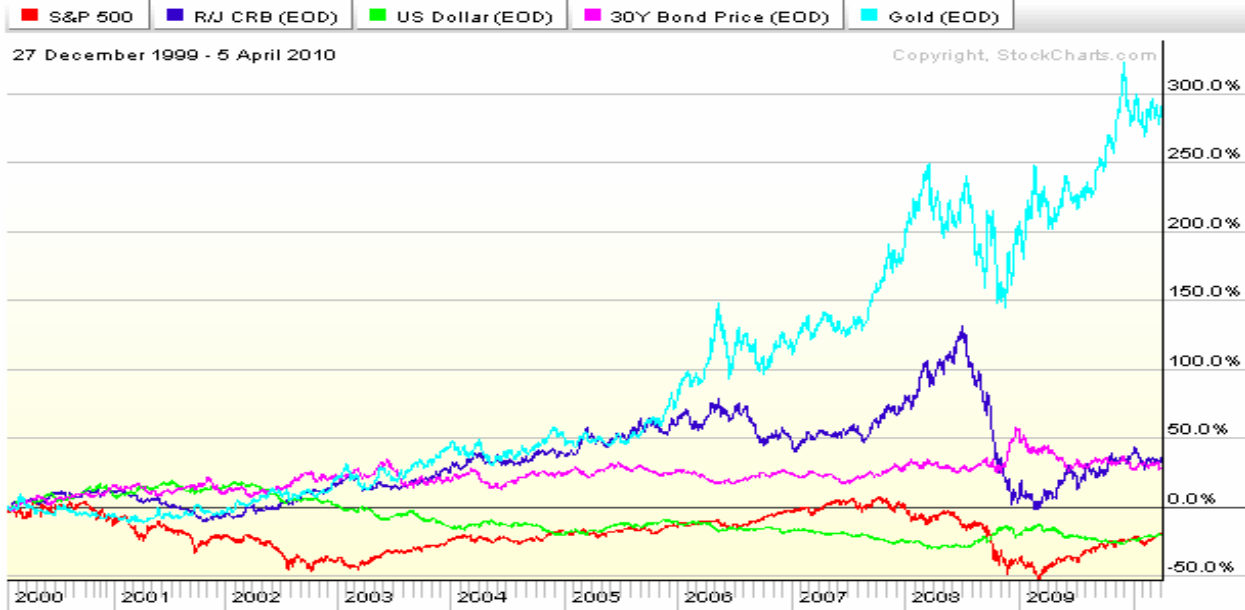


## Guess where the real bull market is?



| Composite / Index   | Q4 %          | YTD %         |
|---|---------------|---------------|
| <b>Regan Macro Absolute Return*</b>                                   | <b>+ 1.49</b> | <b>+ 1.49</b> |
| HFRX Absolute Return Index  | - 1.31        | - 1.31        |
| HFRX Macro Index  | + 0.61        | + 0.61        |
| Dow Jones Industrial Average  | + 4.11        | + 4.11        |
| S & P 500   | + 4.87        | + 4.87        |
| NASDAQ  | + 5.68        | + 5.68        |
| Balanced Composite<br>(60% Wilshire 5000 & 40% Lehman Aggregate Bond) | + 4.33        | + 4.33        |
| Gold  | + 2.57        | + 2.57        |
| Commodity (DJ AIG)  | - 3.63        | - 3.63        |
| Vanguard Prime Money Market Fund                                      | + 0.01        | + 0.01        |
| Oil   | + 5.54        | + 5.54        |

*Performance numbers for the Regan Macro Absolute Return composite are back tested with best efforts internally by Regan Investments and not audited by outside parties. Past performance should not be regarded as an indication of future returns. Share values in the accounts will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original investment. All other performance numbers for listed indices, managers, and stocks in this report are not verified by Regan Investments. They are taken from public sources and Regan Investments does not claim any responsibility for their accuracy. For a complete list of our sources, or a detailed explanation on how we calculate our internal numbers please contact Regan Investments directly.*

\* Net of Fees

# Economy

We are very concerned that the US economy will experience a double dip recession in the next year or two. If this occurs, the Federal Reserve has no room to lower interest rates and can only print more dollars in hopes that our creditors will continue to borrow, thus stimulating growth. The problem is that most governments around the world are borrowing excessive amounts in order to pay for deficits and stabilize their economies. This appears unlikely to continue for more than a few years as government bond ratings fall. US government bonds are already on credit watch and a drop in our ratings would raise havoc in the bond markets.

