



Market Perspective

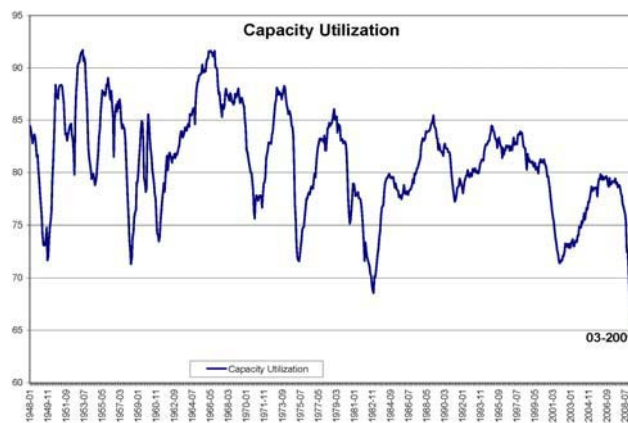
December 31, 2009

“The inherent vice of Capitalism is the unequal sharing of blessings. The inherent virtue of Socialism is the equal sharing of miseries.” Winston Churchill, 1945.

As we conclude the first decade of the Twenty-first century and enter 2010, Winston Churchill’s quote really hits home. Economically, we know that the world is saddled with the results of a “Debt Supercycle” that was building for the last three decades. This massive debt occurred because our politicians became hooked on economic growth and could not bear the political pain that comes with recessions.

Additionally, while the blessings of modern technology, the internet, cell phones and the like, have brought the world closer together like never in the history of man, they have also invited worldwide competition for jobs and production. Though the “global economy” has led to an economic world that is better for most of mankind, it has also created a scenario where America’s jobs are being outsourced to other countries so our companies can stay competitive. Productivity has exploded to the upside, BUT much of our labor force in both service and non-service industries are confronting competition like we have never seen.

The Capacity Utilization Chart illustrates this point well. Capacity Utilization is at all time lows, and this chart reflects only the United States. We must also add in the available capacity from the many countries around the world including the emerging markets, such as China and India.



Churchill Management Group #58

Through Nov 2009

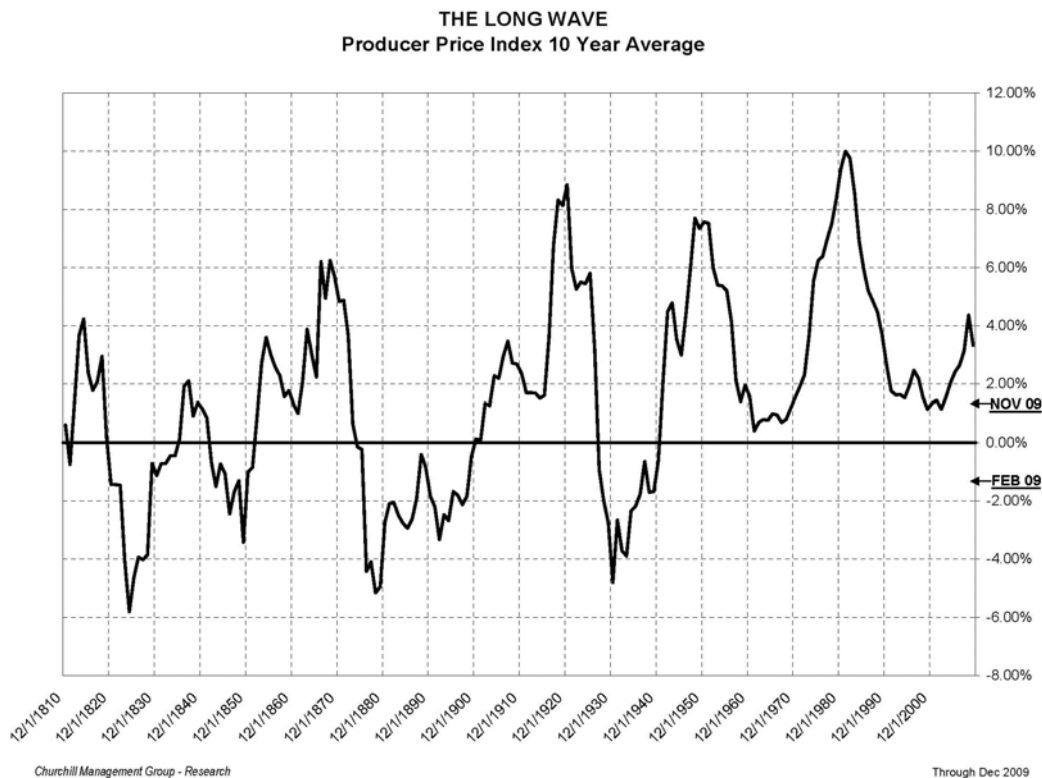
As we have addressed in past letters, we believe this underlying economic background is causing great fears of DEFLATION (where prices and wages are under pressure.) These fears are showing up via foreign political leaders and Central Bankers throughout the world working together to stop “The Great Depression II.” Fortunately, the level of economic sophistication of our current political leaders and Central Bankers is dramatically better than that of our forefathers in the 1920’s and 1930’s. There were similar excess capacity problems then, but instead of being caused by modern technology, the internet, cell phones and the like, there was a huge bubble in the 1920’s tied to the new technology from the Industrial Revolution (automobiles, telephones, radio, etc.)

