

**BEACON POINTE**

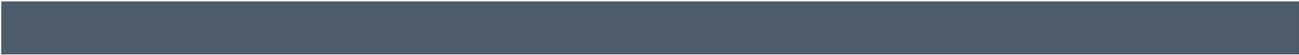
**A D V I S O R S**

**BEACON POINTE RESEARCH**

**THE OPEN PARACHUTE**

**JULY 2009**

*CONFIDENTIAL – PROPRIETARY*



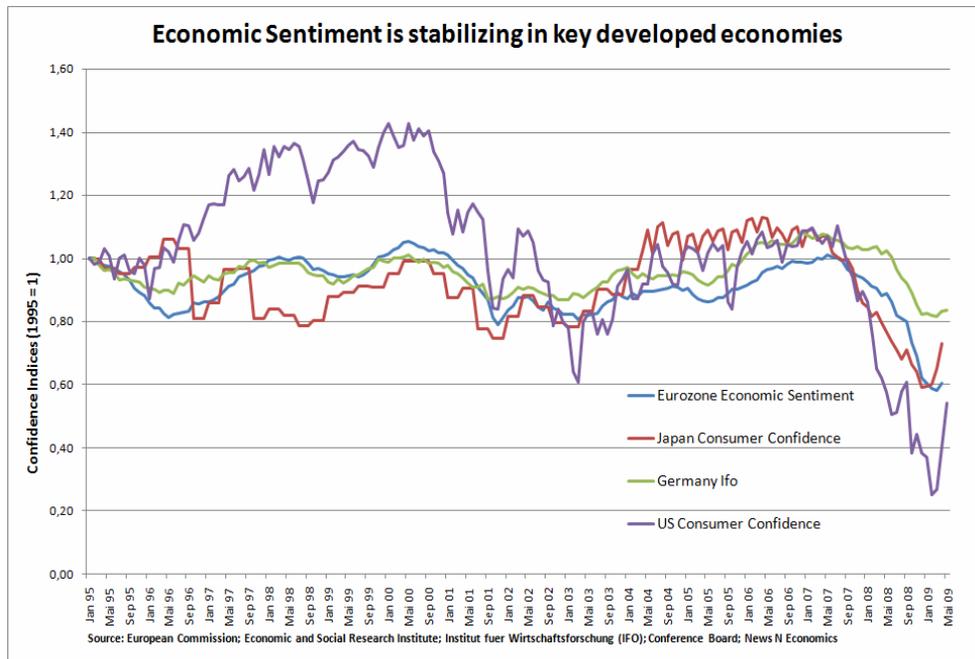
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## The Open Parachute

The stock market rally that commenced on March 10<sup>th</sup> lifted the S&P 500 Index by an astonishing 40% (based on daily closing index prices) through June 12<sup>th</sup>. Since then U.S. and global equities have taken a breather in, what Beacon Pointe believes to be, a normal and healthy corrective move. The S&P 500 Index has lost over 7% since the June 12<sup>th</sup> highs. It should not come as a surprise if the retracement continues for some time. The March-to-June rally simply went too far too fast and, in our opinion, equity prices had gotten ahead of fundamentals.

Strategas Research, in a recent Technical Update, commented that while “investors await clarity as we push through the 2Q earning seasons, additional market weakness could very well come to pass. Ultimately, however, a modest pull-back to a “higher low” is a healthy development for stocks as they continue to chart the lengthy transition from bear market to a new and sustained bull phase.”

Today’s investment vocabulary has expanded to include new terms such as “The Great Recession”, “green shoots”, and “a new normal”. Some argue we are still in the grips of “The Great Recession”, others believe that the economy has passed its trough and is firmly on its way to recovery. One camp finds reason to cheer in economic metrics that are declining at a lower rate or are stabilizing – labeled “green shoots” – while the opposing camp points out that “less bad” news is still not good news. Most everyone agrees that future realities will differ from the past, but no one quite knows for sure what the “new normal” will look like. To be sure, economic sentiment has rebounded somewhat from very depressed levels, as the chart below illustrates, yet still has a ways to go before returning to pre-crisis readings.



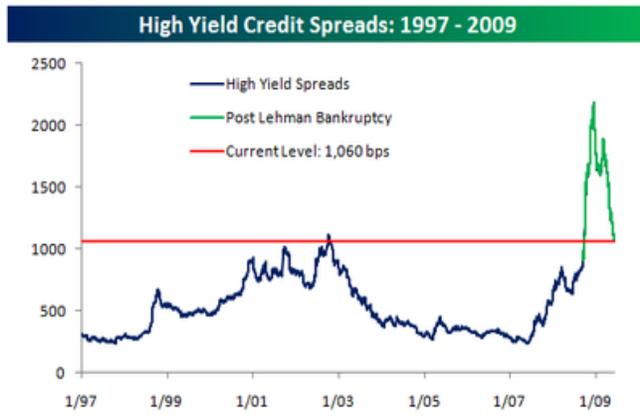
Source: Investment Postcards from Cape Town

In an astute assessment of the current state of our economy, John Mauldin recently noted:

