



FORT PITT
CAPITAL GROUP

FOSTER PLAZA TEN
680 ANDERSEN DRIVE
PITTSBURGH, PA 15220
412.921.1822

801 LAUREL OAK DRIVE
SUITE 103
NAPLES, FL 34108
239.566.1384

WWW.FORTPITTCAPITAL.COM

CAPITAL IDEAS

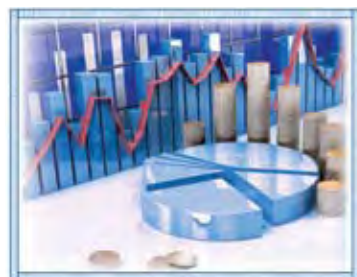
HELPING CLIENTS BECOME SUCCESSFUL INVESTORS

VOLUME 12, NUMBER 3, JULY 2009



AN ECONOMY IN RECOVERY?

(CONTINUED)



International and Emerging Markets:

Over the last 15 plus years, the U.S. consumer has provided the engine of growth for the global economy. A combination of productivity growth and the housing bubble

allowed us to spend beyond our means. Low-cost producers, like China, fueled not only our appetite for goods, but also substantially elevated their own standard of living, transferring millions of people from a primary agrarian economy to an export-based manufacturing economy. This needs to change. We expect that China will begin to grow its local service and manufacturing sectors. India already has a growing service economy, as evidenced by call centers, transaction processing and software development. Brazil is rapidly growing a robust economy, ranging from farming, to energy, to even aircraft manufacturing. While investing in these economies is attractive, we also believe that U.S. multinational firms like Boeing, GE and IBM will be winners in these growing markets.

Policy Issues:

It appears that the Federal government has learned from past policy mistakes, and with the exception of healthcare reform, is moving at a measured pace. There have been limited calls for trade protectionism.

BY DOUGLAS KREPS, CFA

CLEARLY, THE STOCK MARKETS HAVE RESPONDED WELL OVER THE PAST FOUR MONTHS, & WE HAVE SEEN A MOVE TOWARD MORE NORMALIZED CREDIT MARKETS.

The President has retreated from some original proposals to increase taxes. And the Federal Reserve Board has made it clear that they will be inflation hawks when necessary. We do not believe it likely that we will repeat the policy mistakes of the 1930's, but it is something we are closely watching.

Conclusion:

We believe that due to aggressive action from the Treasury Department and the Federal Reserve, we avoided a systemic collapse of the financial system in late 2008. Massive amounts of liquidity, combined with a stimulus package and innovative programs to purchase troubled assets, have set the stage for a gradual recovery. Clearly, the stock markets have responded well over the past four months, and we have seen a move toward more normalized credit markets. We are not out of the woods yet, but we think we are moving in the right direction.



QUARTERLY REVIEW

BY: DENNY BAISH

The major equity indices reversed course and rose sharply in the second quarter. After a disappointing first quarter, double digit gains were the norm for most domestic and international indices (see accompanying chart). This is in sharp contrast to the double digit losses seen in the first quarter. International indices gained considerably more than their domestic counterparts. The widely-followed index of international markets, MSCI EAFE, gained 25%, while the Dow Jones Industrial Average finished up 12%.

Generally investors began to feel more upbeat during the quarter as the end of the recession seemed to be in sight. Some areas of the economy showed signs of stabilizing, providing indications that the worst may be behind us. The appetite for risk returned to the market, as valuations had reached oversold levels. Treasuries, which provided shelter during the stock market fall, saw a substantial selloff as investors moved money back into domestic and international stock markets. The hardest hit asset classes, high yield and emerging markets, saw the biggest gains during the quarter.

Absolute returns were impressive across all market capitalizations during the second quarter. Small-cap companies were the standouts. Mid-caps trailed closely behind, while large-caps lagged. Growth and value styles differed considerably across the market cap spectrum. Small growth outperformed small value by 5%, while large value outpaced large growth by 3%. Mid-growth and mid-value had comparable returns. International markets rose sharply in the second quarter.

INVESTORS BEGAN TO FEEL MORE UPBEAT DURING THE QUARTER AS THE END OF THE RECESSION SEEMED TO BE IN SIGHT.

As noted above, the MSCI EAFE index posted its best quarterly return since the first quarter of 1986. Building on a small gain in the first quarter, the S&P/IFCI Emerging Composite gained 36%. This three-month return for emerging countries was the largest quarterly gain in the twenty-year history of the asset class.

Performance results were mixed for the fixed income markets. High yield bonds shined during the quarter after a dismal first quarter. The Credit Suisse High Yield index was up 20%. Government bonds turned in a loss for the quarter as investors moved out of the most conservative segment of the market. International bonds showed some strength, adding 5%, while corporate bonds were largely unchanged. Barclays Capital Aggregate Bond index of the broad fixed income market finished the quarter up almost 2%.

BENCHMARK INDEXES	
INDEX	SECOND QUARTER RETURN
DJIA	11.96%
S&P 500	15.93%
S&P MID-CAP 400	18.75%
RUSSELL 2000	20.69%
MSCI EAFE	25.43%
BARCAP AGG BOND	1.78%



MUTUALLY ASSURED DESTRUCTION

BY CHARLIE SMITH

Recent data indicates the U.S. economy has stabilized following the worst recession since World War II. The initial estimate of second quarter 2009 real Gross Domestic Product shows things still getting worse, but at a minus 1.0% annual rate, much tamer than the minus 6.4% annual rate of decline in the first quarter. Ten months of frantic money creation and spending by the Fed and Treasury are having the desired effect of putting a floor under consumption and production.

