Park Piedmont Advisors LLC

Registered Investment Advisor

Helping to Achieve Clients' Goals with Indexed Investments

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SEPTEMBER 2009 COMMENTS

SEPTEMBER 2009 MARKET ACTIVITY (ending Wednesday, September 30th)

During September, US and INTERNATIONAL STOCK prices increased for a sixth consecutive month, with broad-based US indexes up between 2.5 % (Dow Industrials) and 7.2% (NASDAQ), and international and emerging markets up even more. YTD results show a wide range of significant gains (from 10.7% for the Dow Industrials to 62.8% for Emerging Markets), with most exceeding 50% since the March 9th lows. (The Month and YTD figures are on page 2.) Even with all the recent gains, stock prices remain far below the highs of October 2007 and May 2008. (Stock price changes since the end of 2006 are on page 5.)

BOND prices of high credit quality bonds also continued to rise. The benchmark 10-year US Treasury yield closed at 3.31%, down 9 bps from August, but still higher than the historically low close of 2.25% from December 2008. Current rates are lower than May's recent high of 3.94%, 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, continue 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).

This next point is repeated from prior Comments: 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.

COMMENTS: INDEX RESULTS for period ending SEPTEMBER 2009

	YEAR 1999	YEAR 2000-2	YEAR 2003-5	YEAR 2006	YEAR 2007	YEAR 2008	YTD 2009	SEP 2009
STOCKS								
Vanguard Total Stock Market Index Fund	23.8%	-37.2%	53.1%	15.5%	5.5%	-37.1%	21.6%	4.9%
Standard & Poor's (S&P) 500 Index	19.6%	-40.1%	41.9%	13.6%	3.5%	-38.5%	17.0%	4.0%
Vanguard S&P 500 Growth Index Fund	28.8%	-48.4%	41.8%	9.0%	12.6%	-38.4%	26.3%	5.3%
Vanguard S&P 500 Value Index Fund	12.6%	-26.2%	63.2%	22.1%	0.1%	-36.1%	14.5%	3.7%
Dow Jones Industrial Average Index	25.2%	-27.5%	28.5%	16.3%	6.4%	-33.8%	10.7%	2.5%
NASDAQ Composite Index	85,6%	-67.2%	65.2%	9.5%	9.8%	-40.5%	34.6%	7.2%
Vanguard Midcap US Index Fund	25.0%	-18.3%	83.9%	13.6%	6.0%	-41.8%	31.6%	7.6%
Vanguard Smallcap US Index Fund	19.6%	-24.2%	87.5%	15.6%	1.2%	-36.1%	30.8%	7.8%
Vanguard International Index Fund (EAFE)	25.3%	-45.9%	95.9%	26.6%	15.5%	-44.1%	32.5%	6.5%
Vanguard Emerging Markets Index Fund	61.6%	-29.5%	162.7%	29.4%	39.0%	-52.9%	62.8%	13.8%
Vanguard Real Estate Investment Trust Fund	-0.4%	47.5%	98.6%	35.1%	-16.5%	-37.2%	18.8%	7.4%
BONDS								
Vanguard Short-term Bond Index Fund	2.1%	25.8%	6.5%	4.1%	7.2%	5.4%	4.0%	0.6%
Vanguard Short-term Tax-Ex. Bond Fund	2.6%	13.8%	4.5%	3.2%	4.2%	3.7%	2.7%	0.4%
Vanguard Total Bond Market Index Fund	-0.8%	30.4%	11.1%	4.2%	6.9%	5.1%	5.8%	1.2%
Vanguard Interm-term Tax- Ex. Bond Fund	-2.9%	23.7%	10.3%	4.4%	3.4%	-0.1%	11.2%	3.2%
Vanguard High-Yield Bond Fund	NA	1.7%	30.7%	8.2%	2.0%	-21.3%	32.3%	5.2%
Vanguard High-Yield Tax-exempt Bond Fund	-3.4%	25.2%	16.5%	5.5%	1.6%	-10.5%	21.6%	5.9%
Vanguard Inflation-Protected Bond Fund	NA	25.5%	20.0%	0.4%	11.6%	-2.9%	8.7%	2.0%

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
		1999				**2000**				**2001**		
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
		2002				**2003**				**2004**		
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
		2005				**2006**				**2007**		
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
		2008				**2009**				**2010**		
S&P 500	(9.9)	(2.9)	(7.9)	(17.7)	(11.7)	13.5	15.2					
NASDAQ	(14.1)	0.6	(8.0)	(19.0)	(3.1)	19.5	18.2					
BONDS	2.2	(1.1)	(0.5)	4.5	0.3	1.8	3.7					

STOCK index prices for US and International indexes posted additional gains during September, as follows: S&P500, +4.0%; Dow Industrials, + 2.5%; NASDAQ Composite, +7.2%; Total US Stock Market (Large, Midcap and Smallcap), +4.9%; Developed International, +6.5%; and Emerging Markets, +13.8%. YTD results had a wide range of +17.0%, +10.7%, +34.6%, +21.6%, +32.5% and +62.8%, respectively. Growth continued to outperform Value, while the REIT sector has had a major recent recovery, now +18.8% YTD.

