

# TimeCapital®

*Investor Advisory Services, Inc.*

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## Discussion Topics

Master Limited Partnerships

Credit Markets

Commodities

US Dollar

Dear Client

The rally that began in early spring continued over the summer, gaining momentum and the quarter finished with the Dow Jones Industrial Average up 15%. Thus, 3<sup>rd</sup> quarter performance exceeded the stellar 2<sup>nd</sup> quarter and was the largest quarterly gain for the Dow since the fourth quarter of 1998 – it was the best 3<sup>rd</sup> quarter since 1939.

The Dow rose 1265.28 points to 9712.28. Even after a 0.3% decline on the last day of the quarter, the Dow is up 48% from its March 9 low and up 11% this year, although still down 31% from its October 2007 record. The 28% gain over the past six months was the best performance since the two quarters ended in March 1987.

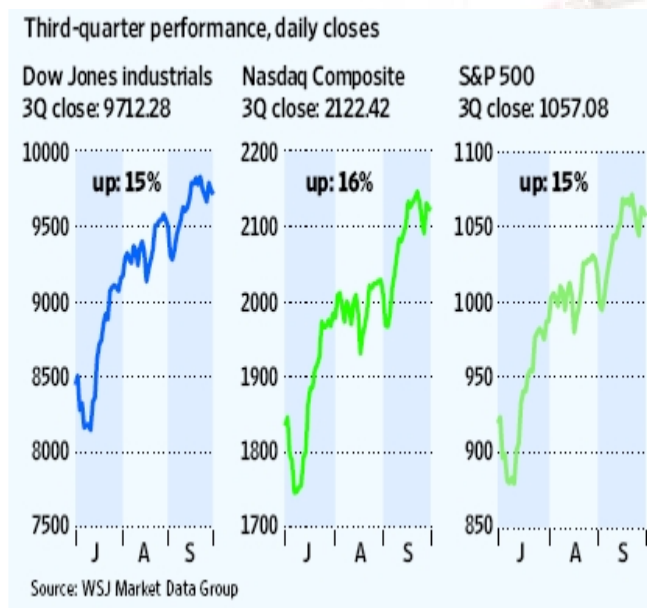
The Standard & Poor's 500-stock index gained 137.76 points, or 15%, to 1057.08, in the third quarter, leaving it up 17% for the year and up 56% from its March low but off 32% from its October 2007 high. It also was the S&P's best quarter since 1998, when the global financial markets were recovering from the Asian financial crisis and the Internet stock bubble was expanding. Then, the market continued to rise until the bubble burst in 2000.

The economy showed signs of stabilization as the rally continued. Corporate profits were above reduced expectations with cost cutting rather than top line growth providing much of the impetus. The momentum was strong enough to roll over concern that consumers remain saddled with high debt, rising unemployment and stubbornly depressed housing prices.

The outsized gains came after a bear market that brutalized those companies with the shakiest balance sheets, heavy debt loads and high levels of fixed costs. The Fed effectively cut interest rates to zero, substantially penalizing savers and flooded the credit markets with additional money while buying up Treasuries, government-backed mortgage securities and agency debt.

With the return on low risk fixed income reduced to zero and the increased money supply providing one of the reasons for a weaker dollar, investors took advantage of the easy money and directed capital into riskier assets; many of the biggest decliners during the crisis posted the largest increases during the rally. Financial stocks were the best-performing sector in the S&P 500 last quarter, gaining roughly 25%; followed by materials, up about 21%; and the consumer-discretionary category, which includes autos and casinos, up about 19%. Small-company stocks, too, posted big gains. The Russell 2000 rose 19% and is up 76% from its March low.

The technique of purchasing volatile stocks is called a “beta trade”. We refer to “beta” as a measure of an individual stock’s movement in relation to the entire market. A stock with a beta of one moves in line with the market, while a stock with a beta of two historically moves twice as much as the market. A basket of the 20 highest beta stocks in the Russell 1000 gained 53% in the third quarter and 141% year to date after declining 75% during 2008. This “beta” driven rally may be said to have been fueled by the Fed’s very accommodative money supply action while earnings surprises provided the momentum.



As markets were closing out the third quarter with gains, the Fed appears to have begun mapping out its exit strategy. The Fed said it will be winding down its program for buying Treasuries at the end of

October, and plans to end buying of mortgage and agency debt at the end of the first quarter of 2010.

Last week, Fed governor Kevin Warsh cautioned that Fed policy could “begin normalization...possibly with greater force than is customary,” a remark that some interpreted as warning that whenever interest-rate increases begin, they could move faster than the markets have been expecting.

The best performing stocks may be those with higher quality earnings rather than speculative issues as timing of the Fed’s next step moves closer.

