

INVESTMENT OUTLOOK

Fourth Quarter and Year End 2009 Review by Whitney Brown

- ◆ Strong stock market returns for 2009.
- ◆ Economic expansion underway.

- ◆ Inflation not a near-term issue.
- ◆ The economy and financial system face ongoing challenges.

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What a difference a year can make. At this time last year, informed people across the globe had legitimate concerns that the world was on the brink of a major depression and that the only viable investments were U.S. government bonds and gold bullion. Stocks in the U.S. and abroad had declined 40% or more in a year's time with a panic selloff testing even the steeliest of nerves. A seizing of credit markets and the unprecedented response by central banks, the U.S. Treasury and other governments heightened the sense of crisis.

Fortunately, the crisis has passed. Massive doses of government-infused liquidity and myriad programs to support ailing financial institutions have staved off disaster.

Also, the simple passing of each day without the world actually ending allowed cooler heads to prevail. Serious challenges lie ahead to restore the global economy, financial system and investor confidence to full health, but there is nothing like a major stock market rally to lighten the mood and bring an appetite for risk back into the picture.



Respectable gains in the fourth quarter of 2009 cemented strong market returns for the full year. An initial advance in October held as the market lapsed into a tight trading range for the remainder of the quarter. After an historic surge of 60% over eight months, a pause was in order.

Few would have expected such a market recovery since the year started with a 25% decline in the first two months. But, extreme levels of fear and pessimism gave way to the tidal wave of monetary and fiscal stimulus unleashed in a coordinated effort by governments of the major economic powers of the world. Stocks that fared best in the rebound generally were those that had suffered the worst of the selloff. A number of emerging market, commodity and financial issues saw a doubling and even tripling in price from their lowest points.

Investors in higher quality growth stocks, those with strong finances and consistently rising earnings, should be pleased with 2009 but may have seen their holdings trail the flashy returns in the major averages. 2010 should be a relatively better year for stocks of larger global companies with the scale and financial strength to thrive in an environment where developed economies experience slow growth and developing countries such as China, India and Brazil

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<u>Market Measures</u>	<u>4th Qtr</u>	<u>YTD</u>
S & P 500 (price)	5.5%	23.5%
Dow Jones Industrial Average	7.4%	18.8%
NASDAQ Composite	6.9%	43.9%
Russell 2000	3.5%	25.2%
MSCI EAFE	1.8%	27.8%
Barclays Capital Aggregate Bond Index	0.2%	5.9%
	<u>12/31/09</u>	<u>6/30/09</u> <u>12/31/08</u>
10-Year Treasury Bond Yield	3.84%	3.52% 2.24%
Three-month Treasury Bill Yield	0.05%	0.18% 0.13%

2009 Credit CARD Act

by Jonathon Grace



The 2009 Credit Card Accountability Responsibility and Disclosure (Credit CARD) Act, which became law on May 22, 2009, contains several provisions that go into effect on February 22, 2010. Congress created the law to address hidden and deceptive pricing strategies employed by many credit card issuers to generate substantial revenue

at the expense of unsuspecting cardholders.

Following is a brief description of some provisions of the Credit CARD Act followed by a brief review of a recent study that indicates questionable practices designed to circumvent the new law are on the rise. The Federal Reserve Board, in conjunction with various other regulatory agencies, is responsible for developing rules that describe how the law will actually work. This may delay the actual implementation of some of the law's provisions.

Under the Credit CARD Act, issuers must notify their clients of rate increases or other significant changes in the terms of a consumer's credit card account at least 45 days before the change becomes effective. The notice must be conspicuous, clear, and offer the consumer a chance to reject the change and close the account. For accounts they choose to close, consumers are not required to pay off the balance in full immediately, but the issuer can require them to double the previous minimum payment and pay in full within five years.

Also applicable under the new law, retroactive rate increases are prohibited except under the following circumstances: 1) the rate can go up if the existing rate is an "introductory" rate previously disclosed as lasting for a certain period of time; 2) variable rate cards are still permitted and the rate changes as the underlying index, e.g. the prime rate, changes; 3) if the issuer temporarily lowered the rate during a "workout" or temporary hardship period, it may raise the rate once the consumer completes or drops out of the workout; and 4) if the borrower is sixty days late on a credit card payment, the issuer can raise the interest rate retroactively (but the consumer must be given a chance to earn back the previous rate by making at least the minimum payment on time for six months).

