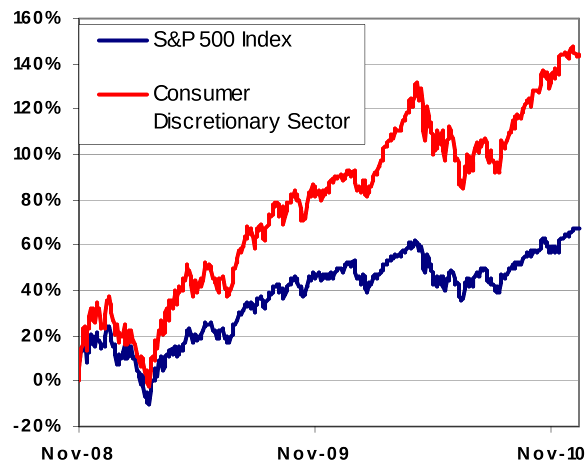
Robshaw & Julian Associates, Inc.
Trusted Investment Advice Since 1979

Investment Matters

For the quarter ended December 31, 2010

Broke, Busted and Disgusted but Still Leading the Economy

It wasn't supposed to happen this way. Pundits from Washington to Wall Street had projected that U.S. consumers were tapped out and would not lead the country out of the Great Recession. Their logic was hard to refute. Consumers had spent too much, saved too little. They were deep in debt and out of work. Their home values had collapsed and their investment portfolios were devastated. Consumers were so financially crippled that it would be many years before they would increase their discretionary spending.



CONSUMER DISCRETIONARY STOCKS HAVE OUT-PACED THE GENERAL MARKET SINCE LATE 2008

But, like Old Faithful, consumers came back, right on time. Even though consumer spending did not recover at its usual brisk pace, it did recover. And the consumer discretionary stock sector, which includes autos, housing, retail, apparel and media, led the advance of the stock market in 2009-2010, just as it typically has during every other U.S. economic recovery.

The lesson here is that while special conditions may modify the magnitude of economic and market outcomes, they do not change the way the world works. The causes and effects which drive the economy and the market are strikingly similar from cycle to cycle.

Two things happen in every recession: As fearful consumers put off purchasing discretionary items like appliances, clothing, vacations, houses and cars, pent up demand for these products continues to rise. At the same time, interest rates on consumer debt are driven down by the Federal Reserve and a shortage of loan demand. Eventually, after enough time, enough pain and enough healing, consumers open their wallets and start to spend. The stock market anticipates this and bids up the prices of depressed consumer stocks. As confidence rises off of the bottom, the whole economy starts to move and a new economic cycle begins.

> *"The consumer discretionary sector...led the advance of the stock market in 2009, just as it typically has during every other U.S. economic recovery"*

Economic cycles are not all the same, but they follow a strikingly similar pattern, a thought worth remembering, when someone says, "This time it's different."

Freedom & Prosperity

Each year the Wall Street Journal and the Heritage Foundation publish the Index of Economic Freedom, which ranks 183 countries around the world on 10 measures that evaluate openness, the rule of law and competitiveness. The ratings system is based on objective criteria as reported by a variety of independent and governmental organizations around the world.

The 10 categories include freedom to open, operate and close a business, trade protectionist measures, tax burdens, government spending, inflation, capital restrictions, banking independence, corruption, property rights, wage and price controls and others.

Worldwide, the Index moved up about one half percent in 2010. 117 countries improved their scores while 58 declined. Most of the improvements were in emerging nations. Developed nations generally moved down in the rankings due to expanding government spending due to the financial crisis. The U.S., which still retains the highest ranking for any country with more than 6 million people, fell one position to number 11. Hong Kong, Singapore, Australia New Zealand and Switzerland lead the rankings while North Korea, Zimbabwe, Cuba, Eritrea and Venezuela are at

Continued on page 2.

Macro: continued

the bottom.

The index ranking has a high correlation with measures of prosperity such as the amount of GDP per person, hunger, housing, etc.

American manufacturing, widely believed to be in distress, produced $3.7 trillion of economic activity during 2008, just as much as the entire economy of Germany.

A million seconds equals 11.5 days. A billion seconds equals 32 years, a trillion seconds equals 137 centuries. The U.S. deficit for just last year, was $1.3 trillion

Is the Federal Reserve Necessary?

In two years the Federal Reserve will be 100 years old. It was formed in 1913 to institutionalize the role that the famous financier J. P. Morgan had personally filled in the Panic of 1907, to serve as the lender of last resort to save a crumbling financial system.

Since that time the role of the Fed has expanded considerably. Under Benjamin Strong, the first President of the New York Fed, it carefully managed the money supply to keep inflation in check. When Mr. Strong died in 1928 the Fed lost its way; many economists believe an accommodative Fed, acting in time, could have prevented the Depression.

Until 1978 the Fed was officially charged only with controlling inflation, athough it increasingly focused on managing the money supply to control economic growth. The Humphrey-Hawkins Act, which was passed that year, gave the Fed a dual mandate: price stability and full employment.

Acting under this dual mandate, the Fed came to occupy a central focus in the economy. Fed Chairman Paul Volker is widely credited with creating the policies which ended the stubborn inflation of the 1970s while Alan Greenspan became known as The Maestro for his role in promoting non-inflationary economic growth in the 1990's.

But despite these successes, the Fed is not without serious critics. Many believe the Fed has exacerbated economic swings and is largely responsible not only for the Depression but for the inflation of the 1970s and the recent financial collapse.

Over time, various mechanistic alternatives have been proposed to replace the judgment based policies the Fed uses to manage the economy. Echoing voices across the ages, Jack Kemp and others have advocated a return to the gold standard. New money could only be issued if it could be backed by more gold. Milton Friedman proposed that the money supply be increased at a constant rate based on the longer term growth potential of the economy. The Taylor Rule, named after economist John Taylor, calculates the desired short term interest rate based on the rate of inflation and the strength of actual potential economic growth.

With Fed Chairman Bernanke in the spotlight for his role in boosting the money supply, expect some fireworks in Congress when they take up this issue later this year.

*****

New home sales, which averaged more than 600,000 per year for the last 50 years, are now running at less than 300,000. Sales peaked in 2005 at 1.4 million new homes.

The Bottom Line: 12/31/2010

Market Indicator	Current Value	One Year Change
Large company stocks *(S&P 500 Index)*	1258	15.1%
Small company stocks *(S&P Small Cap Index)*	416	25.0%
Short term interest rates *(3 Month T-Bill Yield)*	0.2%	No change
Long term interest rates *(10 Year T-Bond Yield)*	3.3%	From 3.8%
Inflation *(Consumer Price Index)*	219.1	1.1%
Energy *(West Texas Intermediate Crude Oil)*	91.44bbl.	15.2%
The economy *(Inflation adjusted GDP)*	14.7trillion	3.2%

QUOTABLE

"Commodities tend to zig when the equity markets zag"

Jim Rogers

Robshaw & Julian Associates, Inc.
6255 Sheridan Drive, Suite 400
Williamsville, New York 14221
Tele: (716) 633-6555
E-mail: info@robshawjulian.com
Website: www.robshawjulian.com