Cynics would sum up the forces behind this improvement as a tale of two payoffs. In the months immediately following the September 2008 panic, the Republican Bush administration paid off their financial market constituents by drastically expanding the Fed's balance sheet, rolling out the TARP for the banks and inserting a large cash funnel into AIG. Markets shuddered and then stabilized. Payoff number two came in the spring, when the newly-elected Obama administration and the Democratic congress repeated the favor for their state and local apparatchiks in the form of a \$787 billion stimulus package. Recent figures on Federal spending show a majority of the stimulus money spent so far has gone to financially strapped states and localities.

In the meantime, Treasury has been busy borrowing hundreds of billions of dollars in world financial markets. Eventually the bill must be paid. Over time, this gigantic debt will be extinguished in one of four ways. Our future depends on our mix of choices.

First, we can work and save our way to paying it back with real dollars. This is the option our pre-baby boom forbears would've chosen. This is also the route a gold standard would've forced upon us. No such standard exists in today's dollar-centric, fiat-money era however. As a result, we've been able to borrow up to our eyeballs in our own currency. One day the Chinese and our other creditors may refuse us this luxury, particularly if they decide the dollar is no longer a reliable store of value.

A second route would be to renegotiate the terms of the debt by lowering the interest rate, reducing principal and/or extending maturities. This could happen if our financial situation became so dire that our creditors saw it as their only path to getting paid. Not particularly likely, but it could happen. Third, we could simply default. This path would mark the end of our status as a first-world nation, so it is not really an option.



Choice number four is the most intriguing, and perhaps the most likely. We could inflate away our obligations by extinguishing them with cheaper dollars. The great capitalist Vladimir Lenin called currency debasement the best method for undermining the capitalist system because it allows government to confiscate wealth in a manner not one in a million people can diagnose. There are 1.3 billion Chinese, so chances are a few of them would figure it out. In fact there are signs they're onto us already. During a recent speech at Beijing University, U.S. Treasury Secretary Tim Geithner was literally laughed at when he insisted that dollar-denominated Chinese assets were "very safe." In addition, Communist party leadership has continued to advocate diversification away from dollar denominated assets. Included on the menu of dollar alternatives are equity investments in resource oriented businesses, and direct purchases of commodity reserves the world over.

There's an old saying that if you owe the bank a million dollars, you have a problem. If you owe the bank a billion dollars, the bank has a problem. Right now our obligation to the Chinese is pushing one trillion dollars (and rising). Financial wags have described our relationship as one of mutually assured financial destruction. They need customers for all their manufactured goods. We need cash to prop up our economy. As long as this is the case, a mix of real effort on the part of Americans to pay down the debt (or at least keep it from soaring at an unsustainable rate), and ongoing diversification on the part of our creditors looks like the best prescription for a more balanced world economy.

AN ECONOMY IN RECOVERY?

BY DOUGLAS KREPS, CFA

After a refreshingly positive quarter, and significant advances from the lows seen in March, investors are wondering what will come next. This is a particularly vexing question, as the economy appears to be slowly recovering, but unemployment remains high, and housing prices are moribund. In order to evaluate what to expect in the coming months, we thought it was helpful to think about the critical factors that will guide the economy, and global markets, going forward. So in no particular order, we offer six areas we are looking at to help guide our clients into the next decade.

Housing:

Clearly house prices have been the bane of the market the past 18 months. Whether it were the fundamental house price declines which hurt consumers, or exotic credit instruments based on house prices, significant portions of our tangible and investment portfolios have been negatively impacted by the speculative housing bubble. As with all bubbles, the collapse was quick, but the healing process will take some time. We are encouraged to see that prices are stabilizing in some markets, and it appears that mortgage lenders are taking their jobs seriously again. But it will take some time before supply and demand meet, and prices begin to rise. While certain markets have not been as negatively impacted as others, the overall drag associated with the loss of wealth clearly impacted the national (and international) economy.

Unemployment:

This in some ways has amplified the housing price crash. Not only are significant numbers of homes worth less than the underlying mortgage, but rising unemployment increases the likelihood of defaults on mortgage loans. The problems are especially acute in areas like southern California, Florida and Nevada, but they have spread more widely into areas that had largely avoided the housing bubble. Detroit and Cleveland come to mind specifically, but the unemployment problem has spread widely.



For example, many states are laying off workers, or encouraging early retirement to balance their budgets. A true economic recovery will not come until we begin to get productive workers back into their jobs.

Inventories:

This is a potential bright spot for the recovery. Over the past 20 years, firms have worked very hard to become more lean and efficient. This means that there is a very low inventory overhang, and the need to rebuild inventories could happen very quickly. Whether it be automobiles, where we are running at an unsustainably low pace, or back to school sales, or capital good purchases, the consumer will at some point be back, and the effects will ripple through the economy as firms restock their shelves to meet consumer demand.

Inflation:

As Charlie points out in a related column, there is growing concern that the massive stimulus efforts among many countries, combined with historically low interest rates, will spur inflation. We think policy makers in Asia, Europe and the U.S. are aware of this risk, and will act quickly to counter inflationary concerns. But as long as big ticket items like homes and used cars continue to decline in value, it is difficult to get to a dramatic inflationary scenario in the near term. In the longer term, we do believe we could see commodity price inflation, especially if the dramatic increase in government debt devalues the dollar. Coordinated central bank action will be key to avoid future inflation.

(CONTINUED ON BACK)