



Park Piedmont Advisors LLC

Registered Investment Advisor

Helping to Achieve Clients' Goals with Indexed Investments

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AUGUST 2009 COMMENTS

AUGUST 2009 MARKET ACTIVITY (ending Monday, August 31st)

During August, US and INTERNATIONAL STOCK prices increased again, with broad-based US indexes up between 2% and 4%. YTD results showed a wide range, with all indexes showing gains and all stock categories making huge percentage gains, approximating 50%, since their March 9th lows. (Month and YTD figures are on page 2.) Even with all their recent gains, stock prices remain far below the highs reached in October 2007 and the levels of May 2008. (For stock price changes since the end of 2006, see page 5.) A recent WSJ article (9/2/09, page C1) makes the point that the S&P 500 would need to gain another 28% to reach its level prior to the Lehman Brothers failure from last September, and would need a 57% gain to return to the 2007 highs.

BOND prices of high credit quality bonds also rose. US Treasury prices continued steady, with the benchmark 10-year bond yield at 3.40%, down 10 bps from July's close, but far higher than December's historically low close of 2.25%. Current rates were lower than the recent high of 3.94%, which occurred in May, as inflation expectations remain low, even with all the government borrowing and deficits. (Typically, bond prices decline as interest rates rise, and prices rise as rates decline, absent credit concerns). The high credit quality corporate bond market, as well as the low credit quality "junk bond" market, continued to post substantial gains, far outperforming a mix of safer, lower-yielding, government-corporate bonds, which is a complete reversal of 2008 results. (Month and YTD results are on page 2.)

The rapid, significant increase in stock prices since the March 9th lows presents the question of whether investors should: (1) sell stock positions to take some of the recent gains; (2) buy more stock positions, since prices have been rising; or (3) retain their stock positions, based on previously-established allocations (and the fact that the S&P 500 is still down substantially from the highs of October 2007). The answer to this question is likely to depend on: (A) your view of the likelihood of an economic recovery in a reasonable time frame, without harmful inflation; and (B) whether you want to act as a short-term investor, focusing on short-term price swings, or as a long-term investor, having established goals for your money and needing some growth potential to meet those goals. As you know, we are major proponents of the view that investing is a long-term process; that no one knows in advance when markets will enter periods of significant declines and/or significant gains; and that staying the course with an appropriately-allocated, well-diversified investment portfolio is the best approach, rather than trying to outguess the market's moves.

Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.

COMMENTS: INDEX RESULTS for period ending AUGUST 2009

	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YTD	AUG
	<u>1999</u>	<u>2000-2</u>	<u>2003-5</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2009</u>
STOCKS								
Vanguard Total Stock Market Index Fund	23.8%	-37.2%	53.1%	15.5%	5.5%	-37.1%	16.7%	4.1%
Standard & Poor's (S&P) 500 Index	19.6%	-40.1%	41.9%	13.6%	3.5%	-38.5%	13.0%	2.0%
Vanguard S&P 500 Growth Index Fund	28.8%	-48.4%	41.8%	9.0%	12.6%	-38.4%	21.0%	2.5%
Vanguard S&P 500 Value Index Fund	12.6%	-26.2%	63.2%	22.1%	0.1%	-36.1%	10.8%	5.4%
Dow Jones Industrial Average Index	25.2%	-27.5%	28.5%	16.3%	6.4%	-33.8%	8.2%	3.7%
NASDAQ Composite Index	85.6%	-67.2%	65.2%	9.5%	9.8%	-40.5%	27.4%	1.9%
Vanguard Midcap US Index Fund	25.0%	-18.3%	83.9%	13.6%	6.0%	-41.8%	24.0%	6.0%
Vanguard Smallcap US Index Fund	19.6%	-24.2%	87.5%	15.6%	1.2%	-36.1%	23.0%	5.2%
Vanguard International Index Fund (EAFE)	25.3%	-45.9%	95.9%	26.6%	15.5%	-44.1%	26.0%	4.2%
Vanguard Emerging Markets Index Fund	61.6%	-29.5%	162.7%	29.4%	39.0%	-52.9%	49.0%	-0.7%
Vanguard Real Estate Investment Trust Fund	-0.4%	47.5%	98.6%	35.1%	-16.5%	-37.2%	11.4%	13.7%
BONDS								
Vanguard Short-term Bond Index Fund	2.1%	25.8%	6.5%	4.1%	7.2%	5.4%	3.4%	0.7%
Vanguard Short-term Tax-Ex. Bond Fund	2.6%	13.8%	4.5%	3.2%	4.2%	3.7%	2.3%	0.1%
Vanguard Total Bond Market Index Fund	-0.8%	30.4%	11.1%	4.2%	6.9%	5.1%	4.6%	1.0%
Vanguard Interm-term Tax- Ex. Bond Fund	-2.9%	23.7%	10.3%	4.4%	3.4%	-0.1%	8.0%	1.3%
Vanguard High-Yield Bond Fund	NA	1.7%	30.7%	8.2%	2.0%	-21.3%	27.1%	0.4%
Vanguard High-Yield Tax-exempt Bond Fund	-3.4%	25.2%	16.5%	5.5%	1.6%	-10.5%	15.7%	3.1%
Vanguard Inflation-Protected Bond Fund	NA	25.5%	20.0%	0.4%	11.6%	-2.9%	6.7%	1.1%