Gains in Europe outpaced the previous quarter while some emerging markets rose at a slower pace than during Q2, European shares rose in anticipation of a full-blown economic recovery aided by low rates and plentiful liquidity. France’s CAC-40 was up 21% and the UK’s FTSE gained 21% while the German DAX added 18%. Overall the Stoxx 600 index of large European companies rose 18%.

China’s Shanghai Composite Index was one of the few that fell for the quarter, down 6.1% (after rising 63% for the first half of the year). MSCI’s emerging market index was up 20% in the latest quarter on top of a 34% rise in Q2. In Brazil, domestic consumption has been relatively resilient and Brazil’s Bovespa Index gained 20% during the latest three months. Japan’s Nikkei Stock Average rose just 1.8% for the quarter.

## How the major indexes performed

	Third-quarter performance	Close 9/30/09	% chg from 9/30/08
Dow Jones Industrial Average	<b>15.0%</b>	9712.28	-10.5
DJ U.S. Total Stock Market	<b>15.8</b>	10911.69	-8.1
DJ World (excl. U.S.)	<b>19.2</b>	194.70	3.5
Value Line (Geometric)	<b>22.1</b>	298.87	-12.0
Russell 2000	<b>18.9</b>	604.28	-11.1
NYSE Composite	<b>17.0</b>	6910.88	-8.3
Nasdaq Composite	<b>15.7</b>	2122.42	1.5
S&P 500	<b>15.0</b>	1057.08	-9.4
Amex Composite	<b>12.4</b>	1778.67	-0.5

Sources: WSJ Market Data Group; DJ Indexes

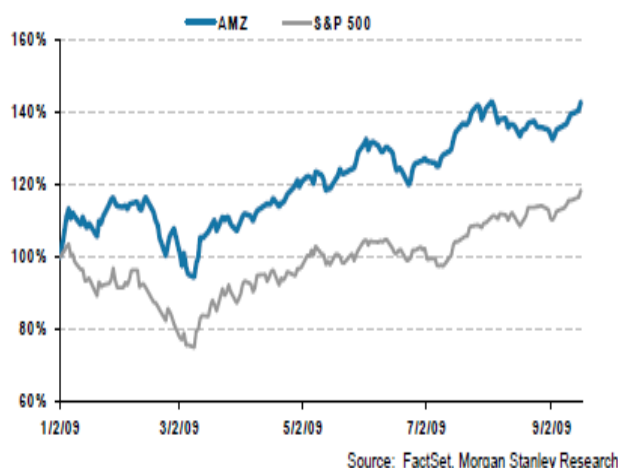
**MLPs**

After a brief pause in August, MLPs continued their bullish run increasing by 5% in September, bringing year to date performance up to 41% versus the 17% return on the S&P 500. Strong performance was aided by the continuing overall stock market strength combined with a further tightening of credit spreads, signs of recovery in natural gas prices and a pick-up of drilling activity as well as capital inflows to the sector. The capital inflows have helped to offset a steady calendar of equity issuance indicating that investors are discounting potential near-term fundamental weakness and focusing on expectations for 2010 to provide economic growth, stronger commodity prices, and acquisition possibilities as well as organic growth.

The macro trends that drive MLP performance should improve over time. Credit spreads should continue to narrow and better access to capital markets for the sector will continue as the economy recovers. For investors looking for yield MLPs are among the most attractive on a risk-adjusted basis relative to utilities, real estate investment trusts and others.

Even with the year to date 41% increase, MLP valuations remain attractive when compared to historical levels, now about 20% below the five year averages. MLPs currently yield 8.5%, trade at median 2010 price-to-distributable cash flow and enterprise value (EV)-to-EBITDA multiples of 9.5x and 10.2X respectively, and are yielding more than 500 basis points above the 10-year Treasury. This compares with the 5 year medians for the sector of 7.1%, 12.1X, 11.0X and 275 basis points respectively. MLPs should continue to benefit from a number of long-term trends, including the Baby Boomer population's search for tax-advantaged income and potential inflationary pressures, for which MLPs have historically provided an excellent hedge. In the meantime, MLP investors are "paid to wait", receiving a median tax-deferred yield of 8.5%, with modest distribution growth to offset potential inflation (average one year distribution growth profile if approximately 5%).

