

# Fagan Financial Report

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## EQUITIES REQUIRE A CATALYST

After a more than fifty percent run-up in prices off their March 9<sup>th</sup> lows, equities have been proceeding in a somewhat choppy fashion as investors remain cautious, as evidenced by the nearly \$9 trillion in assets on the sidelines. Furthermore, despite this run-up investors pulled more money out of equities during September alone than they did over the prior three months combined. Moreover, much of the money that is coming out of money markets and short-term U.S. Treasuries is staying in conservative, fixed-income investments. The result, a lid as well as a floor on stocks has taken shape within about six percent of current levels. What investors need is a catalyst.

This catalyst can take shape in several different forms, not the least of which is the fact that the downward trajectory of the economy has abated and signs of life have begun to sprout. Data pertaining to two important sectors of the economy support this belief. After bottoming during the second quarter, Sales of New as well as Existing Homes have stabilized and in fact have advanced a bit and housing inventories, once bloated to over one year, are now at a mid-2007, pre-crisis level of approximately 8.5 months. Consumer sentiment has also risen sharply off its late second quarter bottom as the potential for a depression-like environment has receded.

Further potential catalysts for stocks include easy year-over-year revenue and earnings growth comparisons for our publicly trading companies, a stabilizing labor market, albeit at uncomfortably high levels of unemployment and a rebound in the economies of Asia and other emerging markets.

On the flip side and as mentioned above, the Unemployment Rate sits at multi-decade highs of 9.8%, continuing claims for unemployment benefits remain above six million, the average workweek is at a record low of 33.0 hours and there exists excess capacity in the manufacturing sector. Topping it all off is the continuing pummeling of the dollar versus other major currencies.

Caught in a bit of a range is where we are. However, as we keep in mind that stocks remain thirty percent off their highs set during October 2007, record amounts of liquidity remain on the sidelines and only approximately one-third of the Stimulus Package passed by the Congress has yet to filter through to the economy, we believe that the path of least resistance at least for the next quarter remains to the upside. With this in mind, we will be looking to add to equities on weakness and stay relatively short in fixed income.



## RECOVERY TAKING HOLD IN FITS AND STARTS

The final look by the Commerce Department at second quarter Gross Domestic Product (total output of goods and services produced in the United States) indicates that the trajectory of the economic downturn has begun to level off and, in many sectors, may in fact be turning up. This stabilization is the first step toward a sustainable economic recovery.

The Commerce Department reported that GDP fell at an annualized rate of 0.7% during the second quarter, far less than the 6.4% and 5.4% drops recorded during the first quarter of 2009 and the fourth quarter of 2008, respectively. The consensus estimate had been for GDP to fall 1.0%. On an encouraging note, inventories continue to decline indicating that when domestic demand recovers, businesses will need to rapidly replenish their inventories resulting in stronger economic growth. It is also interesting to note that there was a positive 1.7% impact from foreign trade on Gross Domestic Product.

Another sector of our economy, one that helped lead us into this recession, that supports at least a bottoming of the economic downturn can be found in the housing market. A couple of weeks ago it was reported that sales of existing homes slipped a bit during the month of August. However, over the past twelve months, sales have risen 3.4%.

In addition, inventories of unsold homes have fallen to their lowest levels since June 2007. Once this excess inventory is worked off, we should begin to see a stabilization in home prices, the first leg to increasing prices and stronger demand. It is also very important to keep in mind that several hundred thousand homes need to be built each year due to the growth of the population in the United States as well as to replace those homes that are intentionally demolished or unintentionally destroyed.

The final piece to the “economy is bottoming puzzle” belief can be found in the labor market, and more specifically, claims for unemployment benefits. Continuing claims, made by individuals reapplying for unemployment benefits due to the expiration of their current claim, has fallen from a record high of approximately 6.9 million to approximately 6.1 million this past week. Now, we’re no Pollyanna. We recognize that hours worked are at record lows, unemployment is approaching ten percent and wage growth is stagnant. However, as with the housing market, the patient has to be stabilized before they can begin to recover. Time will tell. In our opinion, the labor market is a key ingredient to an improvement in the economy.