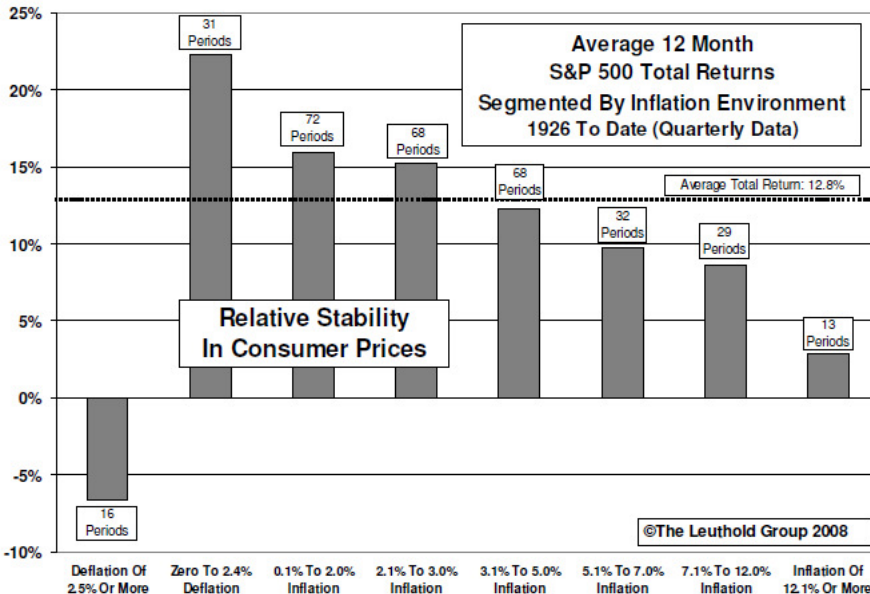
Washington has been doing its part trying to prop up our economy by spending well beyond our means. Long-term planning, while not a trait of most politicians, appears to be non-existent. In fact, anyone who has witnessed former Illinois Governor, Rod Blagojevich, on NBC's *Celebrity Apprentice*, or Congressman Hank Johnson's comments on Guam capsizing, has to be very afraid that this level of incompetence and ignorance is able to rise to the top. Fred Hickey, of *The High-Tech Strategist*, sums it up well in his most recent report:

*The saddest part about the "Decade from Hell is that we didn't learn anything from it. We're losing manufacturing jobs because our companies are non-competitive. Our solution: make them less competitive. The country is burdened by enormous debts. Our solution: spend (mostly waste) record amounts of money and pile on even more government debt. The social safety nets are woefully underfunded. Our solution: massively increase entitlement benefits. We don't save any money. Our solutions: Drive interest rates to zero, drastically increase tax rates on investments and encourage more consumer spending (cash for clunkers, etc.). The Fed continually creates debilitating asset bubbles: The solution — Create some more.*

We are beginning to hear more support for allowing inflation to increase in order to stop prices (homes, etc.) from falling. This would weaken the dollar and increase import prices, allowing our manufacturers to raise prices. Corporate profits would increase (nominally), helping to reduce federal and state budget deficits and allow us to pay back our debt with cheaper dollars.

Currently, the money multiplier is at .8 vs. 1.7 in 2006-2008. This huge drop offsets the Fed's big increase in the money supply. While this will help induce deflation in the short-term, it will be very hard to control inflationary forces once they begin. In the long-term, it will be very difficult for our dollar and our nation's savings.

The chart to the right, originally printed in Steve Leuthold's book "The Myths of Inflation and Investing", shows that high levels of inflation do not offer great prospects for stocks going forward. Hard assets such as commodities and especially gold usually fair much better.