One of the main causes of the Great Depression was the desire by our political leaders in 1930 to protect our jobs, or “PROTECTIONISM”, through the Smoot Hawley Tariff Act. It is fascinating today that one result of our Central Bankers and Political Leaders working with their counterparts in countries all around the world is the weak dollar.



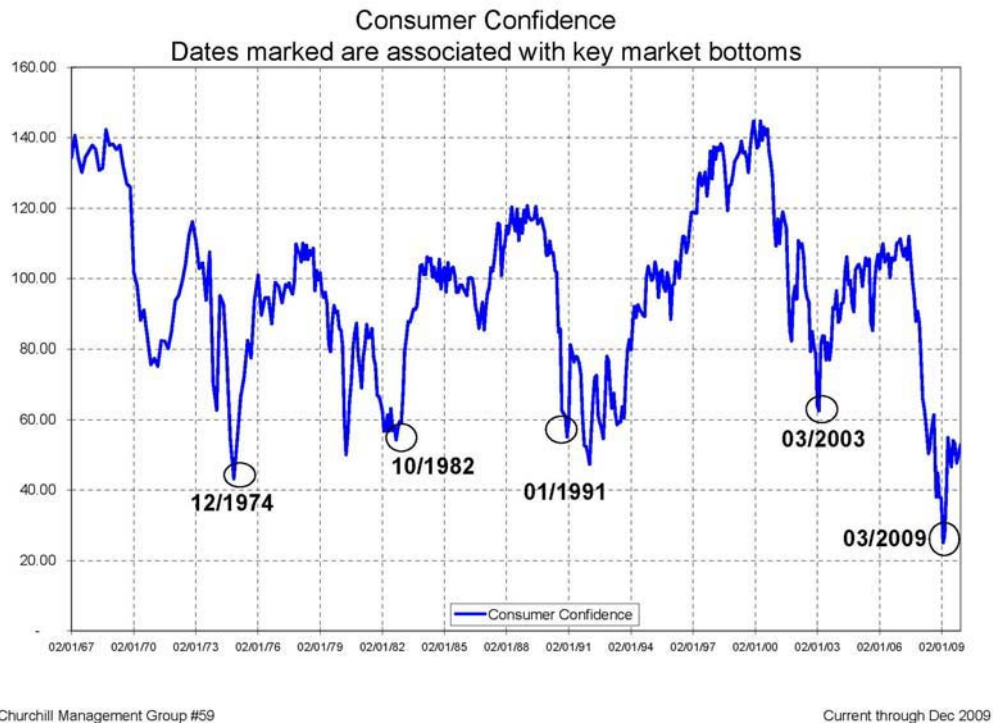
The weak dollar is essentially “protecting” American jobs by making “made in America” cheaper compared to foreign competitors. The weakness in the currency has been hurting China, as it owns large amounts of our treasuries. It should be noted they are not yelling and screaming too loudly as the joint objective of the world leaders is to create DEMAND from the consumer of America in order to stop the threat of DEFLATION.