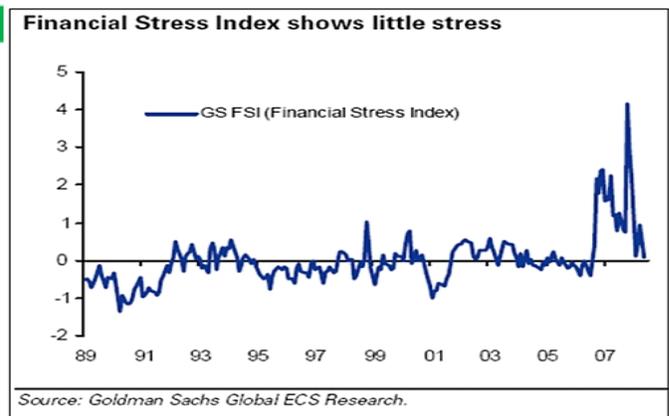
*We are not in an unrelenting death spiral. There is a bottom. It is like a person jumping out of an airplane. They fall rather rapidly until the parachute opens, and as they get closer to the ground they manipulate the chute to further slow the descent. But until they reach the ground, they are still*

*falling. That is the case today. The economy is still falling, but the parachute has opened. We are going to reach the bottom at some point. We will find that new normal. We just need to adjust our activities and plans around that new destination.*

Emerging signs that stress in the financial system are subsiding have to a large extent fueled the stock market rally over the past three and a half months. There are various indicators used by economists and analysts to gauge stress. Below we have included two for illustrative purposes – the level of high yield credit spreads and the Goldman Sachs (proprietary) Financial Stress Index. Both tell a similar story – after peaking in late 2008/early 2009 at the height of the credit crisis, spreads, risk aversion, and, more broadly, financial stress have moderated substantially.

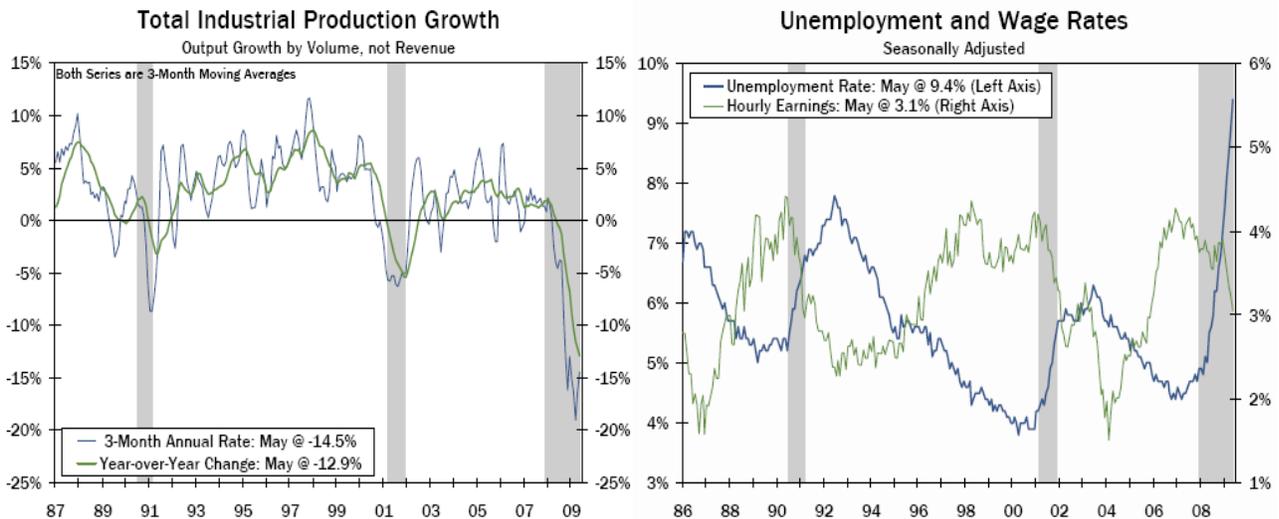


Source: Bespoke Research Group



Source: Goldman Sachs

Despite these improvements, the U.S. (and global) economy is still facing some serious headwinds. Both consumers and businesses continue to deleverage; uncertainty related to health care, climate control, and energy independence regulation persists; and worries about a ballooning budget deficit have escalated. In addition, as shown in the charts below, the unemployment rate – a lagging indicator – is still trending up (albeit at a decelerating rate), while industrial production and capacity utilization have continued to set new lows on a monthly basis. Most likely, the economy’s recovery will take longer and be more fraught with fits and starts than an average cycle would suggest.



Source: Wachovia Economic Research

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What does this mean for investors? Price movements of stocks and other risk assets are likely to remain volatile. Market advances, while welcome, would generally be followed by corrections, such as the one we have experienced since June 12<sup>th</sup>. As economic news and corporate earnings are digested by investors, a clearer picture of the new U.S. economic reality and primary market trend will emerge. We remind our clients, however, that none of them is invested in “the market”. Beacon Pointe builds client portfolios by 1) carefully determining an asset allocation that best fits the client’s specific return objective and risk tolerance; and 2) hiring investment managers that focus on bottom-up stock selection, intense research and due diligence, and a strict valuation discipline, which result in concentrated portfolios of their best ideas. Beacon Pointe strongly believes that such investment managers offer the best opportunities to add value in our client portfolios, regardless of the economic or market environment in the future.

As in decades past and other formidably tough economic times of the past 100 years, Beacon Pointe believes the US economy is resilient and will ultimately find the ground and begin the climb back to better days ahead.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.