As we have stated in the past, we believe deflation is winning the current battle. However, inflation appears to be the only way out from under our nation's debt/liabilities going forward. We think investors' expectations need to be tempered as government and regulatory actions will muddy up the waters even more, and will make navigation through the current investment landscape quite difficult.

# Markets

## No Perma Bears!

We are sometimes labeled as being constantly bearish on the stock market. This perception results mainly because we have been voicing our concerns for stocks (debt levels, valuations, inflation/deflation, etc.) for the last seven to eight years. However, we are bullish on the stocks we hold in our individual portfolios. Most are blue chip names that are cheap (Microsoft), pay a decent dividend (Verizon), or have significant growth potential (Apple). We are also bullish of the gold mining stocks which have drastically underperformed the price of bullion.

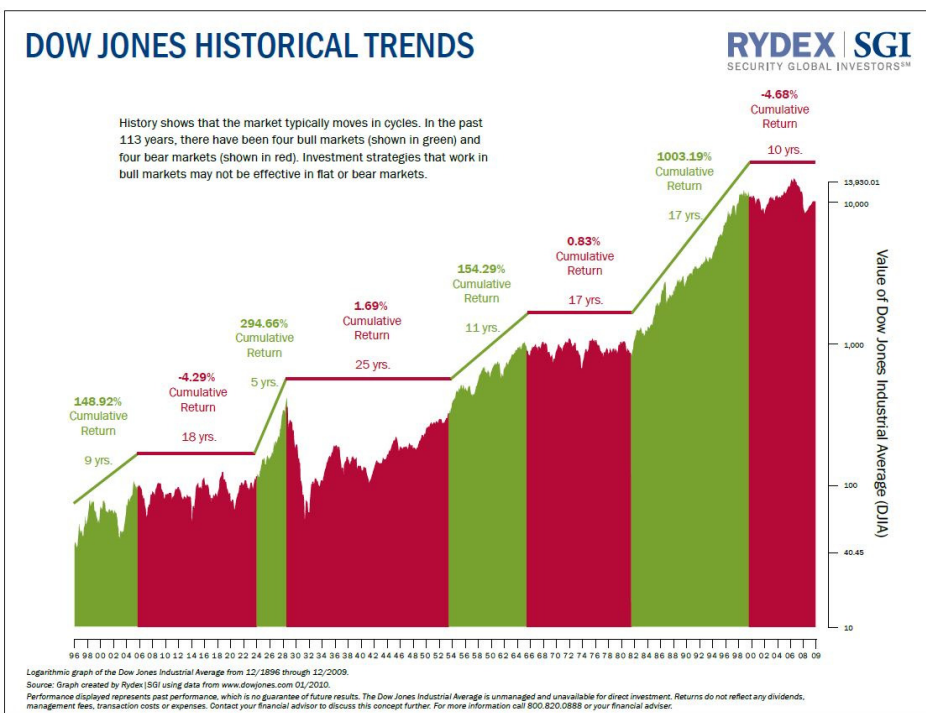
We agree with John Hussman who states, “Current market conditions are characterized by strenuous overbought conditions, strenuous over bullish sentiment, and hostile yield trends.” Longer term, we are concerned that price to earnings ratios will likely contract due to increased taxes, increased interest rates, investor fears of inflation/deflation, and demographic changes as baby boomers retire and start selling stocks and bonds to live.

Stocks, bonds, commodities, currencies, gold, and real estate are all interrelated markets. Within each market are submarkets like corporate debt, utility stocks, gold, Yen, commercial property, etc. When one of these experiences a bear market, another is usually bullish. The chart on the cover of this newsletter shows that gold, commodities, and long bonds have all been going up on a relative basis against stocks and the US dollar. Over that period of time, our success in overweighting the correct assets classes and sub-sectors has led to nearly a 100% return while the S&P500 has achieved a negative return.