The above begs the question, “so what does this mean for my

investment/retirement portfolio?” We have and continue to hold the belief that the move on the Dow Jones Industrial Average from its all-time closing high of 14,164 on October 9, 2007 to 10,000 on October 6, 2008 accurately reflected the severity of this recession. However, the move from Dow 10,000 to its closing low on March 9, 2009 of 6,547 was mostly panic driven. It then becomes evident that, as the panic subsides, a move back to Dow 10,000 over a period of time is likely. However, the pace at which we move toward this number will slow as it is approached. Furthermore, moving above Dow 10,000 will be predicated upon the success of the economy to right itself through the efforts by both public and private entities. Although we are encouraged in the pace of recovery both domestically and abroad, we will keep a watchful eye on continuing developments.



Fagan Associates is pleased to announce that Chris will now be joining Dennis on the CBS 6 Answers Team every Wednesday from 5:00 - 7:00 pm as they answer financial questions from viewers.

## KEEP YOUR EYE ON THE BALL

These days, when the media wants you to believe that you can buy into the stock market at the perfect time and then sell at precisely the right time, when the media wants you to believe that we are in a “trader’s market” and that you need to spend every waking moment watching the business channel and then tweaking your portfolio, it pays to take a moment to become better acquainted with some sound, time-tested, investment principles. After this fifty percent run-up in the stock market, it makes sense to review your long term investment objectives and determine whether your portfolio is constructed appropriately to achieve those objectives.

Our first recommendation to the readers is to *become an investor rather than a trader*. Don’t concern yourself with what will occur in the stock market over the next week, month or even quarter, but rather what do you believe will be the direction of stock prices over the next one to three years. As noted above, keep in mind that the media wants you to be a trader so that you will stay abreast of the markets on a daily basis. Become an investor. Tune out the “halftime report” of each trading day. Tune off “market wrap.” Tune off news teasers like “you can’t afford to miss these earnings releases.” Forget the fact that “September is historically a bad month to invest.”

Assuming that you agree and are an investor rather than a trader

(trading may have worked during the last bull market, but is counter productive to long term growth of capital), make certain that *your stock holdings are diversified across four to six different industries*. You therefore are able to weather any unexpected downturns in a particular sector.

A third recommendation that may help you invest more profitably over time is to *realize that you will not be right all of the time. However, the important factor is to be right over time*. Once again, don’t appraise your portfolio on a daily basis. It becomes not unlike weighing yourself every day. Given these market conditions over the past couple of years, you will never be happy, eventually become exasperated and give up. Measure your performance versus appropriate indices over time and recognize that you will make errors.

What matters during periods of consolidation is that you *exit with the right portfolio*. Simply put, when evaluating your portfolio you must assess the potential of your holdings as we exit the current economic malaise. Do you own the companies with earnings growth potential? Do you own the companies that are increasing their share of the market? Do you own the companies with a proprietary product or service?

*Continue to invest on a systematic basis through your company sponsored pension plan such as 401(k) or 403(b)*. Assuming that you are allocated appropriately between stocks and bonds to meet your long-term objectives, it is imperative that you do not make

Major changes to your investment patterns during this downturn. Use the “sale on stock prices” to continue to dollar cost average. Each dollar invested will now go a bit further in purchasing shares based upon their low net asset value. Remember that *excessive optimism does not yield stock prices at attractive levels, excessive pessimism does*. Where do you think we are now?



Fagan Associates would like to welcome Samantha R. Fagan to their firm. Sam graduated with a Bachelor of Arts from Fordham University in May 2009 and will focus her efforts in Client Service along with Administration. She along with Mary Schongar will continue to provide the clients of Fagan Associates with prompt, courteous and professional service, service which we have been proud to provide for our more than twenty years in business.

## WINDOWS AND ORPHANS BASKET

Every once in a while an investment tenet that we thought was common knowledge is brought to our attention that perhaps this assumption was premature. The one that we'll address within the body of this column is **don't put all of your eggs in one basket**. We believe that many investors don't realize that there are many different types of baskets or perhaps that the same basket has cleverly disguised itself as different baskets. For instance, there is the Widows and Orphans Basket, defined simply as a basket filled with stocks or mutual funds of supposedly "bullet-proof, or "blue chip" companies, that over time, regardless of the economic climate, will ultimately prove profitable. Generally speaking, historically, these companies have also paid attractive dividends.

