KCM'S KOMMENTS—QUARTERLY NEWSLETTER

KELLY CAPITAL MANAGEMENT, LLC

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ECONOMIC & MARKET KOMPASS

1204 Baltimore Pike
Suite 305
Chadds Ford, PA 19317-7374
610 558 1159
jkelly@kcm-invest.com

MARKETS, ECONOMY AND STRATEGY—

2009 was one of those years that reminded us what a roller coaster ride investing can be. After the collapse in global financial markets during the Fall of 2008 and the resultant pummeling taken by stock markets around the world, the consensus in January 2009 was that the worst was behind us. That opinion was to become a sharp reminder of the danger of conventional thinking – by March 9 (the presumed market bottom), the S&P 500 had declined by an additional 25% and emerging markets another 14% from their December 31, 2008 levels.

At that point, the consensus again shifted and there was growing sentiment that we might be entering a long period of economic stagnation or worse. Respected economic forecasters talked about a 20% chance of another 1930-like depression or a "W" shaped market move with the second leg down due in late 2009. It was precisely at this point that the coordinated stimulus spending by governments around the world finally had an impact and we began seeing signs of an economic recovery reflected in both domestic and foreign equity markets. From the markets' bottom on March 9 to the end of November, the S&P 500 was up 65% and the emerging markets up 100%. For the month of December, these markets added returns of about 2% and 4% respectively. For the full year the returns were up 26% and up 79% respectively. Thus, 2009 became a sharp reminder that it is impossible to predict short term market movements.

Despite the recovery in the global economy and markets since March 9, 2009, the general sentiment and confidence level among many people today is still quite negative. Much of that attitude is driven by concerns about the U.S. economy, questioning if it is still the engine of global growth. Of course there are lots of things to worry about in the U.S. – stubbornly high unemployment, a housing market that is still depressed (although no longer in decline), growing problems in the institutional real estate market, and growing government deficits. We also should not forget that we are still at war with an illusive and fanatical enemy bent on our conversion to their "religeo-political" belief system or suffer annihilation.

It is important to remember the underlying positives – our entrepreneurial spirit, our higher education level versus most of the world, and our determination to continue personal freedom and capitalism. We have a stable government and a diversified economy. We at KCM believe the positives outweigh the negatives and that the dire predictions about America's decline are overstated. The USA may not see in the next 24 months the rapid growth we've had in the past four decades but it will see solid growth and solid growth may be more rewarding than rapid, volatile growth followed by a bust. We therefore moved away from "principal preservation" which characterized our asset mix in the first half of 2009 to our current fully invested asset mix which we expect to maintain unless future circumstances dictate otherwise.

We believe that diversification will be of the utmost importance going forward and that combining our strategies in domestic equity, emerging markets, commodities, fixed income, and real estate will provide the broad diversification across every asset class needed to meet future challenges. Our ability to move amongst these asset classes, market capitalizations, and styles, using the growing list of available ETFs, gives us a leg-up on single strategy firms which pigeon hole client accounts into limited approaches. ETFs will remain the keystone of our investment process. We look forward to continuing our relationship in 2010 and thank you again for your business. Our team is always available to talk with you. And remember, the highest form of flattery is your referral. You also benefit from referring us to a prospective new client. For every referral that becomes a new client, you will receive a 10% discount on your next quarter's fee as our way of saying more than thank you!