Wall Street spends billions of dollars a year to reinforce the belief that stocks only go up over the long run. This has been true over the last one hundred years. However, the average person has roughly a twenty year period to invest with decent savings. Historically, stocks have run in secular (long-term) bull/bear markets that average fifteen to seventeen years in duration. If the average person has twenty good years to invest and they begin at the beginning of a bear market, that leaves little time to make up any lost return.

One of the most important questions for stocks today is whether this is the start of a bull market, or just a continuation of a bear market. As you can see from the chart on the right, it appears we have been in a bear market for the last 10 years. It is hard for us to imagine that the greatest and longest bull market in history would be followed by the shortest bear market in history.

We will continue to buy quality stocks while hedging our total market exposure to reasonable levels. If the market keeps advancing, we will likely make money but under perform the major indices. If the market corrects (5-10%) we might make a little or remain flat. If the market appears likely to crash, we will quickly head for the exits to limit downside risk. All in all, stocks are not cheap at these prices. As always, we will monitor and adjust our clients portfolios as the fundamental and technical signals change.



# Markets, Cont'd.

## Stocks

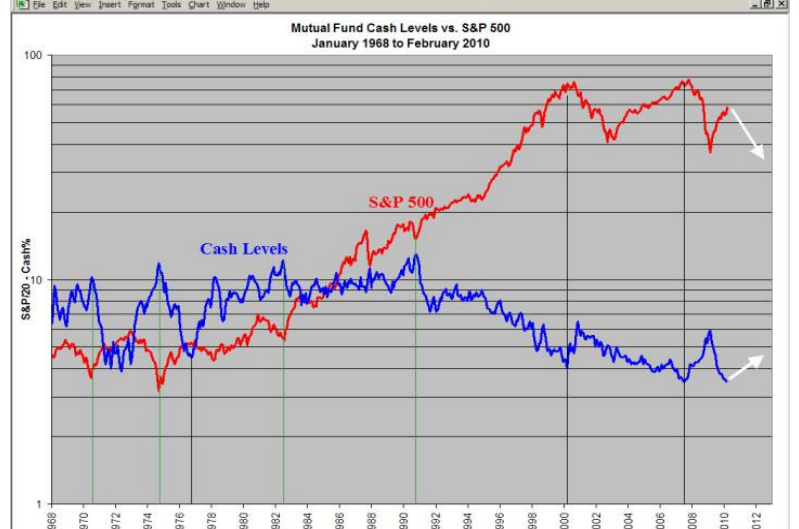
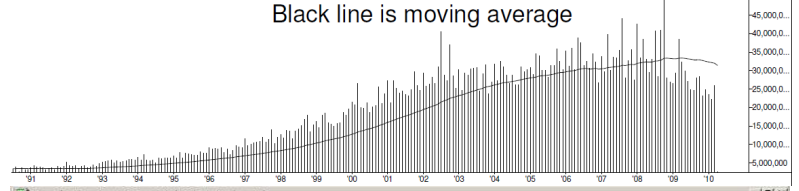
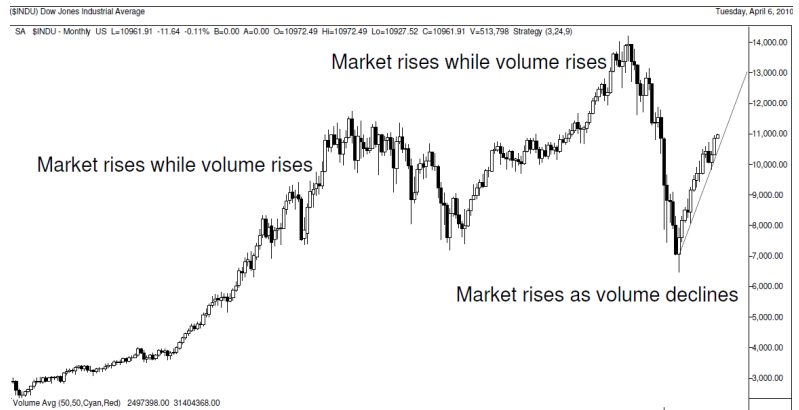
The stock market continued its advancement of 2009. While many believe this is the beginning of a long term bull market, we are suspicious. Trading volume, as seen in the bottom of Chart One on the right is very low. Usually, if a bull market is going to sustain its advancement, volume will increase as the market rises. The current situation shows that volume is decreasing. This is bearish and usually means that stocks are being distributed from strong hands to weak hands.