Regarding over-the-limit-fees, issuers cannot charge such fees if a borrower exceeds his or her limit unless he or she has given permission to authorize purchases that put the account over the limit. Even if a consumer permits over-the-limit fees by specifically authorizing purchases, the issuer cannot charge an over-the-limit-fee more than once in a billing cycle and for more than three months in a row, even if the borrower only pays the minimum payment and it does not correct the over-the-limit situation.

The law also addresses the definition of reasonable

fees, but in an ambiguous fashion. Late payment fees, over-the-limit fees, and any other type of penalty fee must be reasonable and in proportion to the violation. The law allows 15 months from enactment for this provision to become effective. The Federal Reserve Board will work with banking regulators to develop guidelines describing what reasonable fees might be.

In a December 10th study released by the Center for Responsible Lending, author Joshua Frank relates that while the new law will outlaw certain credit card abuses, new ones are emerging quickly. "Some issuers appear to be working to compensate for part of this lost revenue by instituting or accelerating new practices that increase hidden costs on consumers." For example, to get around the limitations on raising fixed interest rates, many issuers are quickly notifying consumers in advance of the law's effective date that their cards are now subject to variable interest rates.

The study, which is available in PDF format from www.responsiblelending.org, examines eight emerging practices that are designed to take advantage of the public's lack of knowledge, behavioral biases, and inattention. All of the eight practices are growing in frequency, with some top issuers changing their account terms recently to adopt or expand a particular practice. Mr. Frank also states that all of these practices are either hidden, obscure, or complicated enough that most consumers are unlikely to fully appreciate their cost implications.

The following new practices are highlighted: 1) pick-a-rate, 2) variable rate floors, 3) minimum finance charges, 4) compression of balance categories in tiered late fees, 5) inactivity fees, 6) international transaction fees: level growth and expanded definition, 7) balance transfer/ cash advance fees, and 8) balance transfer / cash advance fee floors / ceilings. For example, the seemingly innocuous "Pick-a-Rate" change results from a minor change in the fine print of the agreement that states the index rate "will be the maximum prime rate reported in the 90 days preceding the last day of the billing cycle." The study estimates this change will result in annual percentage rates that are higher on average than traditional pricing.

For most of us, credit cards have become an integral part of our personal finances that we take for granted. Consumers would be wise to fully understand the expenses associated with holding credit cards. Consumers should regularly review both the terms and conditions on their credit cards, and the actual charges they receive on each statement. Pay attention to any documents included with monthly statements since they may dictate new account terms. If you maintain a balance on a credit card for any length of time, pay special attention to all mailings from credit card issuers, and be careful not to throw out a change notification, mistaking it for an unsolicited credit card offer.

Fourth Quarter and Year End 2009 Review (continued)

resume their long-term high-growth trajectories.

For bond investors, market-based yields for intermediate and longer maturities have mostly returned to pre-crisis levels. However, the Federal Reserve remains committed to keeping very short-term rates low, almost zero, for the foreseeable future. That policy penalizes short-term savings and puts the dollar under pressure relative to other currencies offering higher yields. Nevertheless, the Fed would prefer to fight inflation down the road rather than let the economy slip back into recession, or worse, in the near term.

Inflation in the traditional sense of higher prices for goods and services is not a problem now or likely to be one any time in the next year. Deflationary forces should outweigh inflationary pressures for some time to come. With the unemployment rate stuck near 10%, there is tremendous slack in the labor market to keep wage pressures in check. In addition, there is abundant spare industrial capacity to absorb any increase in demand. More importantly, a fundamental restructuring of consumer and small business finances is taking place as borrowers are reducing debt and scaling back consumption accordingly.

As a consequence, consumer spending will not be a driving force in the early stages of this ongoing recovery. To some extent, the government's fiscal stimulus programs will account for positive growth, but the economy will depend on business spending to sustain the climb out of the slump. As businesses see improved profits resulting from previous cost cutting measures and further thawing in credit conditions, they should be willing to spend on technology and capital equipment to improve productivity and remain

competitive in a slower growth economy. Low expectations for the consumer are the main reason that most economic forecasts are on the weak side relative to previous post-recession periods.