Many of the widows and orphans companies are found in the financial services industry and include the likes of KeyCorp, Bank of America, and Citigroup. Outside of this sector, some other companies that fit this definition are General Electric, Honeywell and Exxon Mobil. The problem with this basket is that the bear market, that at least for the time, being concluded in early March, has dug its claws deepest into these types of companies. For example, KeyCorp, Bank of America and Citigroup have shed more than 85%, 75% and 94% of their value, respectively. In addition, all three of these securities have

slashed their dividends, income that many counted on to supplement their pensions and Social Security, to \$0.01 per quarter from \$0.36, \$0.64 and \$0.54. What this means is that if an investor held 100 shares of each of these three financial service companies their annual dividend income would have declined to a total of \$12.00 for all three combined, from \$616.00, a 98% decrease. Furthermore, those 100 shares of each that would have amounted to about \$14,500 are now valued at approximately \$2,135. Unfortunately, the prospect for recouping this type of loss over the foreseeable future is slim to none.

Many investors placed all of their assets into the banking sector for the perceived safety of principal as well as the dividend income. From the example above, it is apparent that this choice was a near fatal one.

***THE BOTTOM LINE**– Diversify by sector as well as by objective. Also, don't be so arrogant as to believe you know in which direction the stock market is headed over the short-haul and what sectors will do best. Include both dividend and non-dividend paying growth oriented stocks such as Apple Computer, Research In Motion, Google, and Schlumberger into your portfolio. If the above investor had, then the overall damage would have been much less as these four have soared over the past couple of years. Finally, never buy and hold forever. Always, buy and do your homework on a periodic basis!*

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- A Recap of the financial markets, including company specific and economic news.

- "The Record Review" – an outline of our column that appears in the Troy Record every Sunday.

- "Widely Helds" – a look at the price action and news releases from the most widely held stocks.

- A spotlight on one or some of our **mutual fund holdings or EFT holdings**.

- A look at the upcoming week, including economic data and earnings reports.

- Monthly notable changes to our investment portfolios after the close of the prior month.

- \* Periodic interviews with other industry professionals, including mutual fund managers, insurance professionals, accountants & attorneys.

- \* Periodic interviews with local men and woman making news that affects our lives.



**The RECORD** Read the Fagan Financial Report every week in The Sunday Record



INVESTOR, KNOW THYSELF

The anxiety and despair that was Wall Street just six short months ago has begun to recede. Gradually, investors are returning to investing in the stock market, thus pushing the overall market higher. We believe that there remains a large degree of skepticism about the direction of the market despite all of this seemingly renewed optimism.

We often talk about the stock market being an anticipatory vehicle and that historically advances come during the most trying of economic times. In fact, back toward the end of March, when stocks were just coming off ten-year lows, we penned an article that appeared in *The Record*, entitled "Try The Irrational." Contained within the body of this article were a number of reasons why, despite the fact that the economy was mired in a severe economic recession, one should consider investing in the stock market. We observed that "if the entire objective of investing is to buy low and sell high, why then when investors have the chance to actually buy low and sell high, very few do?"

Fast forwarding to today, we see some sparks in the economy, specifically in housing and some of the Leading Economic Indicators. However, in our opinion, alone not enough to justify the more than fifty-percent advance in the S&P500 off its March 9, 2009 close. Jobs are still being lost, consumer

spending remains soft and businesses are still reluctant to loosen the purse strings. Despite these remnants from this long, deep recession, the stock market remains steadfastly focused on what it appears as a gradually improving economy, one where at some point in time in the not-too-distant future, some of the pent-up demand in both the consumer and business sector will begin to be filled with orders.

Where do you stand in relation to your objectives? How are your assets allocated? Is your current strategy of investing appropriate for your particular situation or have you been scarred by this bear market and, most likely to your own detriment, unwilling to wade back into individual stocks or equity mutual funds? It is a fact that upon exiting a bear market the vast majority of individuals are underinvested in the stock market. Perhaps we may have indeed lost a generation of American investors.

