

TimeCapital®

Investor Advisory Services, Inc.

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MAIN OFFICE
One Roosevelt Avenue
Port Jefferson Station NY,
11776

51 E. Main St.
Smithtown NY 11787

Phone: 631-331-1400
Fax: 631-331-1407
E-mail:
info@timecapital.com

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Dear Client

The quarter just ended had stocks post their best quarter since the fourth quarter of 2003 (early in the last bull market) but the markets remain skittish. The Dow closed the second quarter at 8447, up 11%, or 838.08 points, for the last three months but down 3.8% for the year. It remains down 40% from its all-time high on Oct. 9, 2007. The broad stock market goes into midyear holding onto the bulk of a powerful rally that left the Dow Jones Industrial Average up 29% from the 12-year low hit on March 9 and gave the index its first quarterly gain in over a year and a half. Yet it spent only one day during the quarter in positive territory for the year. The S&P 500-stock index finished June at 919.32, up 15% for the quarter and up 1.8% for the year.

The quarter was effectively a period of healing for markets around the globe. Conditions continued to improve in many parts of the credit markets, which had been the epicenter of the financial crisis. Investors shifted out of US government debt as they became more comfortable holding riskier assets. Many of the large systemically important banks and brokerage firms were able to raise cash in the capital markets in order to shore up their balance sheets. Hopes for global economic recovery helped emerging markets and commodities to big gains. Crude oil prices posted their largest quarterly percentage gain since 1990.

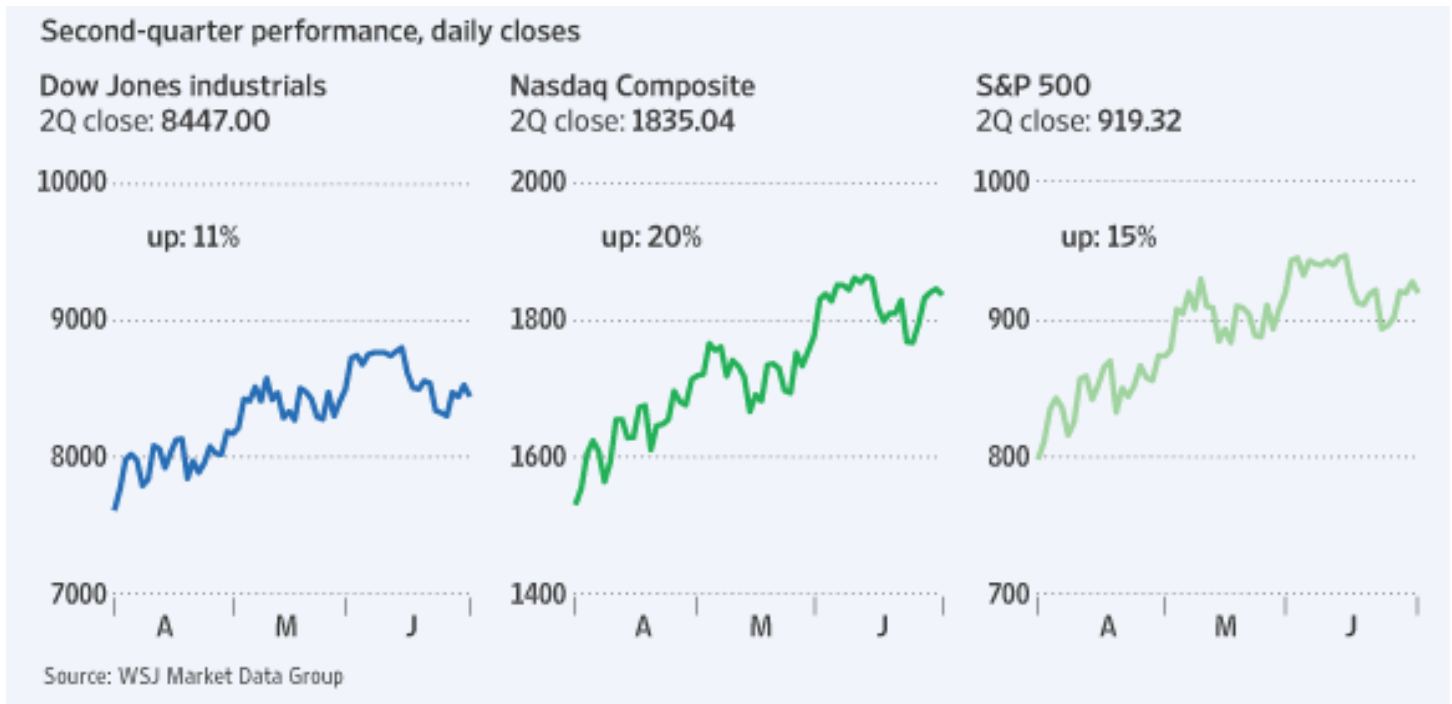
The palpable fear that pressured stocks down to levels that some consider a “generational low” has abated; investors are now focusing on the market’s economic and profit potential underpinnings. While hoping for a strong end to the year expectations remain muted. There is general agreement that for stocks to post a significant advance during the second half evidence will be required that the US economy’s decline has slowed and then activity may actually turn higher by year-end. Corporate profits will need to at least match forecasts for an upswing for the rest of the year to even justify current market values.