NOTE 1: Current Month Results measured from beginning of year, and not beginning of prior month.

NOTE 2: Three-year results start with a base of 100; after each year's % change, the result for that year creates a new base. If at the end of the first year the index is up 10%, then the new base is 110%; if down 10%, then the new base is 90%. NOTE also that a decline of 50% requires a gain of 100% to get back to the starting value, which explains why NASDAQ, down 67%, would require a gain of 200% to get back to its starting value.

NOTE 3: Results for Vanguard funds include dividends and fund expenses but not PPA's advisory fee.

NOTE 4: Results for S&P 500, Dow Jones, and NASDAQ indexes don't reflect dividends or advisory fees.

%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
		<u>1999</u>					<u>2000</u>					<u>2001</u>			
S&P 500	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1			
NASDAQ	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3			
BONDS	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0			
		<u>2002</u>					<u>2003</u>					<u>2004</u>			
S&P 500	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8			
NASDAQ	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9			
BONDS	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0			
		<u>2005</u>					<u>2006</u>					<u>2007</u>			
S&P 500	(2.6)	0.9	3.1	1.6	3.7	(1.9)	5.2	6.6	0.2	5.8	1.6	(4.1)			
NASDAQ	(8.1)	2.6	4.4	2.5	6.1	(7.6)	3.9	7.1	0.3	7.5	4.0	(2.0)			
BONDS	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)	3.8	1.3	1.4	(0.6)	2.9	3.2			
		<u>2008</u>					<u>2009</u>					<u>2010</u>			
S&P 500	(9.9)	(2.9)	(7.9)	(17.7)	(11.7)	13.5									
NASDAQ	(14.1)	0.6	(8.0)	(19.0)	(3.1)	19.5									
BONDS	2.2	(1.1)	(0.5)	4.5	0.3	1.8									

STOCK index prices for US and International indexes posted additional gains during August, as follows: S&P500, +2.0%; Dow Industrials, + 3.7%; NASDAQ Composite, +1.9%; Total US Stock Market (Large, Midcap and Smallcap), +4.1%; Developed International, +4.2%, and Emerging Markets -0.7%. YTD results had a wide range; +13.0%, +8.2%, +27.4%, +16.7%, +26.0% and +49.0%, respectively. Growth continued to outperform Value, while the REIT sector has had a major recent recovery.

BOND returns (price change plus interest) for high credit quality corporate bonds and low credit quality high yield (or “junk”) bonds continued their gains in August and YTD. Last year’s major gains in government bonds, when credit risk was the main focus, have not continued during 2009. Instead, bond investors have been willing to take on additional risk to obtain much higher yields in both high and low credit quality bond markets, as compared to continuing low US government interest rates. Short-term US Treasury yields remain at almost zero, as the Federal Reserve has kept its short-term rates at that level.

ECONOMIC NEWS for August continued to reflect the theme that while the economy is still not good, it is at least improving. All in all, the economy is showing signs of improvement, but from very low levels reached earlier this year. This idea is discussed in much of the material discussed on pages 6-8.

