THE CONROY REPORT

Quarterly Outlook

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Summary

Economic Outlook

The U.S. economy is expanding and the recession has ended, but healthier growth might come from corporate spending instead of personal consumption and government stimulus. Attention must be placed on jobs with the unemployment rate still around 10% for the year.

Investment Recommendations

We reiterate our recommendation to buy short term fixed-income investments. An *Introduction to Bond Investing* is provided.

Economic Forecast

The U.S. economy is expanding and the recession has ended. Real GDP grew by 1.6% in the second quarter of 2010, following a growth of 3.7% in the first quarter (see **green bar** in Chart 1). Last quarter we expressed our belief that the U.S. economy would continue to grow in 2010. The U.S. economy has grown and we believe it will continue to grow in 2010.

Attention must be placed on jobs. The U.S. unemployment rate remains around 10% with a recent reading in August of 9.5% (see **black line** in Chart 2). Although the unemployment rate is now 1% lower than the start of the year, the percentage of unemployed is very high on a historical basis. The government is making positive contribution with job stimulus programs. Private industry job creation is now necessary.

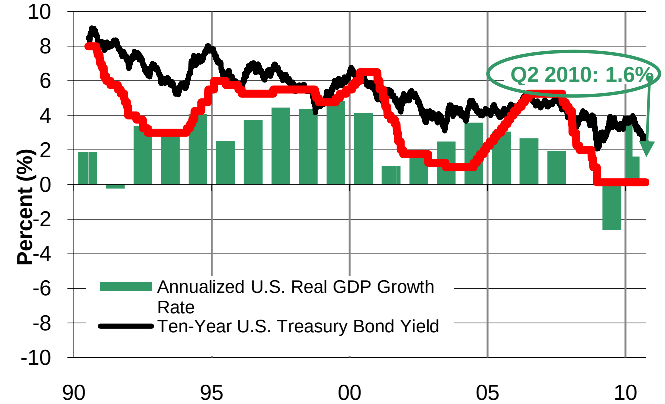
The Bureau of Economic Analysis stated that the increase in real GDP in the second quarter primarily reflected positive contributions from nonresidential fixed investment, personal consumption expenditures, exports, federal government spending, private inventory investment, and residential fixed investment. We remain concerned about personal consumption and government stimulus driving economic growth.

U.S. consumers have become increasingly overextended in debt and this was a major factor in the housing bubble and the recent recession. Poor practices among home mortgage companies contributed to the boom and bust in housing prices. One interesting observation hidden in the GDP data is a very large jump in residential fixed investment, or home building, which threatens the possibility of reintroducing some of the problems the economy has been facing. Excessive government stimulus seems like a short term solution and fuels the nation's budget deficit. We continue to believe that sustained growth must be achieved through healthy corporate spending in forms such as nonresidential fixed investment and inventory investments.

We reiterate our concern about rising interest rates due to inflation pressure. However, last quarter we noted that inflation appeared to have come under control. This trend has continued and the consumer price index showed that prices were lower in the second quarter of 2010. This may be one reason consumers have started to spend more. In addition, interest rates have dropped. For example, the ten-year Treasury rate moved lower by about 0.50% in the second quarter. With our expectations for further economic growth and the lower level of rates recently, we expect greater pressure for higher rates.

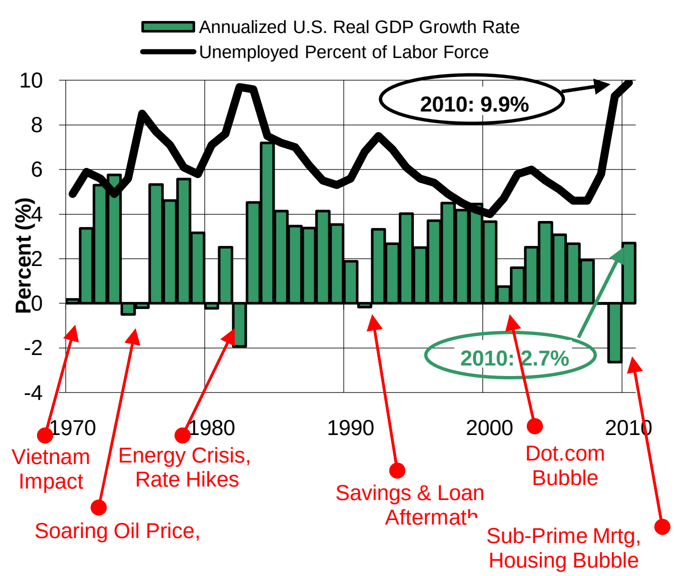
With our expectation for rates to rise, we believe this bodes well for our ongoing investment strategy to buy short-term fixed-income investments. This month we include a introduction to bond investing (see section below). Meanwhile, stock markets will remain volatile as investors react, or over-react, to short-term indicators. Once a long-term trend appears to be firmly in place, we may consider a tactical shift in our asset allocation recommendations.

Chart 1. The U.S. Economy Has Grown So Far This Year



Sources: Federal Reserve, U.S. Department of Commerce Bureau of Economic Analysis, Yahoo! Finance. U.S. Real GDP Growth Rate in chained 2005 dollars.

Chart 2. Unemployment Remains High



Sources: U.S. Department of Commerce Bureau of Economic Analysis, U.S. Department of Labor, Bureau of Labor and Statistics. Seasonal unemployment rate.

Introduction to Bond Investing

We encourage investors that have less familiarity with bond investing to contact us regarding this topic. Following are some important facts about the bond market:

- Bond prices move in the opposite direction of interest rates.
- The rate of return on a bond is a result of price movement, like a stock, as well as income from periodic interest payments or “coupons.”
- The minimum amount to invest is usually $1,000.
- Bond ratings are meant to reflect credit risk and are assigned by rating agencies, such as S&P, Fitch and Moody’s.
- The same diligence should be taken when buying a bond issued by a company as buying a stock of that company.
- Investment-Grade bonds have the highest ratings, triple-B or higher, and are generally considered to be “safe”. This means that the issuing entity is very likely to pay to investors all promised principal and interest and is, therefore, very unlikely to default.
- Corporate bonds can be rated as high as triple-A, but most are double-A, single-A and triple-B rated.
- Treasury, Municipal, and Mortgage bonds are usually rated triple-A.
- High yield bonds are, generally speaking, corporate bonds that are rated below triple-B. This market has higher default risk than the investment-grade market. They are sometimes called “Junk” bonds.

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