*THE BOTTOM LINE— It is important to objectively assess your own portfolio and the amount of risk involved, given the length of time remaining in which to achieve those objectives. Furthermore, it is important for each of us to try to determine their ability to withstand the emotional weight of a declining market. This "tolerance to risk" was by far the most important factor in determining which investors were able to focus on the long-term benefits of investing and which sold at or near the bottom. It is also important to learn from the past, but not live in it. Look forward and keep in mind that stocks have gone nowhere over the past decade. Ironically, this most likely bodes well for stocks over the next ten years.*



**INVESTMENT PRODUCTS**

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# FAGAN FINANCIAL REPORT

## CORPORATE NEWS & EARNINGS REPORTS

*(Please note that all opinions are as of the date indicated and are not meant to be a specific recommendation on your particular situation, but just a general opinion on the appreciation potential of the stock at its current price.)*

### Common Stock & Equity ETF Portfolio Holdings\*\* Ranked by **Market Value** as of September 30<sup>th</sup>, 2009.

<i>Percent of Common Stock</i>	<i>Company Name</i>	<i>Symbol</i>	<i>As of Sept 30<sup>th</sup>, 2009</i>	<i>As of Aug 31<sup>st</sup>, 2009</i>	<i>As of July 31<sup>st</sup>, 2009</i>
6.31%	Hewlett Packard	HPQ	1	1	1
5.47%	Apple Computer	AAPL	2	2	2
4.54%	JP Morgan Chase	JPM	3	3	3
4.51%	General Electric	GE	4	4	4
3.40%	McDonald's Corporation	MCD	5	5	6
3.12%	Exxon Mobil	XOM	6	6	5
2.82%	Nike, Inc.	NKE	7	10	10
2.64%	Intel Corp.	INTC	8	7	9
2.58%	Pepsico, Inc.	PEP	9	9	8
2.51%	MasterCard, Inc.	MA	10	8	7
2.30%	Johnson & Johnson	JNJ	11	11	11
2.20%	S&P 500 ADR's	SPY	12	13	13
2.17%	Conoco Phillips	COP	13	12	12
2.12%	Cisco Systems, Inc.	CSCO	14	14	14
2.03%	Research In Motion	RIMM	15	15	15
1.64%	Emerson Electric Co.	EMR	16	18	18
1.60%	iShares DJ Select Divd Index	DVY	17	16	17
1.50%	Bank of America	BAC	18	17	19
1.49%	Celgene Corp.	CELG	19	19	16
1.40%	Foster Wheeler	FWLT	20	21	25
1.37%	Pfizer, Inc.	PFE	21	20	20
1.20%	Dell Computer	DELL	22	22	27
1.14%	Suncor Energy	SU	23	26	24
1.04%	Microsoft Corp.	MSFT	24	27	28
1.03%	Oracle Corporation	ORCL	25	24	23
1.01%	Baxter International	BAX	27	25	26
0.99%	First Niagara Financial	FNFG	29	23	22
0.66%	Target Corporation	TGT	44	41	21

**Portfolio Concentration: Top 25 holdings represent 62.12% of the common stock portfolio, as of September 30<sup>th</sup>, 2009.**

### Largest Mutual Fund Holdings as of September 30<sup>th</sup>, 2009.

<i>Domestic Equity Funds</i>	<i>International Equity Funds</i>	<i>Hybrid/Fixed Income/Muni Fund/ETF</i>
AF Capital Income Builder	William Blair International Growth	Payden GNMA Fund
Schwab 1000 Select Fund	BLDRS Emerging Markets	Loomis Sayles Bond Fund
Baron Asset Fund	Tweedy Browne Global Value	iShares Lehman Bros TIPS
Parnassus Equity Income Fund	Janus Overseas	PIMCO Total Return
T Rowe Price Growth Stock Fund	BLDRS Asia 50 ADR Index	MetWest Total Return Bond Fund



**FEDERAL RESERVE STATES ECONOMY STABILIZING**

Periodically, the Open Market Committee of the Federal Reserve meets to determine, amongst other things, the direction of interest rates. One such meeting recently concluded and from it, according to their press release, came some very interesting observations.

The release notes that “conditions in financial markets have improved further” since they last met during August and “activity in the housing sector has increased. Household spending seems to be stabilizing, but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth and tight credit.” The key word within this portion of the policy statement and the main reason for the recent run-up in the stock market is “stabilizing.” Think back to one year ago when first Lehman Brothers fell to be followed shortly thereafter by the collapse of American International Group (AIG), investors of all kind were in a state of panic as there was apparently no safe haven. Even the most conservative investors, those that invested in banks, were worried. The belief was that the United States was headed into a depression. Fast forward ahead to early March 2009 when, in hindsight the stock market bottomed. It did so amidst a sea of discouraging economic news as well as a preponderance of consumer and investor pessimism. Therefore, stabilization, although perhaps not adequate enough now to move the stock market higher, is a step in the right direction.