AMZ vs. S&P 500 for 2009 YTD

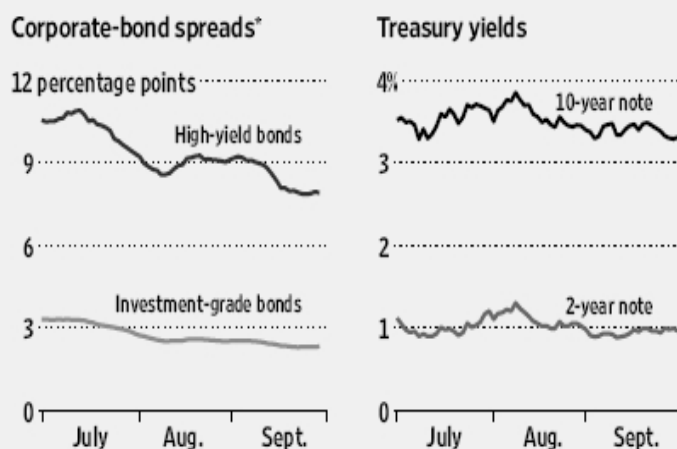


Since 1996 MLPs have provided stock appreciation returns of 7% versus 4% for the S&P 500. When viewed on a total return basis (stock price growth + reinvestment of distributions) MLPs have returned 14% per year since 1996 versus 6% for the S&P 500.

**Credit Markets**

Corporate bonds extended gains from the previous quarter, while a combination of low interest rates and strong investor demand sparked a rush by companies to raise cash by selling debt. Treasuries

Corporate bonds continued to recoup last year's losses, while low Treasury yields helped keep mortgage and corporate interest rates low.



\*As of Tuesday Sources: Merrill Lynch Indexes (spreads); Ryan ALM via WSJ Market Data Group

and short-term debt markets also benefited from improved conditions, helping to keep rates low.

Holders of US government bonds overcame worries that foreign central banks would scale back purchases. Strong interest from overseas investors, coupled with purchases of Treasuries and mortgage-backed securities by the Federal Reserve, helped support bond prices and kept yields and home mortgage rates low.

The yield on the 10-year Treasury note was 3.309% at the end of September, after touching a high of 3.852% in the third quarter, compared with a yield of 3.521% at the end of June. It remains well above the 2.078% reached last December when investors poured money into Treasuries (price and yield move inversely) seeking safe haven amid the financial crisis.

Low short-term rates and paltry returns from safe investments such as money-market mutual funds have prompted investors to move more money into higher-yielding and riskier assets. Those strategies paid off for a second consecutive quarter as most sectors rallied.

High-yield, or junk, corporate bonds, those issued by companies with speculative-grade credit ratings, gained 15% during the past three months. The gap between their yields and those of Treasuries narrowed to 7.9 percentage points, from a spread of 10.6 percentage points at the end of June. In the year to date, junk bonds have gained a record 48%.

Investment-grade corporate bonds also rallied in the third quarter, chalking up gains of 8.3%. Their spreads dropped to 2.35 percentage points at the end of September, from 3.3 percentage points three months earlier and six percentage points at the start of the year.

The average yield on high-grade corporate bonds is now about 5%, making it relatively easy for sound companies to borrow by issuing debt. Financial markets once again hospitable to fund raising by companies allow many of them to pay off debt, build up cash on balance sheets, and, most important,

avoid going into default. Individuals, too, are benefiting from a recovery in the banking sector and increasing issuance of securities backed by credit-card debt, auto loans and mortgages, thanks in large part to actions the Fed and Treasury have taken to support the markets.

The ability to refinance debt will provide companies, as they start to see improvements in revenue and profitability, the ability to use the cheap funds to undertake acquisitions to expand, effectively setting the stage for the next phase of growth. However, hundreds of financially weaker companies will need to refinance \$750 billion in junk bonds and leveraged loans in the next few years and the markets do not appear resilient enough yet for this undertaking.

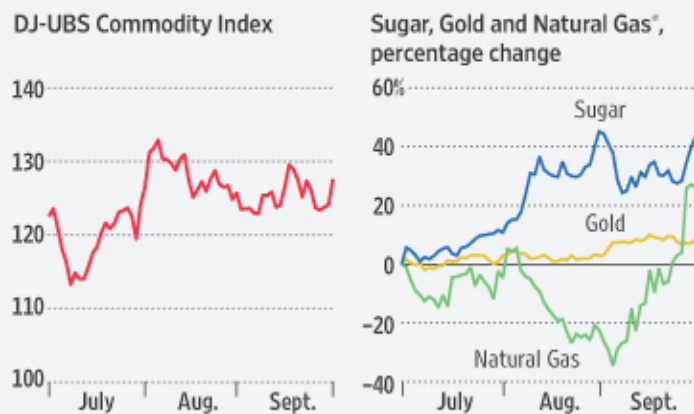
Following two consecutive quarters of strong rallies, there is a sense among investors and analysts that the worst is over for the credit markets and the recession has ended. But the economy remains weak in spots, and many issues, such as proposed regulatory overhauls, have yet to be resolved.

### Commodities

Commodity prices diverged during the third quarter rather than trading in tandem as they had earlier in the year. Crude oil spent most of the past three months range-bound at about \$70 a barrel, before ending the quarter with a 1% increase to \$70.61,

### Separate Paths

A small gain in the Dow Jones-UBS Commodity Index masked big differences among its components.



