

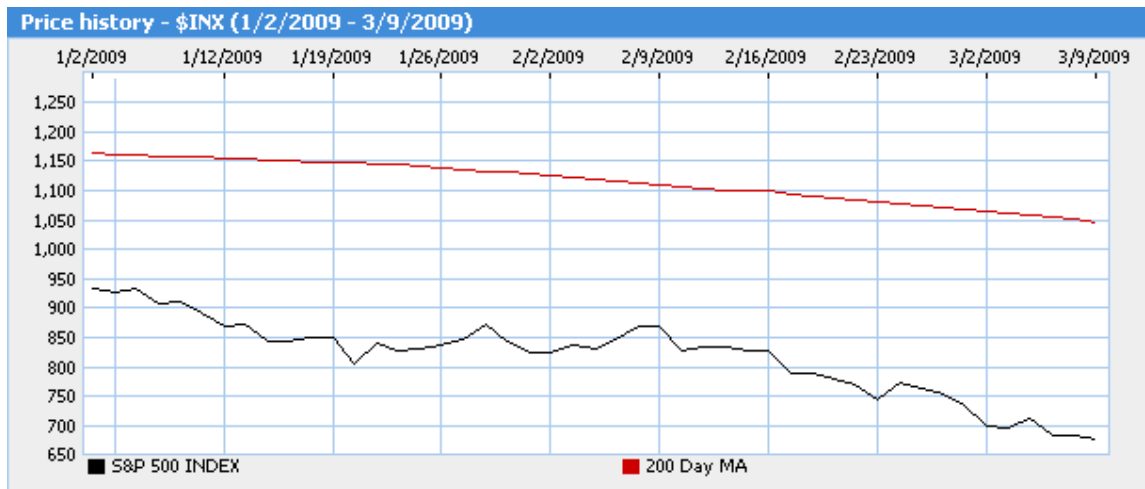
# ARE WE NEAR A TIPPING POINT?

May 11, 2009

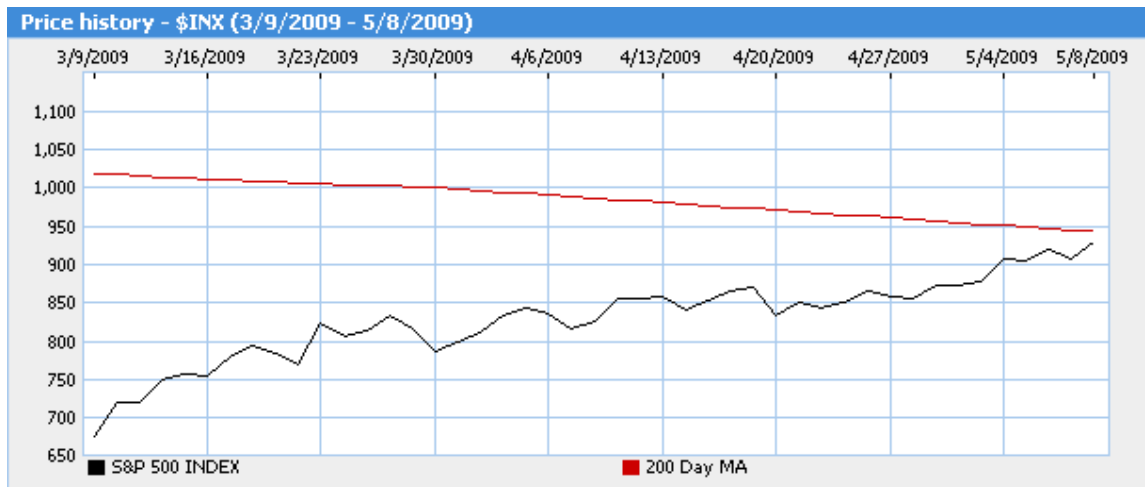
Hello Everyone:

I know that it is hard NOT to get discouraged and a little concerned about the markets and news. I also know that what people talk about is what is happening today not what happened last year or even a couple of months ago. But I am going to take you through the first 4 months of this year to refresh our memories.