The S&P 500 is trading at a price to earnings multiple of 15.7 times expected 2009 operating earnings, close to the historical average. Consensus earnings forecasts for the fourth quarter had been pushed higher by analysts even as they have cut back third-quarter predictions. Earnings in the fourth quarter are now expected to rise 181% from a dismal performance a year ago compared with a 169% increase forecast on April 3. Third-quarter earnings are not predicted to be down 21%, compared with a 17% drop forecast three months ago.

The second quarter began with stocks already three weeks into a rally that would continue almost unabated for another two months. The rally was largely driven by news that some market participants termed “the second derivative rally”. In effect stocks rallied on news that while still bad was becoming “less bad”. An example of this was a leveling off of initial jobless claims which still continued to increase albeit at a slower pace.

Financials were the best performing stocks, despite uncertain near- and long-term profit prospects. Also leading the charge was a group of stocks, energy and materials that historically tend to perform better later in an economic cycle rather than at the beginning of a rebound. This time around they rose on expectations that the global economic recovery will be led by emerging-market economies, where demand for raw materials is high. The rally thus far has been remarkably resilient. Since the March 9 low, the biggest pullback in the Dow during the second quarter was a 3.6% decline in late April.

While some investors feel that the market must pause for fundamentals to catch up with prices, many expect market choppiness with an upward bias. This would be thrown into question if the consumer remains pressured and if home prices do not start to show some significant stabilization.



Credit Markets

Treasuries posted record declines while lowered rated credits rallied – a very distinct example of the high price of seeking safety in the volatile credit space. Corporate bonds and asset-backed securities recovered to levels last seen before the financial world fell apart in September, and the thawing credit markets enabled more borrowers to raise cash. A steep decline in long-term Treasury notes led the broader Treasury asset class to a 3.1% decline for the quarter and a 4.5% loss for the first half; the worst 6 month performance since 1977.

There are signs the recent rally in riskier assets could be running out of steam, and the slowing economy is likely to lead to more defaults among individuals and corporate borrowers. By the end of June, corporate bonds had given up some of their gains, while mortgage rates and yields on long-term Treasuries remained elevated despite efforts by the Federal Reserve to keep them low. Short term T-bills were flat while 10 year T-Notes lost about 6.2% for the quarter; as prices fell the yield on the 10-year note rose to 3.521% on June 30, up from 2.688% at the end of the first quarter and 2.253% at the end of 2008 – remember that prices and yields move inversely.

The return on investment grade bonds (including price changes and interest payments) was about 11%. The yield differential between these bonds and Treasuries (a measure of how much investors require to be paid for the additional risk) contracted to 3.3 percentage points from 6 points at the end of the first quarter (about where they stood before the Lehman Brothers collapse last September).

High-yield, or "junk," bonds, which are issued by companies with speculative-grade credit ratings, rebounded from lows to return 23% for the quarter as investors became less risk-averse. The spreads over Treasuries narrowed to 11 percentage points by the end of June from 17 percentage points at the start of the quarter, bringing effective annual yields to about 13.5%

The yield curve, the difference between short- and long-term Treasury yields, steepened in the quarter, sign investors are concerned about long-term inflation. Inflation-adjusted Treasury securities indicate that investors expect an annualized inflation rate of about 1.7% for the next 10 years. At the end of 2008, expectations were for a rate close to zero.

