



WWW.WESTOAKCAP.COM

WEST OAK CAPITAL, LLC

2801 TOWNSGATE ROAD, SUITE 112
WESTLAKE VILLAGE, CALIFORNIA 91361
TELEPHONE 805.230.8282
FACSIMILE 805.230.8283

July 2009

A welcome rebound in stock prices in recent months has brought the S&P 500 index back into positive territory for the year. Economic reports during the second quarter revealed signs of life among the ruins, and the bond market regained its composure. While this is certainly good news for investors, the early stages of recovery are still tentative and likely to take awhile to firm up. Higher personal savings rates, a sluggish job market and tougher credit conditions all suggest that consumer spending will be subdued for an extended period of time. It seems likely the worst of the crisis is behind us, although we expect the road ahead will lead us through a protracted period of recovery in economic activity, rather than a quick rebound.

Fixed income markets were at the epicenter of last year's meltdown, and those markets are now doing much better. Liquidity and pricing have recovered from the paralyzing credit crisis that took hold last autumn. Monetary policy has been highly supportive in getting the bond markets back up and running. At some point down the road, the Federal Reserve will have to carefully pull back on its stimulus efforts. That will be a delicate assignment. Acting too soon could jeopardize the recovery, but waiting too long could allow inflationary pressures to take hold.

California's epic budget mess is creating headlines, although we continue to believe the state will make good on all its bond commitments. Repayment of debt is second only to education expenses in the California constitution, making it a higher priority than all other state expense items. Also, it seems unlikely that Sacramento would risk alienating investors at a time when California needs to issue vast amounts of additional bonds. California's predicament is representative of municipalities around the country, as well as the federal government, which are running up historic budget deficits. The threat of rising interest rates poses a serious risk in coming years until these debt burdens can be paid back down to more modest levels.

While the government sector is spending, the private sector is saving. This recession has caused a dramatic shift in consumer behavior, as the U.S. household saving rate has surged to 6.9 percent. This is the highest level in the past 15 years and, while challenging for retailers, may help stabilize the economy over time. Paying down debt and socking away a few dollars seems a reasonable reaction to the uncertainties confronted by households across the country as national unemployment rates are rising toward ten percent and personal lines of credit are either shrinking or being assessed more punitive interest rates. The relief in oil prices was short-lived, as geopolitical concerns and speculation have propelled oil prices back up to around \$70 per barrel from the recent low of roughly \$30 reached last December. Without a meaningful change in our nation's energy policies, it is likely oil prices will continue to be in the news. In addition, household budgets will be buffeted by changes in tax policies and healthcare programs

that are widely anticipated in the coming year. All of those factors weigh heavy on consumer spending patterns, which provide roughly two-thirds of our nation's economic activity. Tight wallets suggest it will be a slow, uneasy climb out from this recession.

This month's corporate earnings reports are an important milestone. Earnings took a terrible beating in the aftermath of the credit crisis, and this quarter's results are expected to show the first meaningful evidence of profits regaining their footing. Stock prices tend to follow the outlook for corporate profits. There is a lot of information in the quarterly reports, and analysts currently estimate that companies in the S&P 500 index will produce profits in 2010 that are an encouraging 23 percent higher than this year's figures.

Conditions are getting better, although many of the improvements are probably a bit behind the scenes and out of view for most of the general public. Corporate profit reports and liquidity in fixed income markets tend to be more closely monitored by Wall Street than Main Street. People are focused on the outlook for employment and the value of their homes, and both of those factors tend to be lagging indicators. In other words, by the time employment and home prices are improving, the economic recovery should already be well underway.

Capital markets have weathered some terrible periods in our nation's economic history. They will eventually find their way back to a productive path. In the meantime, we are maintaining our focus on asset allocation, diversification and identifying good quality holdings to help clients navigate through this difficult investment environment.

Please contact us if you have any questions or thoughts you would like to discuss.