



## 2010 – 4TH QUARTER REVIEW AND PREVIEW



### BOB'S CORNER

#### The Answer is: Very Close If Not Yes!

As the market hit the levels not seen since the middle of 2008, it begs the question: **Have I truly got all my money back? The answer for most investors is absolutely NOT!** Unless you were able to manage your portfolio with less volatility than the Russell 3000 index, you are probably still under water. Remember, the simple rules of compounding are: if you lose 50% you have to make 100% to get your dollar back. So if we look at the Russell 3000 (broadest U.S. index that covers 97% of our market value) which dropped 57.1% from the high on October 9, 2007 to March 9, 2009. In order to get your money back from that low of 42.9 cents on the dollar, you have to make 133%. The Russell 3000 is up only 97.3% from that March bottom to year end 2010. In order to get back to whole you would still need to make an additional 36.7%

**Over this same time period our four portfolios averaged a loss of only 36.2% compared to the market loss of 57.1%. In order to get your dollar back to whole, you only have to make 56.5% and as of December 31, 2010 the average All Star portfolio has bounced up 53.7% from the March 9, 2009 bottom. Some of you have already gotten your dollar back while the rest of you are very close!**

Thank you for your trust in All Star!

## Have We Come Full Circle?

### MARKET OVERVIEW

#### Overview

As 2010 drew to a close, the economic recovery began to strengthen. It also marked the point that the stock market came full circle, completely recovering from the March 2009 bottom that occurred after the collapse of Lehman Brothers that triggered the financial crisis of 2008. The market has come a long way, but in dollar terms the Russell 3000 still has to gain almost 37% to get your dollar back to whole! (See Bob's Corner.) The 4<sup>th</sup> quarter also saw a dramatic reversal of fortunes for U.S. taxpayers as both General Motors and AIG conducted successful public stock offerings. As a result, the government is likely to be fully repaid for the \$700 billion in TARP capital invested in these companies and the nation's banks.

Stocks responded to both good economic news and another solid quarter of corporate profit growth. With a rebound in consumer spending and confidence, businesses remain cautiously optimistic as signs point to an improved job market in 2011. After a mid-year swoon in reaction to slower economic growth and European debt concerns, the market enjoyed a solid recovery. Energy, Materials and cyclical stocks led the rally.

Consumers, businesses and the economy have been tested over the past 2-1/2 years. Even though housing/real estate is still down, it now appears that we have entered a period of more stable economic growth, including improved demand, increased production and steady job growth. The foundation for a stable economic recovery has been laid.

### ECONOMY

#### THE 4TH QUARTER

After moderating in mid-year, economic growth surged in the 4<sup>th</sup> quarter. Gross Domestic Product (GDP) growth came in at a 2.6% annualized rate during the 3<sup>rd</sup> quarter, and economists are projecting that GDP growth in the 4<sup>th</sup> quarter will be at least that strong. The most pleasant surprise is the return of the consumer. Both personal income and spending grew by 3.8% year-over-year during the quarter, the strongest gains since the recovery began.

There are some signs that an improved job market has boosted the confidence of consumers and investors. Jobless claims have steadily declined since August. Job growth in October and November was the best since the Census Bureau hired a slew of temporary workers a year ago. Holiday hiring was also strong.

Businesses started to spend on both equipment and inventories, which contributed significantly to the economic growth. Two key private sector measures, the ISM Manufacturing and ISM Service Sector Indexes remain firmly in expansion mode.

Corporate profits have held up well as many firms remain focused on rebuilding their finances and margins. We also saw bank lending increase in November and December. This is the first time in two years the bankers have relaxed their grip on the money supply. That could be a sign of more business expansion ahead.

Inflation and interest rates remain low and the Federal Reserve is focused on keeping rates low until the troubled housing market shows more signs of life. A true recovery in the housing market may remain far off in the future. The most recent S&P/Case Shiller Home Price Index showed home prices declining again late in the year after a few months of improvement.