The following is a chart of the S&P 500 from 01/02/09 – 03/09/09. The S&P 500 was at 931.80 on 01/02/09 and closed 03/09/09 at 676.53 = 27.40% loss.



The following is a chart of the S&P 500 from 03/09/09 – 05/09/09. The S&P 500 on 03/09/09 was at 676.53 and it closed on 05/09/09 at 929.23, a gain of 26.75%. In other words the S&P 500 has gone on a wild ride to no where. Anyone who was in the market from January to March during the panic selling has yet to recoup their losses for just this 3-month period, let alone all that they lost in the wild ride of 2008.



Now, almost everyone is looking for a tipping point. At this time we are looking for signs that the decline in the economy and in the financial markets are lessening and that we might be somewhere near the bottom. If this is the case, then can the turn to recovery be far behind?

It seems that every piece of information currently being released carries with it the claim that “this decline was less than expected” or “the decline was smaller than the last information released.” These are taken as signs of hope.

Even the results of the Treasury’s “stress tests” on the banks are accompanied by the assessment that the major banks that have just been examined are better off than was thought. Therefore, the banking system is not in as bad a condition as feared, and, stock prices can now continue moving upward.

Fed Chairman Bernanke is still the leading spokesperson and “cheer-leader” in the administration and he stated this week that the economy will begin to expand later this year. So we must be at or near the bottom if the administration thinks so. Right?

We still have the nay-sayers out there claiming that things remain in terribly bad shape. Nicolas Taleb, of Black Swan fame, is saying that the economic situation is worse than it was in the 1930s because world markets are much more integrated now than it was then. And, Nouriel Roubini continues to sound alarms about how bad things could get. Part of his argument rests on the fact that the worst case scenario used in the Treasury’s “stress test” is out-of-date due to the recently released estimates issued by the International Monetary Fund that financial sector losses have doubled in the last six months. Yet are their claims sounding awfully shrill these days amidst the hope others are seeing?

### **Where are we?**

To me, the uncertainties still outweigh any real sense of which direction the economy might take. I would tend to lean on the side that we have not seen the bottom yet, but what odds would I place on this possibility? Maybe I would give odds of 2-to-1 that the economy still will decline further. Maybe they should be 3-to-1. Maybe they should be 3-to-2. Somewhere in there.

First off, I am not convinced that the banks are coming out-of-the woods yet. Even if they are able to obtain more capital, I don’t see their lending picking up in any major way. Personal and business bankruptcies are still on the rise and there are still several major “black clouds” on the horizon threatening the storm that has hit bank balance sheets is not over.

There are still large companies that are going out-of-business on a regular basis; in retail, in commercial real estate, in some areas of manufacturing, and we are waiting for the full ramifications of the collapses in the auto industry. Car dealerships are being closed, parts supply companies are on the edge, and the spread of these closures are affecting many other organizations and geographic regions. Toyota lost \$7.7 billion in the last 90 days. First time it has ever had a loss. They said that they are closing assembly lines in Texas and are not going to build the new plant in Mississippi that was planned this year. If unemployment is going to continue to rise, since it is a lagging economic indicator, then there still are houses that are going to need to be sold if not foreclosed upon and some credit card debt and auto loans that will need repayment.

And, speaking of cars. Last time I looked the price of a barrel of oil was approaching \$60. Where

is the price of oil going? And, the price of other commodities? The Financial Times has had several articles recently about why the price of commodities, including oil, might be going higher if a trough or bottom has been reached. What would higher commodity prices do to any recovery?

Then there is the level of interest rates. The government held an auction Thursday for \$14 billion of 30-year Treasury securities. The result? The yield of the new issue came out at 4.288% higher than the expected 4.192%. This caused a decline in bond prices with the 10-year Treasury note trading around 3.30% up from 3.14% late last week which was above the 3.00% level, reached a level earlier last week that had not been crossed since November 24, 2008.

How high are these interest rates going to go and what impact will these higher rates have on mortgage rates and corporate rates? We are already seeing spreads between Treasuries and corporate bonds reach levels since last October and November. And the interest rate spreads on lesser credits have also been increasing. And, there is still much more Treasury debt to come.