Secondly, mutual funds are currently at their lowest cash levels in several years (Chart Two). That means that there is not a lot of buying power on the sidelines. This has been a fairly accurate indicator of market tops in the past.

Chart Three (M2) shows the retail investor has a lot of cash on the sidelines to invest. This chart is a little duplicitous in the sense that most of these investors are probably a little gun shy after 2000-2003 and 2008, unemployment is at extreme levels, and balance sheets have been turned upside down with losses in home prices. Is it safe to assume that these investors will move their cash to stocks or other assets in the near future with the thought of significant losses so fresh in their minds?

One positive for that theory is that thanks to Ben Bernanke, individuals are earning next to nothing in savings. In essence, the Fed wants you to take on more risk. 'Don't Fight the Fed' has been great market advice in the past, but in a world where current slogans consist of 'End the Fed' and 'Audit the Fed', the buck might actually stop here.

We believe the stock market has been tracing out a rounding top pattern since January with the most speculative and low price stocks doing the best. Recently, our higher quality stocks are showing signs of outperforming the more speculative issues. While we continue to let our stocks drift a bit, we are still only about 25-30% net invested and may hedge a little more if we see evidence that a top is more firmly in place. We continue to favor blue chip names with strong balance sheets, cash flows, and preferably, decent yields.



## Markets, Cont'd.

### Bonds

Interest rates in the bond market remain low. Most of our bonds are in the one to four year maturity range and are yielding 3-4% to maturity. We think these rates will stay low into 2011 as the economy continues to be sluggish. We do not like long term bonds at all mainly because we think that inflation will take hold in the next few years. Inflation leads to rising interest rates, which leads to lower bond prices, and an erosion of fixed interest payments.

We favor Corporate bonds over government issues mainly due to the huge levels of sovereign debt. Corporations are flush with cash and offer much more reasonable returns than US government debt. In fact, if the United States was a corporation, its debt would be looked at as very speculative. The fact that we can print money to pay off our debt, separates us from countries like Greece, but for investors, US debt makes for a poor long-term holding. Inflation protected bonds don't offer much if you believe inflation is looming, because the CPI statistics understate the real world inflationary numbers by a wide margin.

Municipal bonds will likely have a tough time as rating downgrades and the public concerns over tax policy will weigh heavily on future expenditures. In addition, municipal bonds are not very liquid, and in a world of "real returns", offer little assurance that one can get out when needed. The tax benefit is nice but if we are potentially headed towards a VAT tax system, income tax levels will probably not escalate as high as most people are proposing. Even with the additional increase in interest tax for high earners that was passed in the healthcare bill, we would much rather have the flexibility to maneuver out of corporate bonds when the inflation picture changes rather than to be left holding municipals that might be much more difficult to sell if the state credit concerns come to light.

### Gold and Commodities

Gold still looks very good for the next three to five years, but could weaken in the short term. Historically, gold consolidates between May and August and we might look to add to our positions if there is a decent pullback. The commitment of traders report shows that speculative positions in long gold future contracts has plunged nearly 30% since the beginning of December 2009. This suggests that gold may not correct as commercial entities (miners and other hedgers) usually take the opposite side of the speculators. It has been much more rewarding to trade on the side of the commercials rather than the speculators.

Gold Mining stocks have been acting much better recently but are still off significantly when compared to the price of gold bullion. While we think the miners offer much better reward, they can sell off with the stock market as well. Again, if a sell off occurs, we would look to buy both junior and senior miner stocks but with more emphasis on the juniors. It is possible we could see the price of commodities drop, the price of gold miners drop, and the price of gold remain stable as concerns grow for the stability of paper currencies. This could present a great opportunity as most mining costs are associated with the cost of energy and while costs would come down, a stable gold price would allow for profit margins to expand significantly.