## LOOKING AHEAD

The recent compromise legislation extending tax cuts and unemployment benefits and adding a 2% payroll tax cut has led most economists to upgrade their forecast for GDP growth in 2011. Many anticipate growth in the 3-4% range rather than the previously projected 2-3%. Two key economic leading indicators (from the Conference Board and ECRI) turned positive again during the second half of 2010. Growth could be even stronger if hiring beats expectations and consumers continue to slow the pace of paying down debt. Business spending is likely to remain healthy through 2011.

Inflation is expected to remain tame through 2011, but there is a risk that stronger global economic growth could drive energy and commodity prices higher. The Federal Reserve appears committed to keeping interest rates low and continuing its second round of quantitative easing by buying treasury debt through June 2011. One result could be a gradual weakening of the dollar, a boost for U.S. exporters.

**We should caution that economic recovery does not equate to economic health.** Unemployment remains uncomfortably high though it should improve modestly in 2011. The fiscal deficit has yet to be addressed in Washington. The recent tax cut extension, while positive for short-term economic growth, only adds to the debt. If we want to see continued economic recovery, we need to see a game plan for fiscal prudence!

## **BOND MARKET**

### THE 4TH QUARTER

The normally safe and steady bond market was anything but in the 4<sup>th</sup> quarter. Usually reliable government and municipal bonds declined during the quarter. The combination of improving economic data and the historically low level of bond yields finally resulted in investors moving money out of bonds and into equities.

The passage of the tax cut extension may have had unintended consequences on the municipal bond market. The “Build America Bonds” program that was part of the original recovery program was allowed to expire. This left state and local governments dependent on traditional bond markets for financing. A flood of new municipal issues hit the market, which overwhelmed demand and drove down bond prices.

Most government and corporate bonds declined by 1-3% during the quarter, but long-term government bonds took a bigger hit, posting a 9% loss. Municipal bond funds dropped 4%. Global bonds, emerging market bonds, and inflation-protected bonds (TIPS) declined by 1-2%. The only bright spots for bond markets in the 4<sup>th</sup> quarter were corporate high yield issues and bank loan funds, both gaining 3-4% during the period.

### LOOKING AHEAD

After investors put hundreds of billions of dollars into bond funds in the past few years, a reversal may be underway. The Fed’s quantitative easing plan appears to be having one of its intended effects, to convince investors to move money out of bonds and into stocks and other assets.

Still, the news is not all bad for the bond market. The Fed’s commitment to low interest rates and quantitative easing should partially offset the impact of money flowing out of bonds. There is still value to be found in corporate and high-yield bonds as well as emerging market issues. All have spreads at or slightly higher than the historical averages. Foreign bonds could benefit if the dollar weakens. Issuers from emerging markets are in a better fiscal condition than many of those from developed markets. Municipal bonds are now more attractively priced and could benefit as state and local tax revenues have begun to rise, partially easing their fiscal strain.

## **DOMESTIC STOCK MARKET**

### THE 4TH QUARTER

The year ended on a strong note for U.S. stocks as investors built on 3<sup>rd</sup> quarter gains. Most broad market indexes finished with double-digit returns for the second consecutive year. The Russell 3000 Index gained 11% in the 4<sup>th</sup> quarter. Mid-cap stocks rose 13% during the period, helped by increased merger and acquisition activity. Large-cap and small-cap stocks both gained 11%. Growth stocks benefited from improved economic sentiment, returning 13% compared to a 10% return for value stocks during the quarter.

Although there was not great variation in performance among asset classes, industry-sector returns were more distinct. Energy and Material stocks led the pack with returns of 20% and 18% respectively. Both sectors benefited from increased global demand and improved profit outlooks. Defensive sectors such as Consumer Staples, Health Care and Telecoms registered modest, single-digit gains.



