

Lighthouse Beacon

A Guide in the 21st Century

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Lighthouse Investment Commentary

Looking Beyond a Turbulent Decade

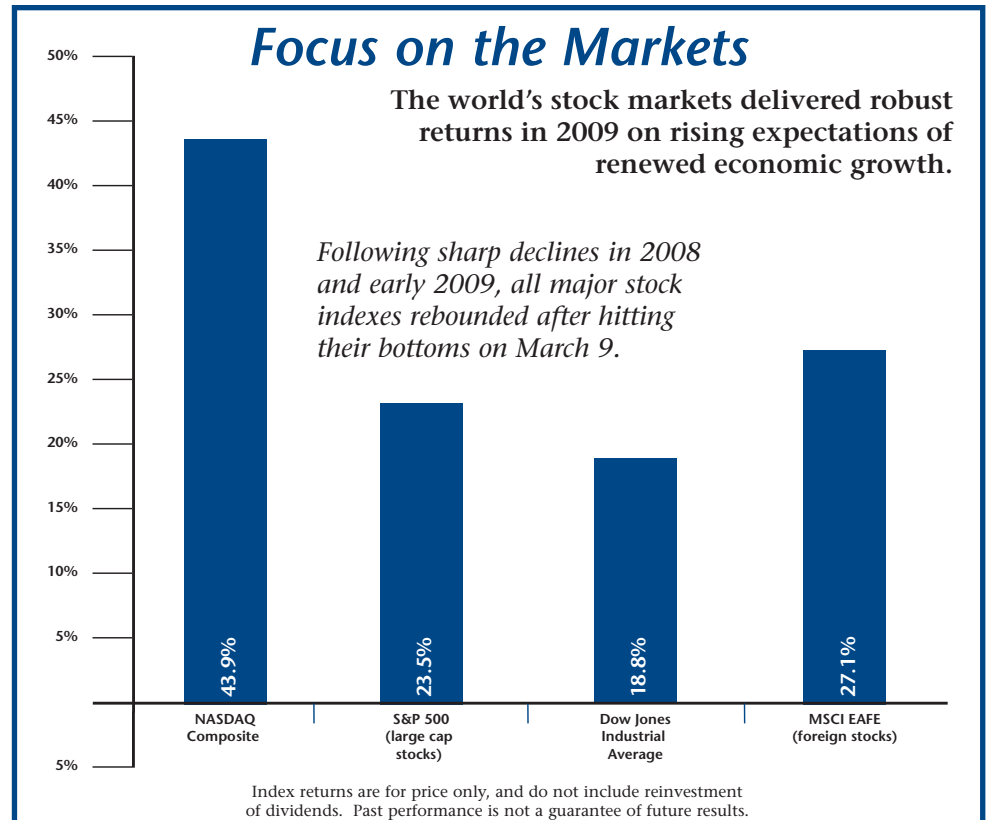
The story of equity investing in 2009 was a tale of two markets. From January 1 through March 9, it was the worst of times. But from March 10 onward, it was the best of times.

By the end of the year, stock markets at home and abroad had delivered robust returns for the year as investors took some encouragement from the stabilization of the financial system and rising expectations that the global economy was beginning to recover.

Nevertheless, the dramatic stock rebound over the final 10 months of 2009 could not erase all the damage from the turbulence that negatively affected the equity markets during the first decade of the twenty-first century. Indeed, the domestic stock market recorded its first-ever 10-year negative return. Little wonder that a general lack of enthusiasm for equities currently characterizes investors' attitudes. This probably accounted for the massive inflows into fixed income funds during the last six months, despite relatively anemic yields offered by the bond market!

Focus on fundamentals, not trends

The extreme volatility displayed in stock price movements over the past two years has encouraged



some investors and traders to try to "game" the market and quickly buy and sell securities in reaction to the latest economic or political statistic, report or commentary. We believe this game can be foolhardy and dangerous, with risks of losing money and/or being out of the market at the wrong time.

At times like these, it is best to keep things simple and look at the underlying fundamentals. At the end of the day, it is not

important whether GDP grows at an annual rate of 3% or 2% during 2010. The important thing is that the recession has ended, the economy has started growing again and corporate profits have begun rebounding. And, while we hate to sound like a broken record, it is worth restating that employment characteristically is a lagging indicator. In the early stages of recoveries, corporate executives typically hold off their hiring plans as they look for a few

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quarters' confirmation that growth has resumed and is sustainable.

This is not to say that we don't have any problems or worries. But there are always problems and causes of concern. It is how investors react to these problems and concerns—investors' expectations—that causes short-term volatility in the market.

Positive longer term outlook

Over the longer term, underlying economic fundamentals guide the direction of markets. The longer-term outlook should build confidence as it becomes more apparent that we will be seeing gradual growth accompanied by only modest inflation. Indeed, the World Bank projects that the global economy should expand by 2.7% in 2010 and 3.2% in 2011, compared to the 2.2% contraction for all of 2009. More importantly, projected growth in developing countries, led by China, is expected to reach 5.8% in 2011. To be sure, it will take time to recover from the losses experienced during the financial crisis, but we should not lose sight of the reality that we are in recovery mode.

Although the recent financial crisis took its toll, it also prompted the largest and most timely government response in history. Central banks throughout the world acted quickly and decisively—often in coordination—to reduce interest rates, increase liquidity into financial systems and stimulate growth. In an extraordinary (and perhaps unprecedented) spir-

it of cooperation, the central banks moved to stem worldwide panic, shore up the financial system and set the foundation for renewed growth, which appears to have begun.

Whatever our personal political views may be, we should all recognize that sometimes government intervention in the economy is necessary. Sometimes governments need to act before our financial system spins out of control and pulls us into a severe depression or worse. Moving forward, the big challenge will be to know when the central banks should begin unwinding their stimulus programs. While this merits watching, we should not allow our political ideologies to lead us to assume they will be unsuccessful.

Invest for the future

One simple fact bears repeating. No one knows precisely what the future will bring, notwithstanding

all we hear from many economists and stock market gurus. We'll have to take the best, most informed advice and then watch, wait and see what happens. As the philosopher Yogi Berra has wisely reminded us: "It is tough making predictions, especially about the future."

Don't be surprised or deterred by possible market corrections of 5-to-10%. They are normal in a new bull market and we should be prepared for them.

We should stick to our investment strategies developed to meet our goals. Along the way, we can review our goals and make adjustments as needed, but we should try to ignore the noise and continue to invest for the future. We can't change the past, but neither should we be hobbled by the past. We only can learn from it and move ahead toward achieving our long-term goals.

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Q: *After the worst decade in stock market history, shouldn't we be concerned that the future brings just more of the same?*

A: We don't think so. As we have been saying, changes were needed to rein in the risks of a financial system that has gotten out of hand. It is no longer "business as usual" and we believe a new environment can be a real positive going forward.

Let's not forget that the stock market returns of both the 1980s and the 1990s were well above long-term averages and comprised the best back-to-back decades in history. While the past decade was terrible, it also wiped out the excesses of the previous 10-year periods.

As difficult as the past 10 years have been, we believe they have set the stage for more normal and positive returns in the years ahead.

For information, please call or write us or visit our website at www.lighthouseasset.com.

James R. McCall, CFA, President
85 Eastern Avenue
Gloucester, MA 01930
978-282-8280
lighthouseasset@gmail.com

Dana P. Blake Jr., Executive VP
85 Eastern Avenue
Gloucester, MA 01930
978-282-8285
ibis22000@yahoo.com

Frank H. Gorke Jr., Senior VP
6573 Marissa Loop
Naples, FL 34108
239-514-7240
fgorke@aol.com