Industrial commodities appear to be topping, and we think a 10-20% drop is possible. While commodities should do well in an inflationary environment, our current world is deflationary. Until we see inflation, commodities will likely fluctuate on supply and demand as countries continue to build infrastructure, homes, buildings, etc. We do not believe that global expansion is going to return to past levels and therefore want to be very careful of when we buy. We look to buy large blue chip commodity related stocks and/or physical commodity positions on significant pullbacks. The grains and natural gas appear to be the best values currently.

Protectionism is raising its voice again as we challenge China about the value of its currency. More and more, the developed world is angry as its exports soften. Our view is that nobody wins in these wars. As protectionism increases, the world economy will suffer just when we need more trade. This is just another headwind facing us in the next few years.

## A promise is worth its weight in...wait!

To the average person, money is a form of payment that allows for the exchange of goods, paying debt, or a store of value for savings. Our US dollars are deemed to be worth the denomination listed on our bills and we buy goods or services that are priced accordingly. Countries like France, Germany, Japan, Zimbabwe, and many others have experienced first hand how swings in inflation/deflation can destroy economic growth and prosperity.

Recently, the BBC had a documentary on television highlighting tribal conflicts between two neighboring Indigenous tribes. Their dispute was because one tribe had killed a member of the other. Retribution for this crime has historically been to negotiate a monetary settlement, kill a member of the guilty tribe, or war. The offended tribe wanted five ancient conch shells as payment to avoid any killing while the guilty tribe offered two ancient conch shells. The local government tried to step in and negotiate a truce between the tribes and offered paper money to help avoid conflict. Government officials tried to teach them that the paper money was much more valuable and would allow them to buy things like medicine and food. In the end, the offended tribe settled for three ancient conch shells and a wad of paper money. In their world, the conch shells are real money.

In the past, paper currencies were backed by a limited supply of gold. With the elimination of the gold standard, countries, especially the United States, have been allowed to print at will with no recourse other than voter sentiment. If inflation is held in check, over short periods of time, people feel wealthier. However, as time goes by, this abandonment of fiscal responsibility will eventually rot the currency.

The United States has received a failing grade over the last century in fiscal responsibility. Our US dollars have been depreciated by over 90% the last one hundred years by rampant money printing. While our dollars were once backed by an equal amount in gold, they are now just a promise of payment by the Federal Reserve (Federal Reserve Note). In addition, by monetizing our debt, The Fed becomes our largest lender and largest guarantor. So, as the Fed prints money out of thin air to bail out consumers and financiers, we as taxpayers are obligated to pay it back.

The top ten creditors to our nation also include a rising superpower (China), a former superpower (Russia), and the oil producing nations. There might be a hint of satisfaction from these nations as we spend our way to the abyss on their borrowed dollars. Is it conceivable that as we sputter about picking trade wars or real wars, that at some point, our creditors might just say enough?

Federal debt is roughly \$12 trillion, state and private debt is roughly \$40 trillion, and entitlements are roughly \$50 trillion. Budgetary spending cuts are meaningless, and growing out of this hole is unrealistic. The Federal Reserve will need to continue to print large amounts of money (inflation) so that we can pay off these commitments and wipe the slate clean. We are not conspiracy theorists, rather, we are monetary realists.

Recessions are good for the overall health of our economy. Like a forest fire, they clear out the excesses and allow for growth to begin anew. If we continue to suppress this cleansing of the system, the pain of fiscal irresponsibility at all levels only ensures that the crashes will become more severe as recessions turn to depressions.

Amidst all of this doom and gloom, we believe that an opportunity of a lifetime is forming. Investors who preserve capital over the next 3-5 years, utilize a macro viewpoint, and are not lulled to sleep by a 'buy and hold' strategy, will be in a very good position to take advantage of the large structural changes. We continue to invest your money exactly the same way we invest our own.

*Thank you again for your continued trust in us. We hope you have a wonderful Spring!*

*Robert, Robert Jr., Erle, and Cynthia*