From a longer-term standpoint, the stock price declines from the October 2007 highs accelerated dramatically starting in September 2008 and reached lows in early March 2009, with the declines approaching 60% from the 2007 highs. The subsequent March-August 2009 rally has been significant, and reduced those declines to approximately 40% (see chart on page 5). From 2000 through June 2009, the Dow Industrials are now 19% lower, the S&P 500 33% lower, and the NASDAQ a stunning 60% lower, even as NASDAQ is the outperformer in the current stock rally. The decade of the 2000s is almost certain to be the first since the 1930s with cumulative annualized negative stock returns, making these returns obviously far lower than their positive long-term average annualized returns of 9.6% (a figure updated by Ibbotson/ Morningstar to cover 1926 through 2008). Going back to the bull market that began in 1995, all three major indexes have similar (and, since September 2008, very much lower) average annual returns, ranging from 5.6% to 6.9%. The mutual fund company Vanguard notes that from 1926 through 2008, in only six of 83 years did stock prices fall within 2%, up or down, of the long-term annual average return of 9.6%.

The moral: Stock returns are truly unpredictable and volatile in short time frames, and can be over long time periods as well, even with (so far) a fairly stable very-long-term average return. Key Questions: Your relevant time frame and tolerance for risk.

	<u>S&P 500 (1)</u>		<u>DOW (1)</u>		<u>NASDAQ (1)</u>	
Ist Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002, Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2005	1,248	(18)%	10,718	(9)%	2,205	(56)%
Year End 2007	1,468	(4)%	13,265	+13%	2,652	(47)%
November 20, 2008 Low	752	(51)%	7,552	(36)%	1,316	(74)%
December 31, 2008	903	(41)%	8,776	(25)%	1,577	(69)%
March 9, 2009 Low	677	(56)%	6,547	(44)%	1,269	(75)%
AUG 31, 2009	1,021	(33)%	9,496	(19)%	2,009	(60)%

Context: Prior Five-Year Gains in Bull Market of 1995 - 1999

	<u>S&P 500 (1)</u>	<u>DOW (1)</u>	<u>NASDAQ (1)</u>
End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Ann. % Gain:'95-'99; 5 years	26.2%	24.6%	40.2%
AUG 2009	1,021	9,496	2,009
Gain	562	5,662	1,257
Avg. Ann. %Gain:'95-8/09;14.67 yrs.	5.6%	6.4%	6.9%

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's fees.

The chart below has been updated monthly to reflect the extreme stock market volatility since the summer of 2007. What appeared extreme in late 2007 and early 2008, however, turned out to be a mild prelude to the declines of Sep.-Nov. 2008, and Jan.-Mar. 9, 2009.

	<u>S&P 500</u>	<u>Change from YE06</u>	<u>Dow Jones Industrials</u>	<u>Change from YE06</u>	<u>NASDAQ</u>	<u>Change from YE06</u>
YE 2006	1,418	-	12,463	-	2,415	-
10/9/07 High	1,565	10.4%	14,165	13.7%	2,859	18.4%
12/31/07 Close	1,468	3.5%	13,265	6.4%	2,652	9.8%
1/22-23/08, and 3/17 Lows*	1,257	-11.3%	11,635	-6.6%	2,155	-10.8%
5/31/08 Close	1,400	-1.3%	12,638	1.4%	2,523	4.5%
10/10 & 24 Lows*	840	-40.7 %	7,882	-36.7%	1,494	-38.1%
10/31/08 Close	969	-31.7%	9,325	-25.2%	1,721	-28.7%
11/21/08 Low*	741	-47.7%	7,449	-40.2%	1,295	-46.4%
12/31/08	903	-36.3%	8,776	-29.6%	1,577	-34.7%
3/9/09 Low*	677	-52.2%	6,547	-47.5%	1,269	-47.5%
8/31/09	1,021	-28.0%	9,496	-23.8%	2,009	-16.8%

* Note – These are not closing prices, but "intra-day" lows

Some key observations from the chart:

- 1) From the October 2007 highs to the new March 9, 2009 lows, all three major US indexes were down a huge 60% to 65%, far exceeding the declines of 1973-74 and 2000-2.
- 2) October 2007, May 2008, and the last week in October 2008 were all periods of price recoveries of 10% or more. The December 2008 price recovery, measured from the November lows, ranged from 18% to 22%. The March-August 2009 recovery from the March 9th lows has been by far the best, with gains now ranging from 45% (Dow) to 50% (S&P 500) to 58% (NASDAQ). (But remember, after a decline of 50%, it takes a gain of 100% to get back to even). These recoveries illustrate the dangers of exiting the stock market after periods of substantial declines on the assumption they will continue, and also about using periods of gain as entry points.
- 3) Even knowing what we know now about the severity of this bear market, there is no way to determine, before the fact, at what point the lows for this market cycle will have been reached until long after the cycle has been completed.