## Performance Update

Market Index	4th Qtr	1 Year	2 Years	3 Years	5 Years
DJ Ind Average	8.01	14.04	18.24	-1.59	4.30
S& P 500	10.49	14.79	20.50	-2.94	2.23
Russell 2000	16.25	26.85	27.01	2.22	4.47
S&P Mid-Cap 400	13.50	26.94	31.90	3.52	5.73
<b>Russell 3000</b>	<b>11.59</b>	<b>16.93</b>	<b>22.50</b>	<b>-2.01</b>	<b>2.74</b>
MSCI EAFE	6.61	7.75	19.16	-7.02	3.26
MSCI Em Mrkt USD	7.34	18.87	45.67	-0.36	12.74
NASDAQ Comp	12.00	16.91	29.70	0.01	3.76
Barclays High-Yield	3.22	15.12	34.96	10.38	8.91
Barclays Agg Bond	-1.30	6.54	6.24	5.90	5.80
Barclays Credit Index	-1.22	7.76	11.77	6.70	6.03
Barclays Gov Bond	-2.34	5.52	1.59	5.07	5.45
Barclays Corp	-1.86	8.47	12.19	6.85	5.98

### LOOKING AHEAD

Optimism is high for 2011 as consensus forecasts of market strategists call for returns of 10% to 15%. Along with the many favorable signs outlined above, stocks appear to be attractively valued compared to other assets in a low inflation and low interest rate environment. The domestic stock market, among the best worldwide in 2010, may lead developed market returns in the years ahead as the U.S. economy remains more dynamic than those of Europe and Japan.

We expect cyclical growth stocks to maintain market leadership into 2011. We especially like the earnings forecast for the Materials sector and expect Financial stocks to perform better as the banking sector gradually heals. Stocks of high quality companies that pay a dividend should also be in a favorable position. We anticipate large, mid, and small-cap stocks to perform comparably in 2011.

### INTERNATIONAL MARKETS

#### THE 4TH QUARTER

International markets as a whole underperformed U.S. stocks in the 4<sup>th</sup> quarter, logging a 7% gain, well below the double-digit returns for U.S. stocks. Signs of inflation in China, Brazil and other emerging markets led to interest rate hikes and other monetary tightening measures, tempering stock market returns.

Japan led non-U.S. markets with an 11% gain for the quarter as bargain hunting by investors boosted returns. Korea rose 10% despite rising tensions with North Korea as the country's cyclically based industries performed very well. Emerging Market stocks rose 6% during the quarter, with Latin America narrowly outpacing Asia emerging. Europe continues to be the weakest link in the global market, with stock markets rising just 2% in the quarter.

### LOOKING AHEAD

Even though our overexposure to the emerging markets hurt us in the 4<sup>th</sup> quarter, we remain bullish on prospects for emerging market stocks and expect them to reassert their leadership position in 2011. Despite concerns that China may be facing an economic bubble, the country has large foreign reserves and appears to be maintaining a modest policy approach, which should help keep its economy on track. South Korean stocks remain attractively valued and should benefit from the global recovery, particularly if the saber rattling with North Korea subsides. We will also retain a broad exposure to global small-cap stocks where good values can still be found.

A cautious approach to the Euro region remains appropriate. Germany appears to be the sole source of strength in Europe where the debt crisis continues to create a serious external risk. While issues in Greece and Ireland have been addressed, Spain, Portugal and Italy have yet to resolve their problems. Japan remains an important global economy and over time, we may see export-focused stocks benefit from an increased global demand.

### SUMMARY

We believe, along with most economists, that the risk of another recession is fading and a sustained recovery of the economy is in place. The only real question is the pace of the recovery. Even as markets have recovered to pre-Lehman levels in both equity and bond markets, we believe a slow but sure expansion is in sight. As we have said before, we think this recovery has the potential to be longer lasting than previous business and market cycles, with the potential for several years of solid but modest returns for long-term investors.