Furthermore, the economic structure of the United States (and the world) has changed. The manufacturing base is going to be different in the coming years and everything is going to be more connected technologically than before. And, what if the personal savings rate in the United States reverts back to 8% or so as it was before 1992? We are not going to be able to force employment, human or otherwise, back into the same industrial and financial structure with the same employment intensity as existed before this economic collapse.

I am not intentionally trying to stay on the "dark side". It would be great if things were bottoming out and the economy were about to start on an upward path once again. But, there are too many "unknowns" out there, unknowns that relate to serious problems, for us to get our hopes up too high at this point. Management teams must still re-focus their businesses and must deleverage their balance sheets. Boards of Directors still must make sure they have the right executives in the right places, and if the Boards don't do this then the shareholders must become more aggressive. Many executives that managed in the pre-2007 period, I believe, are not the executives to lead our companies in the post-2009 period.

Are we at a tipping point? Are we at or near the bottom of the downturn?

The most important questions are still going unanswered: even with the results of the Treasury stress tests. Will a major bank fail? How many regional banks might fail? So far there have been 32 bank failures this year, up from 25 last year and 8 the year before. How will a General Motors ([GM](#)) bankruptcy impact the economy? What other possibilities are out there?

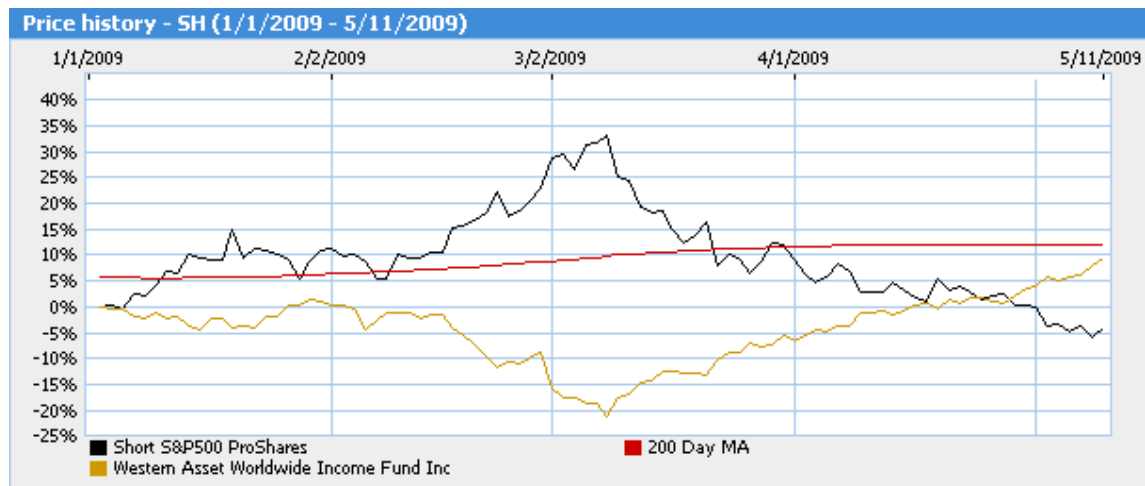
Other company failures? Bloomberg reported Thursday "Moody's is forecasting the default rate among high-yield companies globally to soar to 14.8 percent by year-end from 8.3percent in April as companies that financed a record amount of high-yield, high-risk debt leading up to the credit crisis struggle to refinance."

And, I haven't mentioned the debt overload that exists throughout the country. The list goes on.

It seems to me that what we are seeing a lot of these days is wishful thinking. I really haven't seen anything yet that one could argue was a "hard" fact pointing to a bottom of the downturn. I really don't think we are going to see any "hard" facts in the near future, so the stock market and other areas of the economy will just continue to live off of wishful thinking.

So how do we proceed? By investing cautiously. Example: By putting together SBW which pays a 10% yearly dividend and will go up if the market goes higher. And SH which is an inverse S&P 500 ETF that goes up if the markets turn south. In matching these two funds we may be able to secure the 10% dividend with little risk.

The following is a chart that gives an example of matching SBW & SH



Stay tuned,

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