

THIRD QUARTER 2009/REVIEW AND COMMENTARY

We trust you enjoyed a wonderful summer and hope you're finding the time to enjoy the gorgeous fall colors that make this area one of the most beautiful spots in the world to be in during October!

The economic realities of the past year have been a harsh reminder of how quickly things can change in our lives and our world. From our vantage point we have seen very few, if any, folks who have not been negatively impacted by the events of the past year. While we've always viewed ourselves as "*glass **half full***" sort of guys, we cannot dismiss the reality of the adverse economic impact on the lives of so many people around us.

This reality continued to be at the forefront of the news in the third quarter, as unemployment increased, consumer spending remained at extremely low levels, housing plodded along with a slight increase in sales but rising foreclosures, massive government debt increases, and a declining US dollar.

While *Main Street* appears caught in this new economic reality, there's been a party on *Wall Street*, where despite daunting economic challenges, markets both here and abroad rallied in the third quarter, building on the rally that started back in early March, a rally based on hopes that perhaps the worst of our economic problems are behind us.

The month of October has witnessed the Dow Jones Industrial Average cross the 10,000 mark, reminding us of early 1999, when the Dow hit 10,000 for the first time. Back then there was dancing in the streets; this time, there is relatively little joy, as the Dow hitting 10,000 means that 10½ years after reaching that milestone for the first time, it stands at the same level today – a level that is 30% below its highs of 14,000+ set back in 2007.

The performances of the various indices are listed below:

<u>Index</u>	<u>2007-Year</u>	<u>2008-Year</u>	<u>2009-3rd/Q</u>	<u>2009-Year</u>
DJIA	+ 8.9%	- 32.0%	+ 15.0%	+ 10.6%
S&P 500	+ 5.5%	- 37.0%	+ 15.0%	+ 17.1%
Russell 2000 (small)	- 1.6%	- 33.8%	+ 18.9%	+ 21.0%
NASDAQ (tech)	+ 10.5%	- 40.8%	+ 15.6%	+ 34.6%
MSCIEAFE(overseas)	+ 11.2%	- 43.4%	+ 25.9%	+ 33.0%
Barcap Agg. Bond +++	+ 6.9%	+ 5.3%	+ 3.7%	+ 5.6%

Equity index returns based on index pricing unless otherwise noted; as per Morningstar, Yahoo Finance, and other sources, as of the close of 9/30/2009.

HOW DID BIRCH AND JOSSI'S MANAGEMENT HOLD UP DURING THE 3RD QUARTER?

To be frank, the third quarter of 2009 was by far the most agonizing and difficult quarter in the history of our firm. We completely did not forecast the markets dramatic turnaround . . . and while some of our investment themes, such as gold and commodities, worked well for us during the quarter, our performance dramatically underperformed the overall markets. All told, we experienced a wide range of investor performance amongst our clients during the third quarter, while also spending an intensive focused attention and time managing individual accounts.

SO WHAT ARE WE DOING NOW?

Well, our belief has *really not changed all that much* over the past few weeks ! There continues to be, in our opinion, a massive divergence between what's happening on Main Street and what is being heralded on Wall Street. While it appears that we have averted another Great Depression, the economic fundamentals still appear challenged, and therein lies our on-going dilemma.

What has changed as it relates to our investment strategy is the understanding that sometimes fundamentals don't matter for a specific period of time. **Long Term, Fundamentals do matter**, but we only have to look back to the Nasdaq in the late 1990's to be reminded that *emotion, hope* and *optimism* are powerful irrational forces, forces that helped propel the Nasdaq thru the 3000, 4000 and ultimately the 5000 level in March of 2000. Fundamentals however finally took their rightful place, and the Nasdaq experienced a 75% decline over the next three years.

Do you remember being told that the 'bricks and mortar' business model was dead, and that everyone would henceforth shop only on the web? Anyone remember www.HomeGrocer.com ?

We certainly would love to see a strong economic turnaround, accompanied by long-term stable growth in the stock markets. However, we know that for this or any economy to truly recover and grow, employers will need to start rehiring workers, instead of laying them off.

While companies can appear to show improved corporate profits for a season based on cost cutting and reduced inventories, ultimately employers are only going to stop layoffs and restart hiring when the demand for goods and services increases – which means that **consumers will have to start spending ! !**

Prior to the economic melt down last October, the consumer made up approximately 70% of economic activity in this country. One of the major drivers of consumer spending that ignited the stock market rally during 2003 through 2007 is now essentially dead! That major driver was HELOCs (Home Equity Lines Of Credit), low rate 2nd mortgages that people utilized to buy cars, second homes, RVs and boats, or used to remodel and landscape homes, and pay for vacations, new furniture and the like.

With much of homeowners' equity wiped out during the past three years by crashing real estate values, those HELOCs are essentially a thing of the past, virtually unavailable to many, if not most consumers, in today's world.

Compounding this reality is the fact that access to credit is becoming harder by the day, turning potential purchasers into 'wannabees' who are unable to buy desired goods and services due to frigid credit markets.

So, where is consumer spending going to come from, if consumers are unable to borrow? If not borrowing, the only source for consumers to spend is via government handouts, which has been somewhat successful in artificially stimulating the economy, or pulling money out of savings. Only time will tell if, and when, the consumer gets back in to the spending game to help revive this struggling economy.

Adding to the challenges facing our economy, we now have incurred a trillion plus dollar national debt, a debt that tripled during 2009. No matter how that trillion dollar debt is dealt with, it represents a daunting challenge to any long-term economic recovery.

 Here at Birch & Jossi, we continue to believe that the 'new normal' calls for a flexible and adaptive approach to investing. We have been incorporating some alternative investment strategies that take advantage of the fact that current market volatility has created a 'traders' market, as opposed to a 'buy and hold' market, and at this point, we will continue utilizing this strategy in many of our clients' portfolios.

Recently, we sent out different documents relative to utilizing covered calls, an option strategy that helps create some downside protection for investors while offering attractive upside potential. On the equity side we are favoring emerging markets, many of which are unfettered by the massive debt facing the US.

We are incorporating a combination of “covered calls’ or “stop losses” for a number of the investments in our client accounts. This will allow us to enjoy upside potential while also providing some downside protection should some of our concerns materialize and be reflected in the markets future performance. We have absolute confidence that these strategies fit appropriately into the new investment landscape.

While we maintain a long-term faith in our country’s future, we are concerned that the market’s euphoria of late might have caused the markets to run ahead of themselves – so, caution and prudence continue to guide our investment decision-making process. We have talked with many of you over the past number of months and welcome your perspective if you feel we’re being too conservative. As is always the case, our own money is being invested alongside yours in the manner described above.

We understand that these continue to be challenging times and we remain grateful for your confidence and support. We wish you a wonderful fall season, and hope you make special time for the family and friends who are a part of your life.

Regards,

Raymond Birch, CMFC
Registered Investment Advisor

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