Sound Investments Inc.

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Third Quarter 2009

Summary

Predictions Please

On the back of page 1, please see the chart of the Dow Jones average chart. I drew a line through the 10,000 level, which goes back to 1997. Once this line was broken in 2008, it becomes resistance, which means when the market approaches this level many sellers come and force it down. This is called technical analysis In order for it to break through, there needs to be sustained good news on growth, house prices, inflation, and some job growth. This is called fundamental analysis. I believe the market will move sidewise over the next several months as the market sorts the evidence out.

I do not see a big downward movement is still a tremendous amount of money invested in money markets and short-term bonds. The total is estimated at 3 ½ trillion dollars. The total value of the S&P 500 is only 3 trillion, so these sums represent significant sums that in more normal times would be invested in equities. Since there is so much money on the sidelines, this will act as a kind of support. In other words, these funds will go back o the market on a pullback hence minimizing a downward movement.

The Investment Letter is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research.

Seven-Month Surge

The powerful rally continued into September capping a strong quarterly advance. For the 2nd consecutive quarter, stocks of all types did very well.

Global Stock markets posted their best quarter in 20 years. For example, 39 out of 42 global bench markets have risen at least 15% above their 200-day moving average. European markets were particularly strong, as well as emerging markets. Foreign fund performance benefited from the dollar's slump. For the quarter, the dollar losted 4% of its value against the Euro and nearly 9% against the Japanese Yen.

A Checkered Affair

Consumers remain selective in their spending. For example, recent data showed that retail sales surged by 2.7% in August, the best showing in three years. The strong gain was led by a stellar performance in the auto sector where the now ended "cash for clunkers" helped car sales to their biggest increase in nearly 8 years." Less air travel and local driving also lifted gasoline sales. Beyond those auto related categories, the gains were uneven with sales of furniture and building materials falling and demand for food and electronics increasing modestly and purchases of clothing and sporting goods gaining strongly. These reports imply an evolving business upturn may be a checkered affair, with a succession of peaks and valleys.

Damaged Dollars

The dollar has fallen almost 3% over the past 2 weeks against a basket of six major foreign currencies. The greenback has dropped 20 percent against the euro since early March. This help the market since it makes it less expensive for foreigners to bid it up.

The dollar may not easily snap back. U.S. policy makers and economists "actually argue for depreciation of the dollar to bail out America and make it more competitive," Marc Faber, publisher of the Gloom, Boom & Doom report, said "Nobody in the world has ever become rich by devaluing the currency, but that's what they're advocating in America." To guard against this we should be investing in ownership assets like stocks, tangible things and even real estate. By investing in international mutual funds, we have compensated for the lower dollar since as it goes down these funds go up.

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Leading Indicators Signal Growth, But Jobs Scarce

- The interest rates on BAA rate bonds, the lowest rate investment grade rating, has declined to 6.17% down from 6.4% late month and 7% two months ago. This places the cost of borrowing 322 basis points above the ten –year treasury bonds, down from 300 basis points last month and 348 basis points two months ago. We are gradually moving to conditions that are more normal.
- The incoming data continues to suggest that housing prices are stabilizing. Housing starts are at their best levels in 6 months and building permits have edged higher. The supply of unsold homes on the market declined 11% to 3.6 million homes. This represents an 8.5-month supply at the current sales pace, not far from the 7-month supply level that is considered normal.
- High federal government , spending, growing exports from a recovering and inventory replacement after an unusually sharp inventory correction will likely be the main drivers of growth for the balance of 2009 and 2010. Interest rate will likely remain low until solid economic growth returns …. Most likely, not till the second half of 2010.
- The tough news is on jobs. It will be years before lost jobs return. Moving the unemployment rate from 10% to 5% is going to take some time.

Balance is the Key

Even after 7 months of big gains many investors remain understandable cautious. We know that over the long-term stocks have always shown compelling returns. Looking at all the previous 20-year period returns, the average return from stocks equals the best return that bonds ever produced during a 20-year period. Bonds for all their ability to buffer a portfolio; have not offered much protection against the eroding purchasing power in the long term – for that you need stocks. However, the price you pay for higher long-term returns is market volatility and recent volatility has been so extraordinary high that many investors have withdrawn. Last year we faced extraordinarily times and we retreated to cash. Over the last 6 months, we have started to reinvest and believe over the longer term stocks will outperform but we have to be cognizant of the risk.

Conclusion

Overall, we remain cautiously upbeat. Our sense is that a definite bottom was established in the market early in the year and assuming our projection of an uneven but durable growth is near the mark the stock market after some possible retrenching will head higher at least into early next year.

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