INVESTMENT CONCEPTS: WHAT HAPPENS NEXT?

As the stock and bond market rallies continued for the sixth consecutive month, the question of the rally's sustainability is now in full focus. As might be expected, there are many opinions on this question, and many unresolved issues in the real economy. This month's Comments will discuss a sampling of the conflicting viewpoints and various ongoing economic problems. This discussion will likely highlight how difficult it is to have a strong conviction as to what happens next.

Consider first a full page article in the WSJ (8/18/09, page A13), which presented three possible future scenarios: (1) "After Steep Drop, A Sharp Rebound;" (2) "Economic Anxiety Keeps Growth Slow;" and (3) "A Brief Rebound, Then a New Slump."

The optimistic view, (1) above, stated that "The most common path for the economy after a severe contraction has been a huge rebound in economic activity. Employers usually slashed their payrolls and output so sharply to protect themselves, and consumers postponed so many purchases during the worst of the downturn, that a return to growth came with a fierce expansion... Forecasters who support the strong rebound view expect the economy to grow at a 3% to 5% annual rate through the end of this year and provide the power needed to spark a longer term recovery. Businesses would ramp up output and hiring..., rising stock values would restore consumer confidence and spur additional spending..., and housing construction is coming off rock bottom level."

The middle view, (2) above, made the following points: "The economy may bounce back, but plenty of barriers block the path to a sharp rebound. Trouble with spending and lending could potentially make the recovery a slog. Consumer confidence is falling as job losses mount – albeit at a slower pace than before – and homeowners reshape their finances after severe declines in home values. Households are saving more than they have for most of this decade. That's suppressing consumer spending, the engine for 70% of economic output. The credit shock is likely to impair the business and consumer sectors for years. Businesses are less likely to get easy loans as banks shrink their balance sheets. That's also true for homebuyers who are finding it harder to get new loans... So after a quick bounce, proponents of the slow growth view say the economy is more likely to expand at a 1% to 2% rate over the next year – well below the 4% to 5% that's necessary to heal the labor market after a deep downturn."

The pessimistic view, (3) above, argued that "The economy is likely to see a natural boost in the coming months from a rebound in production, and after that get some help from the bulk of the fiscal stimulus program, but then what? The slack in the economy is so large that consumers won't see meaningful raises for years, and they will have less borrowing power to drive their spending. So consumers could make some of the big purchases they have been postponing and then close their wallets to save more. Businesses, after a frightening period, could remain cautious about ramping up.... State and local governments could continue to cut back as tax revenue plummets. And the troubles aren't over for the banking sector. Foreclosures are still shooting up as loans go bad. Once the boost from the federal government diminishes, the economy could still be without a major driving force such as consumer spending or business investment, risking a return to its contractionary phase."

Bill Gross, who is famous for running the Pimco bond funds and writes a monthly newsletter, has been writing recently that he thinks the US economy requires 5% nominal GDP growth to maintain its long term balance, and that after the current recession, the economy will end up at 3% nominal GDP growth. This GDP decline, he writes, “means lower profit growth, permanently higher unemployment, capped consumer spending growth rates and an increasing involvement of the government sector.” He also states that “a journey to 3% nominal GDP means default/haircuts for assets on the upper end of the risk spectrum, as well as extremely low yielding returns for government and government guaranteed assets at the bottom end of the risk spectrum” (Allianz Commentary, 8/1/09) Perhaps Gross should be placed in category 2.5, using categories 1 to 3 from the previous WSJ article.

