QUARTERLY COMMENTARY
Fourth Quarter 2009

According to *The Wall Street Journal* we have just lived through the worst decade for common stocks in U.S. history. As measured by the S&P 500, $1 million invested in stocks on January 1, 2000 would have been worth about $920,000 when 2009 ended, even including the dividends paid. For more than a decade we have encouraged clients with low, moderate and high risk tolerances to employ our controlled risk, flexible asset allocation strategy. We have cautioned high risk tolerance investors about the dangers of an aggressive approach in this environment. The vast majority of our clients has accepted our suggestion and employs our controlled risk strategy, which has been both protective and productive through the first decade of the new century. On average each $1 million that began the decade under that strategy grew to about $1,610,000 before fees, which vary based on portfolio size.

Although risk aversion has been the most appropriate approach for the decade, it has been the least productive over the past nine months. Despite a horrible start to the year, stocks rebounded off the March bottom, and all equity indexes recorded very strong gains. The S&P 500 closed the year with a 26.5% return. The higher risk Nasdaq Composite posted an even more impressive 43.9% advance. On the fixed income side of the ledger, conservative intermediate and long maturity U.S. Treasury bonds had a negative total return for calendar year 2009, while junk bonds earned over 50%. The very riskiest of junk bonds, rated just above default, returned 112% in 2009. Our conservative approach lagged such results and produced a modest single digit return.

Despite powerful 2009 returns, stretching the performance analysis back an additional twelve months produces a very different picture. Notwithstanding the strong recent rally, the S&P 500 is down more than 20% for 2008 and 2009 combined. Mission's portfolios are all positive over that same two year period.

The success of any investment approach is best examined over an extended period of time. The just completed decade witnessed two giant stock market declines and two powerful stock market rallies.

While Mission employs a flexible asset allocation approach, our preference is to invest large portions of portfolios in stocks when we can buy companies with growing earnings at historically attractive prices. In a decade that included two significant recessions, most companies have experienced several years without growing earnings. The first decade of the new century has also been the most overvalued decade in history by any combined measure of price-to-earnings, price-to-book value, price-to-dividends, price-to-sales and price-to-cash flow. Consequently, Mission's investment process has employed far below normal levels of stock throughout the decade. Fortunately the stocks we have owned have done far better than the market averages. Although our overall portfolios outperformed stock market returns in just five of the ten years (2000, 2001, 2002, 2007 and 2008), avoiding major losses led our portfolios to a more than 70% advantage over stocks for the entire decade.

Of course there are always alternatives to common stocks. Despite their poor recent performance, intermediate and long U.S. government bonds were among the best performing assets over the ten year span. While we did make use of such bonds at times during the decade, we did not anticipate that U.S. monetary authorities would push interest rates to their lowest levels since the Great Depression. We could have done better had we employed these securities through a greater portion of the decade.

Although the U.S. dollar had periods of both strength and weakness, the dollar closed the decade just above ten-year lows. In 2003 and 2004 we correctly anticipated dollar weakness and made significant investments in short maturity Australian and Canadian government bonds in those respective currencies. We remain pessimistic about the longer term prospects for the dollar and may look for similar anti-dollar opportunities ahead. Over the near term, however, the dollar looks like it is trying to rally, which would make such investments inappropriate right now.

Gold was the star of the decade, growing at a rate of 14.3% per year and closing near its all time high. We held small positions in gold stocks for brief portions of the decade and earned a modest net profit. We left a lot on the table in that area. We will continue to examine the potential for a gold position, which would be particularly appropriate should we experience substantial inflation or should the viability of fiat currencies be called into question.

As we have said repeatedly in recent letters, blog posts and seminars, there is great uncertainty about how the economy and the securities markets will progress in the year ahead. While most economic statistics have been improving notably coming off very depressed bases, the levels of most such statistics remain remarkably depressed. The political will for more government bailouts is waning, and it is far from certain that the economy can continue to grow without government assistance.

Stocks have had a terrific rally off the March lows, but few companies have experienced significant revenue growth, and earnings can be improved only so long by cutting expenses. Will the consumer come back in earnest? If not, earnings growth will be difficult to maintain. The rally has elevated prices to such a degree that valuations are near all time highs but for the bubble levels of the past thirteen years.

On the bond side, interest rates could move dramatically in either direction depending on economic progress and on the resolution of the inflation/deflation contest. While we continue to look for an attractive bond entry point similar to what we found in June 2009, we would not consider such a purchase a buy and hold commitment. We could make a case for either rising or falling rates from current yield levels, but if rates rise, the degree of risk is larger than potential profits should rates fall. That keeps us on the sidelines until the risk/reward equation improves.

We believe that the long weak stock market cycle that began in 2000 remains in force. That doesn’t preclude the current rally’s continuation, but it likely means that danger levels will remain high for several more years. In such an environment, investment errors can result in large losses, and profits can quickly disappear. Mission’s performance over the past decade was far better than most. We will continue to apply the same historically based valuation criteria in our effort to protect portfolio asset values and to seek profit opportunities when they present themselves in a reasonable risk environment.

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