

April 10, 2010

I am happy to report that we have reached the one year anniversary of the market bottom, of the recent recession. Over the past year, the US economy has performed pretty much as we expected. The stock market, however, has rebounded faster than we expected. We are now within shooting distance of our all-time highs.

During the first quarter of 2010, the S&P 500 index finally had a modest correction (about 8% peak to trough) but came back smartly to reach a new 52 week high and keep the Bull Market in tact.

During the first quarter, the average of all Capital Dynamics (CD) accounts appreciated by 7.1 percent (after commissions). Over the same time period, the S&P 500 index increased by 4.7 percent.

Over the last twelve months, the CD accounts have appreciated by 44.7 percent (after commissions), while the S&P 500 index has increased by 43.0 percent.

Finally, since January 1, 2008, the CD accounts have declined by 10.1 percent (after commissions), while the S&P 500 index has declined by 21.0 percent.

It is almost certain that the first quarter of 2010 will deliver positive GDP growth. That will make three quarters in a row of positive GDP growth for the US economy. The risk of a double dip recession has become sufficiently small that the optimum strategy requires us to become more bullish. In fact, we are now nearly fully invested, and are beginning to once again gain on the market while it is going up. Our nominal cash position declined a bit to about 6 percent.

As indicated in my last report, I have updated and attached my long-term annual and cumulative performance to this letter. Over the last ten years, the compound annual appreciation of Capital Dynamics managed portfolios is 8.4 percent. The corresponding figure for the S&P 500 index is a decline of 2.6 percent per year. Thus, over the last ten years, we have beaten the S&P 500 index by 11.0 percentage points per year. I am extremely proud of that performance. The CD figures include the re-investment of dividends and interest and are net after commissions – but do not include advisory fees. The S&P 500 figures do not include the re-investment of dividends or the cost of commissions.

### TIMING MODEL

The Timing Model continued to show improvement during the first quarter. It moved to a strong bullish reading of 65%. Thus, it predicts a 65% chance of market appreciation and a 35% chance of a market decline over the next 3 – 6 months.

### ECONOMIC OUTLOOK

Short-term interest rates have been kept close to zero for over a year. Similarly, the thirty year mortgage rate has been kept below five percent to date. This has allowed banks and other financial institutions to maintain modest profitability while gradually writing off their toxic assets. Even more important, the low mortgage rates have stabilized home values.

The above policies, combined with other government programs are allowing our financial systems to heal, and have turned the US economy to resume GDP growth. As I mentioned earlier, the US economy has now been growing over the past nine months. Housing prices have, on average, been creeping upward for roughly six months. As you know, the stock market has had a major recovery, thereby adding the wealth effect to growth.

It should be clear that we are now in a growth mode. Unfortunately, GDP growth has been relatively weak (i.e. 2-3%). In all likelihood, we will not see more rapid GDP growth until the unemployment rate declines and retail sales improve. For the moment the economy is primarily being driven by corporate spending and export growth.

The above scenario is not all bad. Slow growth should allow for decent corporate earnings. Corporate earnings growth should continue to support the Bull Market. Market price appreciation, however, should slow down; probably extending the Bull Market cycle. Slow growth should also provide relatively low inflation over the next couple of years. The negative side of the coin is that slow growth will make job hunting difficult. It will also provide an environment of low interest rates on savings deposits, for an extended period of time.

Sincerely yours,

Ray Hofshi