Another prominent voice in the debate, Alan Blinder, former Vice Chairman of the Federal Reserve and Professor at Princeton, wrote a WSJ article (7/24/09, page A15) stating that “there is good news and bad news, and in this case they are exactly the same: the U.S. economy appears to be hitting bottom... There is a reasonable chance of 3% to 4% growth in the second half of 2009. How, with all our economic travails, could we possibly mount such a boom? The answer is that this seemingly high growth scenario isn't a boom at all. Rather it follows directly from the arithmetic of hitting bottom.” The article then describes how once the economy hits bottom, reasonable growth rates are no surprise because they are being measured from the low levels of the economy's bottom. Blinder then discusses the bad news, which is also the result of the economy hitting bottom. “Economic conditions are dreadful at the bottom of a deep recession. Jobs are scarce. Layoffs abound. Businesses scramble for penurious customers. Companies go bankrupt. Banks suffer loan losses. Tax receipts plunge, ballooning government budget deficits... What's more, GDP is not terribly meaningful to most people. Jobs are – but they will take longer, maybe much longer, to revive... So even though the economy may be making a GDP bottom now, the unemployment rate will probably keep rising for months, which is bad news for most Americans... The bottom of a deep recession leaves the nation in a deep hole. Our economy now has massive unemployment and vast swaths of unused industrial capacity. It will take years of strong growth to return to full employment.” It appears that Blinder would be a 2.0, using those same categories 1 to 3 from the previous WSJ article.

As should be clear from these various viewpoints, one of the major economic problems continues to be employment, since without job growth consumer spending remains weak, and defaults on home mortgages and other debt remain high. Strong consumer spending, which accounts for 70% of the US economy, requires either ongoing income flows or access to credit, and the weak employment market adversely affects both income and access to credit. The most recent employment figures, reported Friday, September 4th, showed that “Employers cut jobs in August at the slowest pace in a year, but a jump in the unemployment rate to a 26-year high of 9.7% reinforced worries that a weak labor market could weigh on consumer spending and the vigor of the economic recovery... The latest figures are consistent with an economy pulling out of the deepest downturn since the Great Depression. But rising unemployment portends persistent weakness in consumer confidence, income and spending, even as manufacturers start bouncing back and stocks revive” (WSJ, 9/5-6/09, front page).

A second major economic problem that emerges from these articles is the extent of the debt still hanging over the economy. This debt can be from home mortgages, auto loans, credit cards, or other forms of spending. A WSJ article discussing the debt problem (8/10/09, page C1), states that "Despite an uptick in consumer saving, debt levels have only barely begun to come down. Even after the recession ends, economists expect the gradual reduction of the nation's massive debt to take years. In the meantime, they are warning that the economic growth surge expected for the second half of this year could be followed by slower growth and a softer stock market in 2010." Discussing the same subject, a front page NY Times article (8/29/09), stated that "Millions of Americans spent years tapping credit cards, stock portfolios and once rising home values to spend in excess of their incomes and now lack the wherewithal to carry on. Those who still have the means (to spend) feel pressure to conserve, fearful about layoffs, the stock market and real estate prices." Citing Mark Zandi, chief economist at Moody's, the article states that "lower income households can't borrow and higher income households no longer feel wealthy....There is still a lot of debt out there. It throws a pall over the potential for a strong recovery. The economy is going to struggle."

Another part of the economic puzzle relates to the ability of businesses to make suitable profits, which would provide a basis to expand their businesses, hire more people, and support stock prices. One WSJ article about corporate profits (8/10/09, page A11) makes the point that high corporate profits do not necessarily mean there will be a robust economic recovery. The article takes the position that "The financial crisis hastened the trend toward efficiencies, leaner inventories and integrating both technology and global supply chains, leading to severe pressure on the American working class and eroding employment. As these companies profit from global expansion and greater efficiency, they have little or no reason to rehire fired workers or expand their US work force. So we are facing a conundrum: companies can grow by leaps and bounds and yet unemployment can skyrocket and remain high." A second WSJ article discussing corporate earnings (8/31/09, page C1), raised the question of whether favorable earnings based on cost cutting could be maintained for very long in the absence of rising revenues. "You can not simply cut costs forever to have sustainable earnings. You need revenue to grow them over time." And all the problems associated with a weak job market, and excessive debt, work against the likelihood of strong revenue growth for business.

As a summary to this section, it should be emphasized that even if you make a correct judgment regarding the likely direction of the economy, the stock and bond markets may provide results that do not necessarily follow the real economy. A prime example is the most recent, substantial six-month rally, coming amidst signs of a modest economic recovery at best, and that recovery coming from very low levels.



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