

*“Climbing a Wall of Worry”*

The U.S. and other major global economies continue to gain strength. The gains are modest, measured and deliberate. Inflation remains at low levels. Unemployment appears to have stabilized at the 10% unemployed level. Housing has bottomed and has begun to show signs of improving. The consumer spending decline has abated and seems to be steady.

Most major banks have returned the government money they were provided with to get through the credit crisis. The credit markets continue to repair with interest rate spreads between U.S. Government Bonds and Corporate Bonds narrowing. The markets for securitized mortgages and other debt investments have begun to loosen. This improved liquidity has led to increases in the prices of these securities. Corporations are once again able to raise debt in the public market.

On the fiscal policy side, the U.S. and other countries' central government stimulus money has begun to increase economic activity. This increased economic activity has resulted in new jobs and an increase in individual savings. Although military spending will increase with the added involvement in Afghanistan, the cost of the health care initiative is likely to be lower than first expected. Therefore, the increase in the U.S. budget deficit will also be lower than was expected.

From the point of view of business, corporations seem to have achieved a major part of their objective in restructuring costs to bring them in line with the new lower levels of demand. The vast majority of cuts in employment have been completed. This has had a significant positive impact on productivity. Inventories, having been reduced, are now also in line with the new lower levels of demand. These adjustments are beginning to be reflected in improved profit margins and higher corporate profits. The lower value of the dollar is helping to improve the U.S. balance of trade, as U.S. goods and services become more attractively priced in global markets. Exports are growing and imports are slowing as consumers in the U.S. build their savings.

The commercial real estate market which had been over-extended in terms of price and leverage is going through a correction. This correction is being cushioned by the banks working with the Federal Reserve to restructure loans to avoid bankruptcies. These efforts will have a stabilizing effect on the decline in commercial real estate prices, and therefore limit the destabilizing impact it will have on those financial institutions that financed the bulk of the real estate loans.

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Both the stock and bond prices have increased to reflect these improvements. Bond prices have increased as yield spreads have narrowed. The Federal Reserve has held short term rates extremely low to accommodate the weak economy. Because of the Fed's impact on short term rates, the yield curve is quite steep. Rates on bonds with maturities of 4-12 years are significantly higher than rates on maturities of less than 2 years. As the economy continues to repair, we would expect the Federal Reserve to eventually tighten short term money, which will increase short term rates at a much faster pace than long term rates. These activities will flatten the slope of the yield curve with shorter rates having a more normal relationship to longer rates. Because of this anticipated change we are emphasizing bond investments in the 4-12 year maturity range over those of less than 4 years.

The stock market continues to defy a number of investment professionals who had expected a correction in the sharp increase in stock prices from their lower levels of March 2009. Abner, Herrman & Brock's economic and market outlook has and continues to be positive. We continue to position equity portfolios for a market of rotating corrections in a secular rising trend. We expect the economy to continue to grow in a measured and reasonable growth pattern. In such an environment, equity prices will also gain in a secular fashion, following a measured rise in economic activity. Because we do not foresee a boom and bust economy over the next several years, it is unlikely we will experience a boom and bust in the equity market. Improved government regulations presently being put in place will have a positive effect on alleviating excesses created by leverage and speculation.

In the stock market and economic environment that we are currently forecasting, it is likely that the valuation of equity prices will improve in the form of the ratio of price to earnings. Higher price to earnings ratios are awarded to those companies that have a clearer visibility of their earnings growth potential over a longer period of time.

As long as there are a fair number of market participants who are concerned about the potential disruption to the economy and market rise, we feel comfortable in our stock market outlook. When the "worriers" become believers, or our economic outlook changes, it will be time to reevaluate our investment strategy.

Best wishes for a Happy and Healthy New Year.

**Investment Policy Committee**

**Abner, Herrman & Brock Asset Management**

Founded in 1981, Abner, Herrman & Brock Asset Management manages portfolios individually structured to assist each client in achieving their investment objectives. Stock portfolios are managed utilizing a Core Equity philosophy, investing in both large capitalization value and growth disciplines with an objective of long-term, after-tax appreciation and below market volatility. Portfolios are diversified across economic sectors, industries and companies. Bond portfolios are managed to provide a high rate of current income and total return. Portfolios are invested in staggered maturities of U.S. Treasury, government agency and investment-grade corporate bonds and where appropriate, investment-grade municipal bonds. Portfolio managers are available to meet with clients upon request.

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