The municipal-bond market got a shot in the arm from Build America Bonds, a new type of taxable debt that states, cities and other municipalities can issue to finance capital projects and obtain a 35% interest subsidy from the federal government. Roughly \$13.4 billion of such bonds have been sold, mostly to pension funds and other buyers of long-term debt. Overall, municipal bonds returned 2.7% in the quarter.

The short-term debt markets also healed. Yields on commercial paper, which companies issue to borrow for short periods, fell to below 0.4%, according to Standard & Poor's. The three-month London interbank offered rate, an indicator of banks' willingness to lend to one another, dropped to 0.595% from 1.192%.

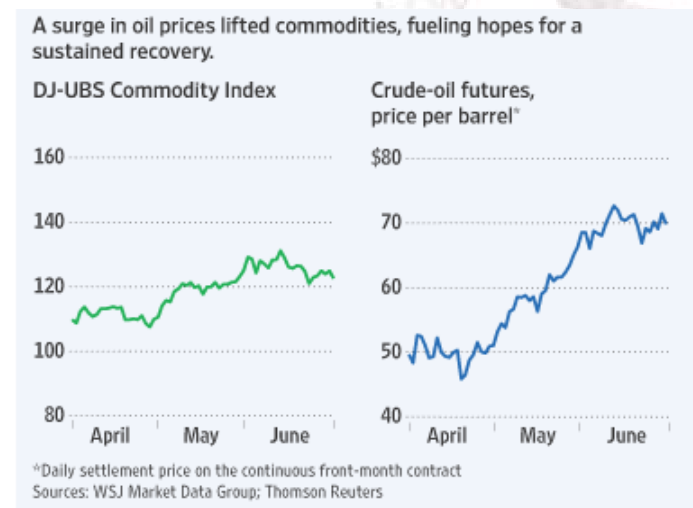
Commodities

Signs that economic declines were slowing emerged in developing economies and then spread to the U.S., sparking optimism about a quick recovery from recession and driving a strong rebound for commodities across the board. Rising fuel and food prices, in turn, fed inflation concerns and spurred investors to buy commodities as a hedge, making the commodities market one of the strongest of the year.

Oil prices rose 41% in three months, to \$69.89 a barrel, more than double the early 2009 low of \$33.98. Copper rose 23% in the quarter, putting it up 62% for the year. The Dow Jones-UBS Commodity Index finished the second quarter with a 12% rise and now has recouped all its losses since November. Even with this strong showing, many commodity levels remain at about half their year earlier prices. The rally slowed significantly in the waning weeks of the quarter.

The second-quarter surge was very much a China story. The World Bank in mid-June raised its growth forecast for China in 2009 to 7.2%, up from 6.5% it forecast in March, citing "very expansionary fiscal and monetary policies." China's favorable government policies and increased bank lending rippled through global commodities markets.

Oil prices were buoyed by China's record auto sales, which surged 55% in May, according to the China Passenger Car Association. In addition, the country stepped up efforts to hoard raw materials, leading to a jump in imports of soybeans, crude oil and copper. In late-May, Goldman Sachs Group analysts made a "China call" for increases in copper, zinc and soybean prices.



In the first half, about \$25 billion of net cash flowed into 1,500 commodities funds, surpassing all previous annual inflows. Funds investing in precious metals, natural gas and agricultural commodities had the biggest asset increases. As cash poured in, commodities, which started moving up later than stocks, quickly caught up. In May, the Dow Jones-UBS index registered the best

monthly performance since calculations began in 1991, rising 13%. Aggressive output cuts contributed to the moves. Toward the end of the quarter, a strengthening dollar triggered a broad sell off in commodities, which trade in dollar terms. Bulls say commodities are still in a long-term up trend resulting from general inflationary pressure and renewed economy activity down the road.

The rally also stoked fears of inflation. Some food makers saw higher costs, as prices of soybeans and sugar rose 29% and 33%, respectively. Drivers also felt pain at the pump, with U.S. gasoline prices soaring 32%. Gold, typically the ultimate hedge against inflation, didn't move as sharply as other commodities, perhaps because it hadn't fallen as much from its 2008 highs. It gained 0.5% to \$927.10 a troy ounce.

US Dollar

As markets stabilized during the second quarter and investors moved dollars into commodities and emerging markets, the dollar's yearlong rally came to an end. The dollar likely will continue to weaken as long as the world economy avoids falling back into the black hole from which it began to emerge in March. Investors who poured into dollars as a haven bet when the financial crisis struck last year unwound those positions and moved dollar bills from mattresses to stocks and commodities, especially oil.

