

ANDRESEN & ASSOCIATES

P.O. Box 1434 Salinas, CA 93902-1434

Phone: (831) 758-1575 or 1-800-345-9644

Fax: (831) 758-1576

PETE@ANDRESENASSOC.COM

WWW.ANDRESENASSOC.COM

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	Value	YTD %
Dow Jones Industrial Avg	10319	-1.0%
Vanguard 500 Index	100	-1.7%
Vanguard Total Bond Index	10.8	6.7%

WHAT'S NEXT?

We are taking the unusual step of sending you an additional newsletter this month because new information has emerged. This data is altering the world's expectations of our economic recovery.

Earlier this week the Treasury sold 3 year T-notes at a yield of 0.844%. This is a stunningly low interest rate. Investors apparently expect the economy to stagnate for the next three years, and inflation to remain non-existent.

The US is currently paying over \$1 billion a day to bail out government-owned mortgage wholesalers Fannie Mae and Freddie Mac. Those government-sponsored entities aren't recovering easily.

This week the Bureau of Labor Statistics released the information that non-farm productivity fell .9% in the second quarter of 2010. This tells us that productivity of current jobholders is maximized. The details also suggest that we may experience a "jobless" recovery. In other words, some unknown proportion of the jobs lost since 2008 will be replaced with technology, not by new hiring of people. Many of the currently unemployed may be job-hunting for awhile.

FactSet Research reported that the average earnings per share of 450 of the 500 members of the S&P 500 GREW 43%. The rest haven't reported yet. Equipment which is essential and wearing out is being replaced. Also, technology is providing attractive earnings as we all become more technology-dependent.

Both of the major political parties recently received their lowest ratings in the 21 year history of the ongoing Wall Street Journal/NBC News political sentiment poll. This implies that a period of social unrest has been building over the last decade and is likely to continue to fuel a groundswell of social unrest.

The same poll indicated that only 1/3 of the randomly chosen respondents, regardless of income or social position, believe that the economy will improve in the coming year.

All this information suggests that we are in a VERY uncertain economic and social climate. Of greatest importance is our national sense of malaise and surrender.

My thinking is that the national mood is usually a contrary indicator: when we are most in despair, we are nearest to a national turn-around. It doesn't seem that way now, but history clearly suggests that this is so.

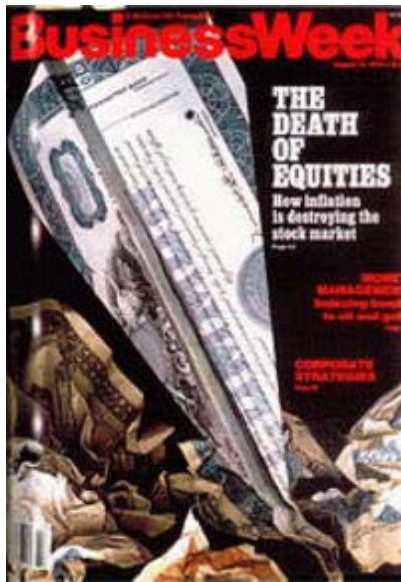
When the national mood is angry, despondent, or fearful, we tend to think and act with a very short-term time horizon in mind. These are times when we tend to replace the political party in power and over-regulate our private sector. Both of these phenomenons have happened since 2008.

On the other hand, when we are buoyant and brimming with optimism, we tend to ignore stormclouds on the horizon. We often make vast political and financial mistakes, and a market top is usually somewhere close by. Most frauds and abuses happen during the best of times, and are only discovered later.

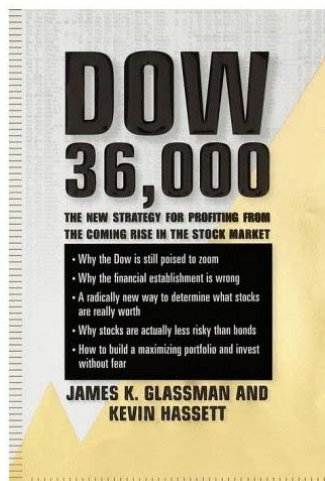
When times are hard, we make good decisions and lay the groundwork for a later success.

Check out history and you'll see that this situation occurs time and time again.

Here's what happened at the bottom of our last period of national angst: Post-Vietnam, in the throes of inflation, with Jimmie Carter as President. Check out the Business Week magazine cover on August 13th, 1979 predicting the death of the stock market, titled "The Death of Equities." The Dow Jones Industrial Average was then lower than 2,000, and it is now over 10,000.



As a nation, we have over-reacted during boom times as well. This book was published on October 1st, 1999, and was a best seller. The following year the stock markets plunged and have not yet recovered their value. While our portfolios have done relatively well since then, the stock market indices have not yet recovered their pre-crash values.



My point is this: from a multi-year perspective of at least 5 years, the national mood is a CONTRARIAN INDICATOR! If we follow a long-term plan, expect a rocky but historically congruent path, and invest carefully, then we should do very well in the multi-year context from this point.

I am expecting interest rates to GO UP from here. We don't know when and we don't know to what degree, but interest rates will go up, either very suddenly or very slowly or in some manner in between.

When interest rates go up, bonds go DOWN. The average maturities in our portfolios are already quite short, but I will gradually make them shorter.

We should emotionally prepare ourselves for small temporary losses in our short-term bond funds if interest rates rise suddenly. In my opinion, staying in these short-term funds is worth the moderate risk of damage caused by a sudden upturn in interest rates because at the moment, cash is yielding nothing.

I am also biasing our portfolios towards investments which can thrive in uncertain times, regardless of the rocky recovery which lies before us. Right now that means reducing our Vanguard REIT fund, which has grown a beta risk statistic of 1.67, and buying a technology index fund with a beta risk statistic of 1.

The S&P 500 Index may go sideways for the next year or so. However, certain sectors of the stock markets will probably do quite well, while others struggle.

What all this means is that better times are ahead. The situation may now seem desperate and dismal. In the short term, one year or less, we will probably experience lots of public anger and recrimination. We may see even worse economic numbers, but based upon centuries of history, we know that beyond one year, if not surprisingly sooner, our economy and our society will go on to better times.

Bottom line: at the moment the national mood is dismal. Economic statistics are mixed, with earnings suggesting that a recovery IS UNDERWAY! And most importantly, the national mood is a CONTRARIAN INDICATOR!

Let's prepare for rocky years ahead, but let's also prepare for good times in the future. Our current malaise will pass. ■