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William A. Harris, CFA
Chief Investment Officer

2009 Market Review: A Euphoria Follows the Near-Death Experience

In my first letter last year, [The Great Derangement](#), I resisted the notion we were heading into a second Great Depression and hailed instead a host of deranged values. I also reiterated the fundamental precept which guides our strategic decisions regardless of market environment: “that the American system of political economy will shoulder forward in the long haul and ultimately benefit those who participate patiently.”

How the year played out had little to do with patience, however, as markets turned hard on their heels in early March, and prices which seemed doomed by gravity began suddenly to defy it. Having lost more than half its value in 17 months, the S&P 500 rocketed 65% higher by yearend. Granted, it finished a quarter off its all-time peak, but did -25% ever look better? Winston Churchill wrote that there is nothing so exhilarating as being shot at without result; turns out that getting shot at and hit, yet surviving, can feel pretty good too.

As a way of reviewing 2009, let’s look at outcomes versus my outlook in *The Great Derangement*:

- Investors did indeed rediscover the income statement, or at least its bottom line, and profits driven by expense-cutting (job-cutting, unfortunately for Americans’ top line) propelled valuations.
- Stockholders’ demand for higher risk premia didn’t survive past mid-year, as prices began again to pull away from fundamentals (for our part, we continue to believe that euphoria is not a rationale).
- U.S. Treasuries indeed proved a false refuge and were 2009’s conspicuous loser.
- The jury’s still out on whether Federal efforts have fixed or just gilded a broken engine. While the stock market did indeed “jump off the blocks and bounce down the road like a crazed robot,” the economy sure hasn’t.
- The jury of common opinion seems ready

to conclude that in 2008-2009 the US dollar was not just diluted but debauched; we’re not convinced that this will play out so apocalyptically, though we’re still not dumping all the precious metals shares we bought in late 2008. The clues we had hoped for are not yet conclusive.

- Diversification, seemingly having failed to the downside, did indeed work splendidly to the upside; assets *were* cheap.
- We did survive, and even prospered, though it “hurt like hell along the way.”

Considering 2009 in isolation from the perspective this year and next may bring, I was wrong in one big way: believing that time alone was the likeliest cure for what ailed us. As it turned out (or so far has turned out), the markets found their *deus ex machina* in the Federal promise of systemic backstopping; faith can be stronger than proof.

Now, briefly, predictions for 2010:

- Whereas 2008 hinged on the balance sheet and solvency, and 2009 on the income statement’s bottom line profitability, 2010 will hinge on the income statement’s top line: revenues will be the barometer, both company-by-company and market-wide. Meanwhile, we’ll also be keeping our eyes on actual cash flows.
- Dividends, off 21% in 2009, will resume their accustomed path upward, though with their historical trendline fractured, it will be from a lower base.
- The market’s big challenge will be P/E multiple contraction, both as inflation threatens “down the road” and my failed 2009 prediction about stock investors demanding a higher equity risk premium is born out; this will be fine if fundamentals keep improving, and ugly if economic problems remain intractable.
- Fundamentals will trump momentum.
- Temporarily papered over in 2009, rotten loans will begin to stink again. Ironically, this will force banks to seek profit from the radically steep yield curve and resume lending in spite of themselves.
- We will survive, though it may hurt like hell along the way.