In the quarter, the dollar shed 5.3% of its value against the euro and 2.66% against the Japanese yen. The British pound bounded back 14.7% against the dollar, as investors concluded the U.K. economy wasn't hit as hard by the financial crisis as they had feared, while currencies with strong ties to commodities rallied sharply. The dollar declined 5.5% against a trade weighted basket of currencies, its first decline since the first quarter of 2008 as investors contemplated large U.S. budget deficits that will require substantial foreign financing. Some fear the Federal Reserve will allow inflation to rise as a way to erode the value of that debt, making it easier for the U.S. to pay it back. That fear has helped depress the dollar's value. One refrain in the dollar conversation in recent months has been about its status as the world's so-called reserve currency. The heads of the emerging BRIC economies --

Brazil, Russia, India and China -- met in June for the first time on their own. At the meeting, Russian President Dmitry Medvedev called for creating a "supranational means of payment" other than the dollar.

Emerging Markets

At the start of the quarter, emerging markets already were moving higher, as the outlook for the Chinese economy improved and as the Group of 20 industrial and developing nations decided to give more money to the International Monetary Fund to handle financial crises. An index tracking emerging markets rose 34% in the latest quarter, in dollar terms, through Monday, according to MSCI Barra. Quarterly gains in developing countries such as Russia and China beat stocks in the U.S., France and England. In June, some global markets dipped as doubt crept in ahead of second-quarter earnings reports, and as investors reconsidered whether gains reflected fundamental economic improvement or just relief that the worst-case scenario hadn't panned out. China's benchmark Shanghai index gained 25% in the second quarter, and Brazil's was up 26%, compared with a rise of 11% in the Dow Jones Industrial Average and gains of 8.2% in the U.K.'s FTSE 100. Stocks in India surged in the second quarter. Its benchmark Sensex index gained 49% over three months. India's mid-May election results, which brought a strong victory to the ruling Congress party and its allies, helped stoke investor optimism. This year, cash inflows into emerging-market stock funds have returned more than half the outflows in 2008, according to a Citigroup report.

Among developed markets, Japan was a top performer, with a rally that beat gains in the Dow industrials; also the U.K., France and Germany. In the second quarter, Japan's Nikkei Stock Average of 225 companies gained 23%. Japanese shares still look cheap, "even after the rally," said Taizo Ishida, lead portfolio manager for the Matthews Japan Fund. Just over 60% of the companies in Japan are trading at prices below their book values, he said.

Master Limited Partnerships (MLPs)

TIMECAPITAL® INVESTOR ADVISORY SERVICES INC. continues to focus on MLPs as an asset class with very interesting income and growth characteristics that has provided our clients with substantially better than market returns. The Alerian MLP Index (including reinvested income) started the year at 428 and rose 31% to 560. The index began on December 31, 1995 at 100. With reinvested income the compound annual return has been nearly 13%.

As we have indicated previously, MLPs (which generally hold and operate assets related to the transportation and storage of energy) have been one of the best performing market segments. They are designed to pass through cash flow to unit-holders without prior corporate taxation. They are an integral part of our investment model and certainly fill the bill in our "get paid to wait" concept.

For the second quarter, MLPs posted a record quarterly gain of 16.7% (19.1% on a total return basis). Top MLP sectors for the quarter include General Partners (+42.2%), E&P (+38.6%), G&P (+29.7%) and Crude (+24.7%).

Recent investor concerns have focused on the potential negative impacts of inflation and higher interest rates on MLP price performance. MLPs should continue to provide a good inflation hedge in a rising interest rate environment:

- 1) Inflation Adjusters: many pipeline MLPs have contracts which adjust for inflation annually.
- 2) Higher Commodity prices: inflation would likely cause commodity prices to increase, which would increase revenues and margins for commodity-sensitive MLPs (gathering, processing and upstream).
- 3) Distribution Growth: distribution growth has largely outpaced increases in the CPI, making MLPs a good hedge against inflation.
- 4) Low Price Correlation with Inflation/Interest Rates: MLP price performance is not as sensitive to interest rate movements and/or inflation as commonly perceived. While sudden spikes in interest rates have caused declines in MLP price performance, there has only been a 0.29 correlation between MLP price performance and the ten year Treasury note over the past 5 years.