CITIZENS WEALTH MANAGEMENT

Market Commentary

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Market Returns

	October 2009	Year-to-Date as of Oct. 31		October 2009	Year-to-Date as of Oct. 31
DJIA	**-0.0%**	**10.7%**	**MSCI EAFE**	**-1.2%**	**23.9%**
S&P 500	**-1.9%**	**17.1%**	**MSCI Emerg Markets**	**0.0%**	**61.2%**

October Musings Most companies reported earnings during October, and while the numbers generally exceeded expectations, most stock indices showed modest declines. The market's future course will be affected by how the Fed drains off the excess liquidity it has created, and returns to more typical, albeit less accommodative, interest rate policy. Perhaps equally important for stocks would be an uptick in payrolls. Since January, 2008, monthly increases in job losses have been reported, but the rate of loss has slowed in recent months. A positive payroll number, showing actual net job creation, could be a huge stimulus for stocks.

Emotion and Investing – A Fatal Combination. Dalbar, a financial industry standards and research arbiter, produced a study called "Quantitative Analysis of Investor Behavior," which reported that the average equity mutual fund experienced returns far better than those of the average equity mutual fund *investor*. While this appears paradoxical, investment returns exceeding those of actual investors, Dalbar explains that investors let their emotions time their buying and selling as well as the sectors they choose, such as buying technology funds at their peak in 1999 (does this behavior sound familiar?). In a 2004 study covering a 20-year period, the average equity fund investor earned 1.87% annually, less than inflation's 2.89% rise, and far less than the S&P 500's 8.35% annual return. This emphasizes both the need to eliminate the emotions that so often govern investment decisions, and the value of picking an asset allocation with which you can stay the course through good and bad markets.

Bond Feeding Frenzy Morningstar reported that in 2009's first eight months, risk-averse investors snapped up 209.1 billion in bonds funds, dwarfing the mere $15.2 billion stock fund inflows by an almost 14 to 1 ratio. Investors bid up bond fund prices even though market yields were historically low. The secular bull market in bonds is growing old, dating back to 1981, and many alive today may not recall the carnage wrecked upon bonds as interest rates rose through the 1970's. This powerful surge of money into bonds may be a warning sign. As the old Wall Street adage goes, "The crowded trade is the wrong trade… eventually."

Fed Tightening Bullish for Stocks Contrary to the popular belief that Fed rate increases will hurt stocks, according to CitGroup Global Investment Committee's October report, **"Equity returns are normally healthy in both the 12 months before and the 12 months after the first Fed tightening, which has yet to transpire."** We've already had had 7 months of good markets, but the Federal Reserve would be unlikely to increase interest rates until an economic recovery is well underway. While the first rate hike may spook equity markets, the effect should be short-lived, as the economic fundamentals of an improving economy reassert their control.

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