The press release observes that although “businesses are still cutting back on fixed investment and staffing, though at a slower pace; they continue to make progress in bringing inventory stocks into better alignment with sales.” In other words, the supply out there is somewhat in proportion to current demand. Furthermore, “the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will support a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability.” There is that word again, “stabilize.” What we gather from this paragraph is that the Fed sees a stabilization of economic growth with little inflationary pressures, at least in the foreseeable future. In fact, the Fed goes on to state that “with substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.”

Concerns of economists are now beginning to center around the question of “how do we exit this period of easy monetary policy and quantitative easing?” The Fed begins to address this issue. “In these circumstances, the Federal Reserve will continue to employ a wide range of tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent

and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.” However, “the committee will gradually slow the pace of these purchases (agency mortgage-backed securities and agency debt) in order to promote a smooth transition in markets and anticipates that they will be executed by the end of the first quarter of 2010.” The phrase “gradually slow the pace” is the equivalent of the Fed taking away the punch bowl, and to mix metaphors, eventually passing the lending baton to the private sector.

*THE BOTTOM LINE comes with the assurance that “the Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets.” With this in mind, we believe that this accommodate policy by the Fed along with the Obama Administration makes for an attractive investing environment, one in where, we believe, that the risk is being out rather than in.*

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COFFEE SECOND**



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**Cup O’ Joe For A Joe**

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**INFLATION NOT ANY NEAR-TERM THREAT**

Investors hear a lot of talk today about how the massive spending by the Federal as well as State Governments along with the potential for a pick-up in economic activity during the latter part of 2009 and into 2010 may be inflationary. To this point we can agree. However, until all of the excesses in the economy get soaked up, inflation remains at bay.

This past week at the conclusion of their regularly scheduled meeting to determine, amongst other items, the direction of interest rates, the Federal Reserve's Open Market Committee issued a statement outlining their reasoning behind keeping interest rates at 0.25%. They stated that "conditions in financial markets have improved further, and activity in the housing sector has increased. Household spending seems to be stabilizing, but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth and tight credit."

Furthermore, they noted that "although economic activity is likely to remain weak for a time, the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will support a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability."

Contained within this statement is also the conclusion that "the Committee will maintain the target range of 0% to ¼% and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

Their conclusion is our conclusion. Digging a bit deeper than the policy statement, one can find that Capacity Utilization, the percent at which our nation's

Mine, factories, and utilities operate at remains near historic lows. This excess capacity must be soaked up before any inflationary pressures mount. Furthermore, and as is referenced in other parts of the *Fagan Financial Report*, hours worked remains at or near all-time lows. It would therefore be natural for employers to offer more hours to their current employees rather than hire new ones. Once again, for at least the next two to three quarters, this should keep the unemployment rate relatively high and wage growth tame.

The Unemployment Rate stands at 9.8%, a multi-decade high. Furthermore, assuming that all of those that needed jobs were actually looking for them, the Unemployment Rate is approximately 17%. Once again, before any inflation pressures mount regarding wages, the rate of unemployment would have to fall substantially.

Finally, consumers continue to repair their balance sheets by deleveraging. The Federal Reserve recently reported that consumer credit dropped by a record \$21.5 billion this past month, an unprecedented sixth consecutive monthly decline. We believe that this deleveraging is part of a secular trend that will continue into the foreseeable future thereby reducing the pricing power of retailers and therefore controlling inflation.

*THE BOTTOM LINE – Don't expect inflation and therefore interest rates to tick up anytime soon. We would strongly recommend that your investment portfolio reflect this expectation by looking for alternatives to Certificates of Deposit and other Fixed Interest Accounts. Otherwise, the level of investment income will be far below what you are accustomed to and perhaps what can maintain your standard of living.*

*Fagan Associates, Inc. offers a wide variety of assets to meet all of your investment needs. We are an independent, fee only firm. We don't sell you a product to generate a commission. Dennis and Chris structure your portfolio to help you achieve your financial goals, without using any proprietary products.*

*When you call Fagan Associates, Inc., you will speak with your investment manager, not a salesperson. If you have any questions about ETFs or any other investment asset or strategy; please give Dennis or Chris a call at 518-279-1044 or 800-273-6026 Stocks, Mutual Funds, ETFs, Bonds and Fixed Income*

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