trough	Peak from last peak
1854-2001 (32 cycles)	17	38	55	56*
1854-1919 (16 cycles)	22	27	48	49**
1919-1945 (6 cycles)	18	35	53	53
1945-2001 (10 cycles)	10	57	67	67

Table 2 average cycles in months *31 cycles ** 15cycles
Source NBER

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