

“The Return of the Long Term Investor”

All signs point to a continuation of an improving economy both in the United States and abroad. In the U.S., increases in unemployment appear to have leveled and are now beginning to improve. Gross Domestic Product has increased in the last two quarters and will most likely continue to increase although at a slower rate of gain. The housing market has stabilized with prices and transactions improving. Industrial production has increased for more than 6 months in a row providing evidence of a rebound in manufacturing. Retail sales are also beginning to show gains as consumer confidence improves. Consumers have continued to reduce debt and increase savings as their confidence grows. One area that has yet to bottom is commercial real estate. This area utilized excessive amounts of debt which provided a significant amount of leverage. Commercial real estate is now entering a work out stage of deleveraging and restructuring as banks off load this debt to new investors.

Because of the high levels of unemployment there is currently little upward pressure on wages that would cause an increase in the rate of inflation. Manufacturing is operating at approximately 65% of capacity, significantly below the optimal level of 80% - 85% of capacity. With large amounts of excess capacity it is unlikely there will be pressure to increase prices. In sum, inflation is at low levels and is expected to remain there until the economy significantly improves from its current level.

Looking outside the U.S. the economies of the developing countries of Brazil, Russia, India and China are once again expanding at above average rates. In fact, both China and India have taken steps to slow their countries growth rates to avoid another economic bubble. The improving U.S. and foreign economies have benefited from the quick action of both the U.S and foreign central banks in taking over the speculative debt of each country's financial institutions. Because of the large amount of debt now on countries' balance sheets, investors have become concerned about the credit worthiness of various countries' national debt.

Greece, Spain, Ireland and Portugal are countries whose debt is now a concern to investors. The U.S. debt which grew as a result of the economic stimulus programs and the cost of the war in Iraq and Afghanistan is now questionable as to its AAA quality rating. Because of this increase in debt, investors' flight to quality by purchasing U.S. Government debt is in the process of being reversed. The flight to quality embraced by bond investors is now receding as the spread between U.S. Government bonds and corporate bonds narrows. We are even witnessing instances where issues of highly rated corporate bonds are trading at lower comparative yields than U.S. Government bonds.

The improving global economic outlook has been reflected in the rise in equity and bond prices. Both markets have experienced significant increases in the prices of their securities from the depressed lows of March 2009. As we look out over the next several months and years we continue to believe we are in the early stages of a longer term advance in stock prices. This forecast is based on the belief that both global economies and financial markets are entering a significant positive revaluation. Excesses have been eliminated and forces are in place to free the global economies of a return to the speculative activities that created these excesses. Governments are working together to implement a coordinated improvement in the regulation of both the banking system and the financial markets. This is taking the form of implementing more clarity to investments by including central accounting for transactions. A separation of high risk activities from that of traditional banking functions is also being considered. More accountability and higher reserve levels for issues of credit default swap is under consideration. Also, more restrictions for short selling to avoid bear raids on a company's stock are but a few of the changes being reviewed.

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Questions regarding the validity and accuracy of the Modern Portfolio Pricing Theory which argues that the financial markets are efficient has caused senior management of financial institutions to reevaluate the risk levels associated with a variety of hedged investment strategies. Regulators are also evaluating whether computer driven high speed trading is a legal form of investing or perhaps is illegal “front running” of customer orders. As regulators and senior management of financial institutions and others address these concerns there has been a marked reduction in the amount of assets allocated to these investment strategies.

The result of this reevaluation is a reduction in the level of volatility and risk in today’s financial markets. One indicator is the VIX index which measures volatility in the equity markets. After having maintained a high level of 50 or better, the VIX index of under 20 indicates a significantly lower level of volatility. Volume in the equity markets has also been reduced. We believe this is a result of a reduction in arbitrage and program trading. Investors are reevaluating the risk/reward ratios associated with these investment strategies as increased regulation has tended to reduce their potential returns. This has lead to a reduction in the fees charged to investors who invest in these areas. Today investment managers have difficulty charging the high fees they had been receiving if they cannot deliver higher returns. This same change is spreading to private equity investments and other thought to be creative investment strategies that offered potentially higher rates of returns with supposedly limited risk.

As this process of change continues investors are returning to longer term traditional growth and value investment strategies. These investment strategies attempt to anticipate change as opposed to quantitative trading strategies that rely on historical data to forecast future stock price movements.

There is clearly a change being embraced by the investor away from high speed, high risk, leveraged trading toward more traditional longer term investing. AHB clients have benefited from the longer term growth and value investment strategy that we have employed over the past 30 years. Today, we continue to invest for the longer term with greater knowledge and experience and a broader and deeper professional staff.

We believe that the probability of a further narrowing of the spread in yields between U.S. Government bonds and corporate bonds is limited. However, there remains an opportunity to take advantage of the steep slope of the interest rate yield curve. Yields on intermediate bonds are significantly higher than the yield on bonds that mature in less than three years. To achieve our expectation of a flattening of the yield curve, interest rates on shorter term U.S. Government bonds are likely to rise.

For the above reasons we continue to believe there is greater risk/reward opportunities in investing in the equity market than in bonds at this juncture.

Investment Policy Committee

Abner, Herrman & Brock Asset Management

Founded in 1981, Abner, Herrman & Brock Asset Management manages portfolios individually structured to assist each client in achieving their investment objectives. Stock portfolios are managed utilizing a Core Equity philosophy, investing in both large capitalization value and growth disciplines with an objective of long-term, after-tax appreciation and below market volatility. Portfolios are diversified across economic sectors, industries and companies. Bond portfolios are managed to provide a high rate of current income and total return. Portfolios are invested in staggered maturities of U.S. Treasury, government agency and investment-grade corporate bonds and where appropriate, investment-grade municipal bonds. Portfolio managers are available to meet with clients upon request.

Please visit our website at www.ahbi.com for a more detailed description of our investment **Philosophy, Process and People**.