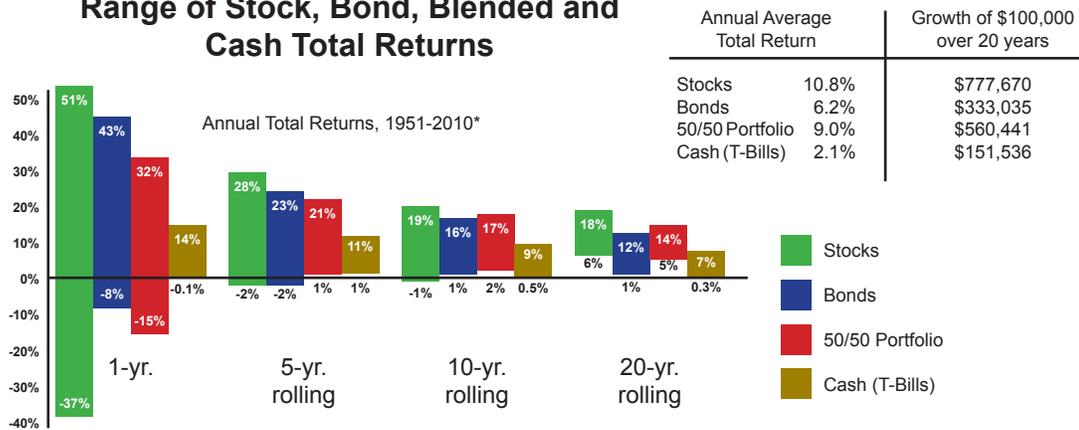
**We appreciate your trust as we look for new opportunities and values in the changing investment landscape that lies ahead.**



## Slow But Sure Does Win The Race!

Looking back over the past 60 years puts our most recent volatility into perspective. Through good times and bad you can see that a simple, diversified 50/50 portfolio of stocks and bonds over the last 1, 5, 10 and 20 year rolling time horizons has always produced a positive annual return! Looking specifically at the 20 year intervals, that same balanced portfolio never returned less than 5% annually and was second only to stocks as the highest performer at 14%. This data reminds us that it is never wise to put all of your eggs in one basket and the “It’s not how much you make – it’s how much you KEEP” philosophy of All Star Financial truly does win the race!

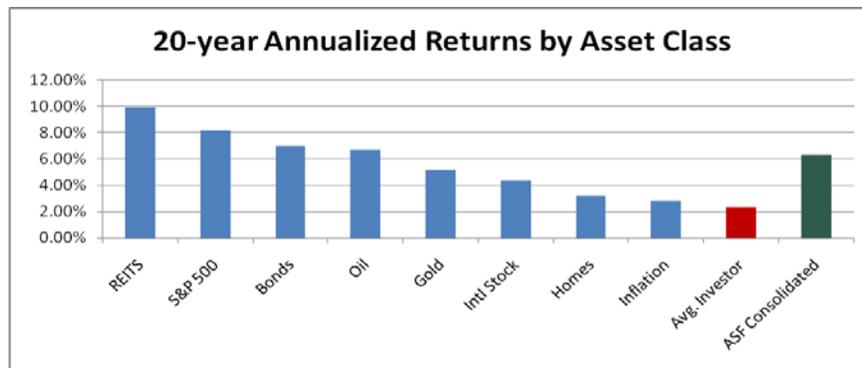
### Range of Stock, Bond, Blended and Cash Total Returns



Sources: Factset, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management. \*The 20-yr. Cash (T-Bill) returns were calculated using 20-yr. annualized returns from 1951-2010. Data are as of 12/31/10.

## The Average Investor Does Poorly!

Left to their own defenses, the statistics also show that the average investor does very poorly. In fact most investors do not even beat the 2.8% inflation rate. The emotion gets the best of most people and forces them to sell low and buy high. Our consolidated portfolios have averaged a 6.3% gain over that time period, our conservative growth and growth portfolios a bit more and our income portfolio a bit less.



Data as of 12/31/2010

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