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 September 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 the 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 September was mixed, as a weak employment report cast doubt on other more favorable data. "Employers cut 263,000 jobs in September, raising worries that the persistently weak labor market could undermine a nascent recovery from the worst US recession since the Great Depression… Despite signs of the economy improving, employers don't appear to be in a hurry to hire. What seems prudent for businesses may prove problematic for the recovery" (WSJ, 10/3-4/09, A1 & A2). This most recent negative news came about even as other economic data showed improvement, and Fed Chairman Bernanke suggested the recession was over (WSJ, 10/2/09, A2). (Our Note: Recessions are measured by declining GDP, not rising unemployment, which is said to be a "lagging" indicator.)

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-September 2009 rally has been significant, reducing those declines by more than half (see chart on page 5). From 2000 through June 2009, the Dow Industrials are now 17% lower, the S&P 500 31% lower, and the NASDAQ a stunning 58% lower, even as NASDAQ is the major 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, considerably lower) average annual returns, ranging from 5.7% to 7.0%. 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.

	S&P 500 (1)		DOW (1)		NASDAQ (1)	
1st 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)%
SEPTEMBER 30, 2009	1,057	(31)%	9,712	(17)%	2,122	(58)%

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

	S&P 500 (1)	DOW (1)	NASDAQ (1)
End 1994	459	3,834	752
End 1999	1,470	11,500	4,070
Gain	1,011	7,666	3,318
Avg. Ann. % Gain:'95-'99; 5 years	26.2%	24.6%	40.2%
SEPT 2009	1,057	9,712	2,122
Gain	598	5,878	1,370
Avg.Ann. %Gain:'95-9/09;14.75 yrs.	5.7%	6.3%	7.0%

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.

	S&P 500	Change from YE06	Dow Jones Industrials	Change from YE06	NASDQ	Change from YE06
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%
9/30/09	1,057	-25.4%	9,712	-22.1%	2,122	-12.1%

* 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-September 2009 recovery from the March 9th lows has been by far the best, and longest, with gains now ranging from 48% (Dow) to 56% (S&P 500) to 67% (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 and the current recovery, 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: WHEN THE EXPERTS DISAGREE

This section in last month's Comments discussed the many conflicting viewpoints regarding the future direction of the economy and the financial markets. This theme is repeated this month, presenting in depth the points of view of two highly respected and experienced investment commentators. Bill Gross has directed Pimco's highly regarded bond funds for many years (now part of Allianz Global Investors), and James Grant has been editing the Grant's Interest Rate Observer for many years, as well as writing a number of books on investments.

Aside from the substance of the two positions, which reach quite different investment conclusions, we suggest that the key take-away point is that there is no way for even a knowledgeable investor to know which outcome is more likely to occur. And if that is so, then trying to time the markets, and figure out the next short-term market moves based on predictions of economic data, are not likely to prove beneficial to the investor.

Gross (who we also quoted briefly in our August Comments) wrote in his August Investment Outlook: "Common sense tells us that consumer spending growth comes from highly employed, well-compensated labor, and we are far from even approaching that elemental condition. The fact is that near double digit unemployment has resulted from numerous business models that are now broken: autos, home construction, commercial real estate development, finance and retail sales… Reflating nominal GDP by inflating asset prices is the fundamental, yet infrequently acknowledged, goal of policymakers. If they can do that, then employment and economic stability may ultimately follow."

Gross then goes on to explain the thinking of his group. "A country's Gross Domestic Product (GDP) is really just an annual total of the goods and services produced by its existing stock of investments (capital in the form of plant, equipment, software and certain intangibles) and labor (people working). Over the last fifteen years or so in the US, that annual production (GDP) has increased in nominal (real growth and inflation) terms of 5% to 7%... Not every year, but pretty steadily over longer time frames, and consistently enough to signal to capitalists that 5% was the number they could count on to justify employment hiring, investment spending plans, and which would serve as well as a close proxy for the return on capital that they should expect… While objectively hard to prove, logic dictates that that is exactly what has happened over the past several decades. Businesses expanded with a developing certainty that demand, expenses, and return on the economy's capital would mimic this 5% consistency… Both real economy and financial markets, then, were geared to and, in fact, mesmerized by this 5% GDP/CAPM (capital asset pricing model)."

Gross continues: "Now however, things have changed, and it is apparent there is massive overcapacity in the US and indeed the global economy… Nominal GDP has not only sunk below 5%, but turned at least temporarily negative. If allowed to continue, a portion of US production capacity and labor will have to be permanently laid off. Nominal GDP has to grow close to 5% in order for the economy's long-term balance to be maintained."

