

Hi Everyone,

First, a little business to take care of: We sold Fidelity Contrafund (FCNTX) and replaced it with an ETF symbol IVE. This is an equal exchange. Fidelity is allowing us to use 25 different ETF's now free. No charge to buy or sell. So I took advantage of this.

Thank you, Fidelity and Shari for working so hard to provide more service and less cost to our clients.

On to the markets:

Stocks started last week on a sober note and ended the week with a tinge of regret. Perhaps it was a case of buyer's remorse after a two-week rally bring the Dow from a -10% loss to -7% loss. It seems as if investors really want to believe that corporate earnings are on track, sovereign and corporate debt holders will be repaid on time, and the global economy is kicking into a higher gear. But doubts are still creeping into their outlooks.

The key issue facing investors today is that governments and central banks have nearly reached the apex of their willingness and ability to supply fiscal and monetary assistance to the recovery. They may not be at the very top -- President Obama offered new aid packages to small businesses and housing just last week, which are being bulled through Congress -- but they are definitely close.

Think about it this way: Slightly more than 800 policy efforts have been launched worldwide over the past two years. We added those up, handful by handful, in 2009, as reasons to get long stocks amid an unprecedented wave of new liquidity. Government assistance absolutely helped drag the global economy back from the abyss, and helped companies and individuals recover.

But now we see the opposite beginning to transpire as governments realize that they cannot keep borrowing endlessly to keep their largesse rolling.

Week before last, the Federal Reserve lifted its discount rate. Before that, the Australian central bank lifted its short-term rates twice. The Chinese are tightening their banks' reserve requirements. ISI Group adds it all up, and finds 21 initiatives announced around the world. And now the inevitable conclusion is that the direction is set, and there are 779 more tightening initiatives to go.

These kinds of inflection points are really important for us to recognize as investors. To be sure, the U.S. market didn't shatter on the first tightening, but Chinese stocks have certainly faltered, and the European market is stumbling. And this is occurring at a time when staggering levels of debt repayment in Europe threaten to sap the Continent of vitality; they'll be lucky to record GDP of 0.5% this year. Trouble is afoot amid policymakers in a way that just was not evident last year.

To be fair, of course, government funds are being withdrawn because in some important ways the rates of growth seen in industry already is astounding. ISI points out that semiconductor equipment orders are up 645% annualized in the past six months, while raw steel production is up 88%, machine tool orders are up 113%, the oil and gas rig count is up 85%, heavy truck sales are up 75% and railcar loadings are up 22%. Plus, government projects are pushing engineering and construction companies' prospects higher. Overall, industrial production in the United States is up at a 9.7% annualized rate over the past seven months, which ISI says is a record compared to previous recoveries.

Moreover, government help is being withdrawn because policymakers know that their prior efforts work with a one- to two-year lag. The White House just announced last week, for instance, that \$170

billion of the stimulus package passed a year ago will be spent over the next eight months. Plus, \$195 billion in tax cuts have yet to be paid out, an amount that should dramatically help retailers.

This spending should pave the way for businesses to restock enthusiastically, though that is one of the strangely missing pieces to this puzzle. While capital expenditures and inventories have plunged and corporate profits have risen, corporate savings rates have risen dramatically. This is a curiosity that is not solved by simply stating that companies are less spendthrift than in the past. It appears that they are actually very worried about what's ahead, and not all that impressed with the dramatic improvements that are in the rear-view mirror. U.S. gross corporate saving is now 35% above U.S. gross private non-residential investment, according to federal data.

So the issue is not will businesses recover and make stuff again -- that is happening. The question is what happens when governments turn off the pump-priming equipment. And it is this question that is causing investors to hedge their bets this year, and step cautiously.

There is little doubt that governments are stepping away from their aid. Let me list a few examples from recent headlines:

- Norway lifted rates in mid-December to 1.75% from 1.5%;
- Israel lifted rates to 1.25% from 1% in late December;
- Northern Ireland lifted its value-added tax back to pre-crisis levels of 17.5% on New Year's Eve;
- China vowed to keep "hot money" out of its property market in mid-January;
- China lifted banks' reserve requirement by half a percentage point in mid-January;
- China told some banks to limit lending in late January;
- The Reserve Bank of India lifted its cash reserve ratio to 5.75% from 5% in late January;
- Moldova lifted rates to 6% from 5% in early February;
- The Bank of England halted its bond purchase plan in early February; and
- Last week the Fed lifted its discount rate to 0.75% from 0.5%.

Now that we have these dynamics underway, the rest of this year will be characterized by tension between improvements in economic activity brought about by the stimulus, and fear that the improvements will disappear as stimulus is withdrawn. In other words, investors will wonder whether they should be motivated to invest in Taiwan and Thailand companies because employment, exports and GDP figures are coming in so great, or to withdraw from those countries over expectations that the recent highs represent stimulus-goosed peaks.

As we battle to make those decisions, keep in mind that employment is the basis of countries' long-term economic health, and at present, despite all the advances listed above, jobs are just not being generated. ISI analysts came up with a good way of quantifying that this week with this observation: Payroll employment would have to increase by 200,000 per month for 12 years for the ratio of employment to working-age population to get back to its 1999 peak.

That's a bleak outlook to be sure. Optimists will point out that labor slack this dramatic will keep down the wage pressures that create inflation, but that's a pretty thin crutch to lean on.

If I were to summarize the tension here, we now face a race between debt and growth. Governments' decision to withdraw stimulus is in part a matter of them recognizing that they shot their wads last year, and cannot float more debt at low interest rates to solve their problems. So they are hunkering down now, -- lying low and seeing if they created enough growth last year to allow businesses and individuals to prosper enough such that rising tax revenues will pay off the debts. If not, the next 18 months will be a bumpy ride indeed.

In this environment of "wait and see," I continue to expect a very choppy market.

Have a nice week,

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