

# KAY INVESTMENTS

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*The current reality is that a strong rebound in corporate profits (the greatest and truest stimulus of all), ultra-easy money from the Fed, and some small stimuli from government spending are working to generate a stronger-than-expected recovery in a basically free-market economy that is a lot more resilient than ... critics think. Larry Kudlow, "A V-Shaped Boom Is Coming", CNBC, Kudlow Report, 4/9/2010*

*Let's try to sum it up. We have a Muddle Through Economy this year (not much more than 2% overall growth for the year), with a slowing economy next year. Unemployment stays high. If we get our deficits under control, we lock in a slow-growth economy for 5-6 years, but after that we could get back on track. A recession puts that brighter outlook out a little farther. Unemployment would go north of 12%. I might note that the stock market drops an average of 40% during a recession. John Mauldin, "Is This A Recovery?", Frontline Weekly Newsletter, 4/3/2010.*

*Inflation or deflation? A V-shaped recovery or something indistinguishable from recession? Enough new hiring to reduce unemployment or another jobless recovery? Predicting the future is always a crap shoot, no matter how hard economic modelers try to convince you otherwise. Getting a grasp on the here and now is generally easier. Not this time. Rarely have so many observers looked at the U.S. economy and come to such diametrically opposed conclusions. We're either entering the Promised Land or staring into an abyss. Carolyn Baum, "How Can We Explain The Bipolar Economy?", Bloomberg.com, 4/20/2010.*

In my last newsletter I talked about the current bull market. All bull markets climb a wall of worry and this one is definitely no exception. The above quotes illustrate the differences of opinion that always exist. It is a matter of fact that all the dissenters EVENTUALLY are correct. It is a mistake, as I see it, to dwell on what might or might not happen. The best way to answer the question of whether the market is headed up or down is not to answer it. The correct question is "what is moving today?".

As concerns today's opportunities, small and mid size companies are rallying the most. This is fairly common in new bull markets. Many of you who are long time clients remember that we made good money in small cap funds at the start of the last bull market. For a while we have held good size positions in two excellent such funds: the William Blair Small Cap and the Fidelity Midcap Value. We are also holding Fidelity OTC which combines technology with small companies. Beyond these, we hold positions in certain strong industry sector funds: Select Industrial Equipment, Select Biotech, Select Medical Delivery and more recently Select Transportation. We may sell Medical Delivery soon since the fund is not sure it still likes the new health bill. We are not using foreign specific funds right now because they are lagging the above. If you are using the moderate or conservative model, you hold a major position in the Loomis Sayles Strategic Bond fund, which has been an all star. Those of you in Fidelity-funds-only accounts are using Total Bond and Small Cap Stock instead of William Blair and Loomis Sayles.

Looking back on the last 24 months, we greatly outperformed the averages and other advisors during the first year, but left money on the table with our one year staged re-entry culminating in March 2010. Overall, the numbers show that we have outperformed for the 24 months; nevertheless, I have changed some of our systems to enable a faster return to 100% invested in the future. In any case, we are unequivocally fully invested today and actively participating in what we believe are superior sectors, funds and market segments.

Please contact me with any questions regarding your allocations or risk profile.

Darrell Kay

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