\*Data for daily settlement price on the continuous front-month contract  
Sources: WSJ Market Data Group; Thomson Reuters

restrained by still-fragile demand and high inventories but with support from a weak dollar. Amid better-than-expected economic readings, copper, which has many industrial uses, extended its first-half rally and surged 24% during the quarter. Gold has remained well above \$1000 / ounce since breaking its 2008 record of \$1018.90 on September 16. By the end of September, The Dow Jones-UBS Commodity Index had edged up 4% for the quarter and 9% for 2009.

In the US, two gauges for commodities demand, industrial production and retail sales both turned positive. Fed Chairman Ben Bernanke's statement in mid-September that "the recession is very likely over" provided another boost.

In the third quarter, China's government-backed stockpiling efforts started to wane. Beijing slowed its imports of iron ore, soybeans and fuel products in August as its central bank put a brake on lending to avoid overheating in certain areas.

Evidence of economic recovery in the US and Europe suggests that demand for raw materials will rise. Many investors expect a rebound in commodity prices as companies start to rebuild inventories in anticipation of a recovery in demand.

Sugar prices reached a 28-year high in August and continued to rise amid concerns over shortages due to falling output in India and Brazil. During the third quarter, sugar prices soared 43% to settle at 24.12 cents a pound on the ICE Futures U.S. exchange. Small markets like sugar tend to overshoot in the face of supply disruptions.

Natural-gas prices tumbled 55% to the lowest level since 2001 in early September as producers continued to pump gas into nearly full storage facilities; gas prices later bounced back 93% as the injection pace slowed. At the end of the quarter, natural gas was up 26% to \$4.841 per million British thermal units, and down 14% for 2009.

Regulators' scrutiny also became an issue during the quarter as traders and investors worried that proposed rules changes targeting excessive

speculation could force some participants out of the market and change the way that commodities are traded.

In July, the Commodity Futures Trading Commission broadcast its intention to rein in excessive speculation by limiting certain holdings beyond current restrictions in agricultural markets.

A group of commodity exchange-traded funds, which had a total of \$59.6 billion in assets as of the end of August, according to ETF tracker the National Stock Exchange, is among those taking action in the face of a potential regulatory overhaul. Some fund managers moved to limit growth by halting issuance of new shares in these funds, which affected investor access to commodities. U.S. Natural Gas Fund, an exchange-traded fund, stopped issuing new shares and buying more natural-gas futures due to regulatory uncertainties; Deutsche Bank's decision to close down an oil exchange-traded note after hitting limits upset some traders.

### Dollar

The US dollar continued to slide during the third quarter, particularly as investors moved their cash reserves into riskier investments searching for higher returns. The decline may continue in coming weeks as investors anticipate that other countries will begin to raise interest rates before the Federal Reserve, boosting the returns on those currencies. While some feel that the dollar weakness has pretty much run its course, other investors forecast continuing multi-year erosion in the value of the greenback as the Fed's "unwritten" plan to devalue its way out of the mountain of debt created during the current bailout programs plays out.

In the quarter, the dollar lost 4.1% of its value against the euro and dropped 6.8% against the Japanese yen, dipping to 89.77 yen on Monday, its lowest level since late January. Currencies of big commodity-producing nations soared against the dollar, with Australia's currency rising 9.5% partly on optimism about China, a big buyer of its natural resources.

While the dollar was weak, the British pound was even weaker. It lost 2.9% against the dollar and 6.9% against the euro. That decline came after the pound gained 15% against the greenback in the second quarter.

Investors see the U.K. economy as particularly vulnerable to the after effects of the global financial crisis and few expect British short-term rates to rise anytime soon. Moreover, the Bank of England has warned against assuming a sustainable economic recovery is assured, further battering the pound.

The US government's efforts to pump money into the economy have made dollars unusually cheap to borrow at a time when US assets offer paltry fixed returns. As a result, traders have made the dollar the new "carry trade", borrowing dollars and using the proceeds to purchase higher-yielding investments in other currencies. This technique tends to depress the borrowed currency, resulting in a "flight" out of the dollar.

The dollar's slide also is prompting questions about how long the world's largest central banks will continue to consider it the best currency for their reserve holdings. Some critics, especially in China and Russia, have called for an alternative to the dollar or for switching to a system of multiple currencies.

But the dollar's weakness could end up helping break its own fall before year's end, investors and analysts say. Some say that we may very well be in the "eighth inning of this process" as earlier than expected US interest rate increases, or a major crisis in emerging countries as well as a geopolitical event, could push investors back into dollars.

We welcome the opportunity to be of service and as always appreciate your questions and comments.

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