

Sound Investments Inc.

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First Quarter 2010

DJIA: 10856

S&P 500: 1169

NASDAQ: 2397

Summary

Based on the above information it is our belief that the bull market that began in Mar 2010 will not come to an end any time soon. We believe that the preponderance of evidence on earnings growth and technical market indicators point to the likely hood that a bear market will not begin this year. We view short-term pullbacks as bull market corrections and as an opportunity to accumulate stocks. Corrections or pullbacks in the order of 5 to 10% are normal. There is a good chance we will see a pullback.

The short-term correction from Mid January to early February produced a closing decline of 8.2% for the S&P 500 index. It was followed as noted above, by renewed market strength to a new cyclical bull market high.

We are raising our earnings estimate for the S&P 500 up to \$80, up from 74.50 and our price / earnings ratio estimate remains at the historical norm of 16 to 17 times. Therefore 80 x 16 or 17 leads to a target for the S&P 500 index in the upper 1200 (Currently at 1194). We believe earnings growth out to 2011 looks favorable and will continue to review the situation to see more evidence of the economic recovery.

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.

Recovery Continues

A raft of March reports showed a surprisingly strong rate of expansion in manufacturing around the world, providing clear evidence that a global economic recovery is progressing. S&P earnings were up 96% last quarter, more than most analyst predicted. Consumer spending rose to near normal levels, yet persistent long term-term unemployment remains a big problem.

Economic numbers globally and almost consistently keep coming up better than expected while being largely dismissed. In part, this is because the fastest recoveries are happening in the emerging market countries. Maybe it is unnerving that China and Brazil are leading us.

As I write this, earnings reports from a number of companies such as J P Morgan, Intel and United Parcel Service are reporting stronger earnings and in some cases a doubling of profits. In March consumer spending surged 1.6% adding confidence to the recovery predictions.

As noted above, the recovery in Asia and even South America is looking stronger than expected. Some countries posting double digit growth rates, a trend that could stimulate U.S. exports. Most less developed countries don't have the debt problems and are helped by relatively good prices for commodities like oil and copper.

So is the Great Recession over? Most economist think it ended in Dec 2009 but with unemployment at 9.7% and a continued tough housing markets we have a way to go, but we have turned the corner. The future doesn't always unravel the same as before, and we may have higher unemployment for some time. Maybe the answer is Key Sectors Improve but Fragility Remains. I think we do not have to have all the problems solved to have an economic recovery.

Corporate America has the Dough!

Business are sitting on a cash trove. Approximately 15.7% of commercial assets are held in cash. This highest in 23 years and is a resources that businesses can tap to expand. With sales of capital goods up 6% in the quarter. and up an impressive 19% in the last quarter of 2009. Rising operating rates are driving the spending and higher profit margins are helping out. Replenishing inventories is also playing a role.

Politics Enters the Picture

One of the major influences of the market is the election year cycle. The stock market has registered mid-term off-presidential election year bottoms in every case during the past half-century. A very significant stock market rally has followed the completion of each midterm election year bottom. I posted a chart on the back of the first page going back to 1962. It is a little hard to decipher. The chart comes from the Marketimer written by Bob Brinker. I phoned him and added some notes.

So, to the Future ... Predictions

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The hot area is the US Midcaps followed by Small Caps, Large Caps funds followed by Internationals. The higher dollar translated into lower international fund returns. We continue to follow the market and upgrade or switch to higher reward areas. We also favor a balance approach using bonds. Currently we like high yield bonds with a term of less than 5 years over long-term government bonds as interest rates may rise. We have a constructive approach to the market but we had a good run with the markets topping 11,000 on the Dow as I write this, and could easily see a 5 to 10% pullback. We do see a pullback or market correction coming but this is normal and are expected after an extended period of gains. There is a resistance level on the Dow Jones average at 11400 and could takes some time for positive earnings developments to work through this level.

Conclusion

Successful investing is about making decisions based on long-term goals. We reiterate our belief in the power of business and their shares, to out-perform all other investment classes over the long term. We use a momentum strategy to align us with the market leaders. At the same time, we believe most investors are suited to a balanced portfolio that includes fixed income to buffer the volatility of the markets up and downs.