Gross asks whether government "can successfully reflate to 5% nominal GDP and recreate an old normal economy." He concludes not, for a variety of reasons, including the point that most politicians, and ordinary citizens, want "limits on monetary/fiscal expansion… If there are such future political constraints or caps (both domestically and from abroad), then one should recognize that most of the ammunition has been spent stabilizing the financial system, and very little directed towards the real economy in terms of job loss prevention… In brief, the new normal nominal GDP, the future return on our stock of labor and capital investment, will likely be centered closer to 3%, for at least a few years once a recovery is in place beginning in this year's second half."

Gross closes by presenting an investment conclusion: "A 3% nominal GDP new normal means lower profit growth, permanently higher unemployment, capped consumer spending growth rates and an increasing involvement of the government sector, which substantially changes the character of the American capitalist model. High risk bonds, commercial real estate, and even lower quality municipal bonds may suffer more than cyclical defaults if not government supported. Stock P/Es will rest at lower historical norms, and higher stock prices will ultimately depend on tangible earnings growth in the form of increased dividends, not green shoots. An investor should remember 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."

Obviously the Gross view presents the powerful argument for slower growth in the real economy, which in turn generates lower returns in the financial markets. Interestingly, the next commentator, James Grant, long a bear on the financial markets, presents a bullish case for a strong recovery, as quoted from a WSJ article titled "From Bear to Bull" (9/19-20/09).

Grant begins: "As if they really knew, leading economists predict that recovery from our Great Recession will be plodding, gray and jobless. But they don't know and can't. The future is unfathomable." (This part about the unknown future is a constant Park Piedmont theme). He continues: "(I am) about to propose that the recovery will be a bit of a barn burner. Not that I can really know either, the future being what it is."

Grant quotes a CEO he respected that "we are subject to a tremendous number of outside influences and the vast majority of them cannot be predicted" (another point made frequently by Park Piedmont). He then asks "how many influences, outside and inside, must bear on the US economy?… Depleted inventories, bloated jobless roles and rock bottom interest rates suggest that people are preparing to meet the future from the inside of a bomb shelter. The Great Recession destroyed confidence as much as it did jobs and wealth… and has set unwanted records in such vital statistical categories as manufacturing and trade inventories, capacity utilization, and industrial production. It isn't every postwar disturbance that features zero percent Treasury yields, a coast to coast bear market in residential real estate, or a Federal Reserve balance sheet beginning to resemble that of the Reserve Bank of Zimbabwe."

By citing the severity of the problems created by this recession, Grant is preparing us for his key point: "It has been a generation since a business cycle downturn exacted the collective pain that this one has done. Knocked for a loop, we forget a truism. With regard to the recession that precedes the recovery, worse is subsequently better. The deeper the slump, the zippier the recovery." He cites an economist that "the most important determinant of the strength of an economic recovery is the depth of the downturn that preceded it. There are no exceptions to this rule, including 1929-1933."

Grant goes on to discuss the huge amounts of money that the Treasury and Federal Reserve have injected into the economy. "Our Great Recession would be marked for greatness if for no other reason than by the outpouring of federal dollars to repress it." He also states that falling prices create bargains that consumers and investors respond to. "Bargain hunting is the balm of recovery even today, dead set against low prices the Federal Reserve might be."

Grant then takes on the Federal Reserve. "The Fed's voice is among the saddest in the choir of bearish forecasters, and for good reason. By instituting a debt boom, the Fed was instrumental in causing our troubles… Belatedly grasping how bad was bad, it now maintains this stance of radical ease lest it get the blame for a relapse. However, by driving money market interest rates to zero and setting American records in money printing, the Fed is putting the value of the dollar at risk… The value of the dollar is anchored by the analytical acuity of the monetary bureaucracy that failed to predict the greatest financial crackup since the 1930s…. If mispriced debt was the root cause of the narrowly averted destruction of global finance, the Fed is well on its way to setting the stage for some distant (let us hope) Act II. In the meantime, ultra-low interest rates have lit a fire under the stock and debt markets. By rallying, equities and corporate bonds not only anticipate recovery, but they also help to bring it to fruition… One year ago, the Wall Street liquidation stopped world commerce in its track. Today's bull markets are helping to revive it."

He concludes: "I promised to be bullish, and I am (for once); bullish on the prospects for unscripted strength in business activity… The world is positioned for disappointment. But, in economic and financial matters, the world rarely gets what it expects."

Our conclusion: It seems Grant takes a totally different view of what is likely to happen to the economy than does Gross. If two of the truly distinguished observers on the economy and the markets can come up with such divergent views of what is coming, what chance does anyone have to make the right call on the future? A fifty-fifty flip of the coin, at best.

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