

NEW DECADE, NEW BOOK; CHAPTER 1

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Since January 19 investors' confidence has been shaken by the same group that helped restore it in 2009: government(s). Government actions/response isn't bad for stocks or bonds per se. The policy decisions ahead will dictate how quickly or slowly growth prospects change. During 2009, global government responses (monetary accommodation and fiscal stimulus) were "tailwinds" boosting the financial markets. Action to stimulate a year ago was near unanimous. Now, the direction of the wind (government response) is shifting slowly to a "headwind". As countries' economic conditions improve at differing rates, the timing and pace of winding down quantitative measures will vary. Some governments are acting on improved economic data and beginning to pull back the stimulus, while others continue to fight to stay afloat. In essence, the current global recovery is asynchronous.

Investors want to see proof of economic rebound, including improvement in company sales and rehiring unemployed workers. Without near-term proof, the Fed remains on hold and investors continue worried.

Stocks lost value in January with the S&P 500 slipping 3.6%. This was the third consecutive January loss (-0.6% in 2008; -8.4% in 2009). Often, the month of February is the second worst month of the year, and the last 3 were no exceptions (-2.0% in 2007; -3.2% in 2008; -10.6% in 2009). Given the weak start of February 2010, it appears probable to maintain its pattern. Below are equity style and client portfolio objective returns for January.

Style	January	Client Objectives	
		(Stocks/Bonds)	January
Small Value	-2.6%	20/80	+0.1%
Mid Value	-2.8%	35/65	-0.3%
Large Value	-2.9%	50/50	-1.1%
S&P 500	-3.7%	65/35	-2.2%
Small Growth	-4.6%	80/20	-2.8%
Mid Growth	-4.6%	95/5	-3.1%
Foreign	-4.8%	S&P 500	-3.7%
Large Growth	-5.0%		

Often, when January starts slow, the remainder of the year is subdued. After the 64% run-up since March 9 (last year), investors should expect a pause. The market cannot keep rising at a quick pace without a "rest". Often, the pause is a hic-up that reduces the market value by 5% - 10% before the next leg upward resumes. History does offer perspective about the next year. In the calendar year following previous "25% and up" years (2009 full year return was +26.5% for the S&P 500), the S&P was up 6 of the 7 times, gaining an average of +14.8%. This outcome is probable and investors need to maintain a big picture perspective; huge global policy response is creating a significantly improved global economic and corporate outlook – the transition to revenue expansion should follow in 2010.

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NEW DECADE, NEW BOOK; CHAPTER 1 -CONTINUED-

The first chapter in a new book is being written. We are being introduced to the characters. They are familiar; but their significance is evolving. The "New Decade, New Book; Chapter 1" begins with investment decision and forecasting abilities being more complex. Life in the "new normal" is not US domestic-view only; it is global. And the stage, once dominated by the US economic engine, is quickly changing. The US economy, still the world's largest, shrunk by 2.4% in 2009 to \$14.5 trillion; China's economy grew 8.7% in 2009 to \$4.9 trillion in size. China is quickly growing in global influence. During the next decade, China's "new book" will develop and influence global life significantly.

As Chapter 1 is now being written, China economic policy decisions in early 2010 are impacting global and US financial markets. Last year, China's monetary policy (focused on *new* loans not interest rate action) created ¥9.6 trillion new loans (2.3 times bigger than the ¥4.2 trillion in 2008, or ¥3.6 trillion in 2007, or ¥1.6 trillion in 2005). China influences their economic growth (and global growth) via new loans (i.e. to stimulate growth by allowing more loans to be offered; to slow growth, their policy limits loan growth). China announced (January 19th) a need to ratchet back loan growth (tighten monetary policy) as a consequence of an overheating economy. They announced loan growth to slow to ¥7.5 trillion (and it needs to slow more). China's economic growth, the biggest engine for commodities and world economic growth, should moderate. Thus, China will influence the pace of the global recovery in 2010. Let's continue watching how Chapter 1 evolves.

Developing an investment outlook is more challenging than in the past. More players (global investors, multiple government policy response) create a complex jigsaw puzzle mix. As China tightens down their economic engine and argues over trade issues, the European Common Union (ECU) is dealing with potential Greece debt default. The problem could spread to other developing European countries. The Euro is sliding in value (while the US dollar is rising) as the EU decides to offer a bailout (entails fiscal risk) or not (entails monetary risk to the Euro). These issues are important, as proof the worlds are changing; global economic growth is now asynchronous.

We expect the global recovery to continue. We expect the US recovery to continue. Global policy response does not want economic growth to stall or recede. The pace of recovery will vary and debt problems of 2008 will continue to resurface in the future (on weakened government balance sheets that provided bailouts), causing deleveraging to continue for years. The US will recover slowly; developing economies recovered quickly, but they are expected to slow their future pace. Inflation should not be a 2010 problem in the US. And, the "bill is coming due". We anticipate positive portfolio performance in 2010, and we are tactically invested via a broad diversification of no-load mutual funds to experience the advance.

The new book in a new decade is largely about China and its evolving influence on world economic and financial growth.

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