As measured by the stock market indexes, 2009 ranks as one of the best years of the past decade for stocks. Still, markets remain well below the all-time highs of late 2007. Most valuation measures indicate that stocks at current levels are no longer cheap but may still have room to run, if improvements in corporate earnings develop as expected. Dire investor pessimism has given way to some optimism, though there is plenty of evidence that the general investing public has not fully embraced this cyclical rally.

As the new year progresses, it is likely that the Fed's ultra-easy monetary stance along with further indications of a growing economy and a stabilizing labor market can take stocks higher in the near term. We should expect a correction to develop at some point well into the year. If the economy is still improving and the Fed has not changed tack on interest rates, even a deep correction may not bring an end to the market's up-cycle.

We have no doubt that the year ahead will bring unexpected twists and turns. Difficult questions regarding the strength of the U.S. dollar, the durability of the economic recovery, and the actions of the Federal Reserve will dominate investor thinking. We expect a positive year on balance with ups and downs in the financial markets and continuing economic growth, but we would be very surprised to see a return to the kind of extreme swings we experienced in 2008 and 2009.

The Natural Gas Alternative by Watt Dixon



It seems that one thing most Americans can agree on is that we need to cut our dependency on foreign oil. While wind and solar energy seem to grab most of the headlines, natural gas, more specifically what is called unconventional natural gas, holds the most real promise as an alternative to imported crude oil. The most prominent source of unconventional natural gas is known as shale gas. This natural gas, found below the earth's surface in shale rock formations, is a clean, relatively low carbon fuel.

Shale has low permeability, and the gas is usually trapped in very tight formations, so production in commercial quantities requires creating fractures to provide permeability. For years, shale natural gas reserves were ignored, given the

lack of efficient production capabilities. The emergence of horizontal drilling and hydraulic fracturing (or fracing) has changed the economics for shale gas drilling. Horizontal drilling uses new technology to increase the exposure to a gas reservoir by drilling at an angle, and hydraulic fracturing methods use water, sand, and pressure to break the rock and release the gas. By combining these two methods, the extraction of shale gas has become much easier and thus profitable for the companies that have embraced these techniques.

The five most productive spots for large reserves of shale gas in the United States are known as the Big Five. The Big Five is comprised of the Barnett Shale in Texas, the Haynesville Shale in Louisiana, the Marcellus Shale in the

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Appalachian Basin, the Fayetteville Shale in Arkansas, and the Woodford Shale in Oklahoma. In addition to the Big Five, many new discoveries have been made throughout the United States and Canada. Each shale field is unique in its make up, and each presents different challenges for extraction methods. Production of shale gas has risen 15% from 2007 to 2008. Proven shale reserves have risen to 245 trillion cubic feet (TCF) in 2008 from 177 TCF in 2000 despite having produced nearly 165 TCF during those years. At current levels of demand, the U.S. has about 90 years of proven and potential supply – a number that is bound to go up as more and more shale gas is found.

The electric power industry will have to decide which fuels they will use in the future to generate electricity in their plants. Coal has long been the standard energy source used in power plants. Political pressure is building to enact climate-change regulations, and natural gas, with its much cleaner emissions seems to be the “natural” choice. In addition, natural gas plants can be built more quickly than coal fired plants.

Thus far, the only negative aspect to arise from shale gas extraction has to do with water. The fear is that chemicals used in this fracturing process could pollute nearby ground water. This seems to be a minor concern due to the fact that gas-bearing layers of shale and water-bearing layers of shale are widely separated by thousands of vertical feet, as well as by rock, with the gas being much deeper. In addition, the Shell Oil Company has developed a technique that uses a “freeze wall”, essentially a barrier around the shale site where cooled liquids are pumped into the ground. This freezes any groundwater that may enter the site and keeps harmful byproducts like hydrocarbons from seeping out.

All of the new supply becoming available has kept a lid on natural gas prices. But just in the past few weeks, major oil companies Exxon-Mobil and Total have announced major investments in natural gas producers. They are taking big stakes in the U.S. natural gas industry. In the coming years, if domestic natural gas does catch on more widely as a replacement for imported crude oil, investment in natural gas producers could prove to be a good long-term opportunity.