The good news is the Stock Market is telling us that, at least for the near term, the world economic policies are working. It is true the governments around the world are printing money and creating huge deficits. Indeed, this may be setting the scene for another major financial crisis many years down the road. If governments are unable to get their fiscal policy under control, the history of the markets strongly implies the markets will force their hand with nasty implications. An example is the current announcement that Fannie Mae and Freddie Mac will now have an unlimited backstop from the Treasury for mortgage losses. This is one of the most sweeping government interventions in private financial markets in decades. Clearly this implies INFLATION is likely a few years down the road and would be consistent with our studies of the histories of cycles of extreme inflation and deflation. The following chart of the “Kondratieff Wave” shows a 40 to 60 year average cycle of INFLATION followed by DEFLATION, followed by INFLATION again....



After forty-seven years of studying the Stock Market, we believe the market itself gives us the most reliable perspective in judging the economic and investing world in which we live. It certainly is not an exact science, but the cycles of the Stock Market almost invariably anticipate the future. The Bear Markets begin when optimism is extreme which often foretells the coming difficulties. The Bull Market does the opposite. It begins when the investing public is scared to an extreme and, thus, does not anticipate the good news that will follow.

The Stock Market in the United States reached an emotional Bear Market low on March 9, 2009. The Free Press (which we all support!) alarmed people like we have never seen.



The pressures on the U.S. consumer to retrench suggested in economic terms that “The Debt Supercycle” is over in the Private Sector. However, it appears that we have now begun a “Government Leverage Supercycle.” We know that this will create huge imbalances and excesses many years down the road. Fortunately, the Stock Market again is anticipating that the worst is behind us, at least for the near term.

The current Bull Market is now almost 10 months old. During past economic turmoil periods, like the 1930’s and the late 1960’s & 70’s – what we have referred to as Secular Bear Markets similar to the one we are in today – the average Cyclical Bull Market lasted over two years. Additionally, the typical pattern of a Cyclical Bull Market has two legs. The first leg of the Bull Market that we are now in is getting mature, but that does not mean that it can not last for a number of more months going forward. The Dow Jones Industrial Averages and Transportation Average continue in a confirmed Bull Market. The internal market – the breadth (the cumulative advance/decline line) on the New York Stock Exchange – also confirms the uptrend. The NASDAQ and the technology stocks in particular have been the leadership (along with the emerging markets) and are moving up in a positive way, even stronger than the New York Stock Exchange. The odds favor that this Bull Market will have an intermediate correction

(where the popular averages fall over 10%, but less than 20% which means it is not a Bear Market by definition) in the near future. Our style will be to reduce some exposure in the Premier Wealth and Maximum Growth strategies and the Chartwell Family Funds, so we do not give back all the profits that 2009 has brought. Fortunately, the odds also favor that following this intermediate correction *there will be a second great buying opportunity!*

For those accounts that pay Capital Gains Tax (not IRA's or 401k's etc), tax considerations will be part of our decision making process, but we will remember the old Wall Street axiom, "short term gains are better than long term losses." Our actions will be guided by our research on the individual stock investments as well as our TOP-DOWN work in the Chart Room, watching our fundamental, technical and sentiment indicators. We will keep you informed, and may everyone have a happy and healthy new year.

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** This report is meant to inform the reader of our current market opinion, which we, as professional money managers, use in our decision-making. It should be noted that stock market and bond market data are subject to varying interpretations and any one interpretation will not necessarily guarantee investment success. The information obtained from the sources specified herein and used as basis for our current market opinion is believed reliable, but we do not guarantee the accuracy of such information.

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