Courier Capital Corporation

Market Review & Update

FALL 2009

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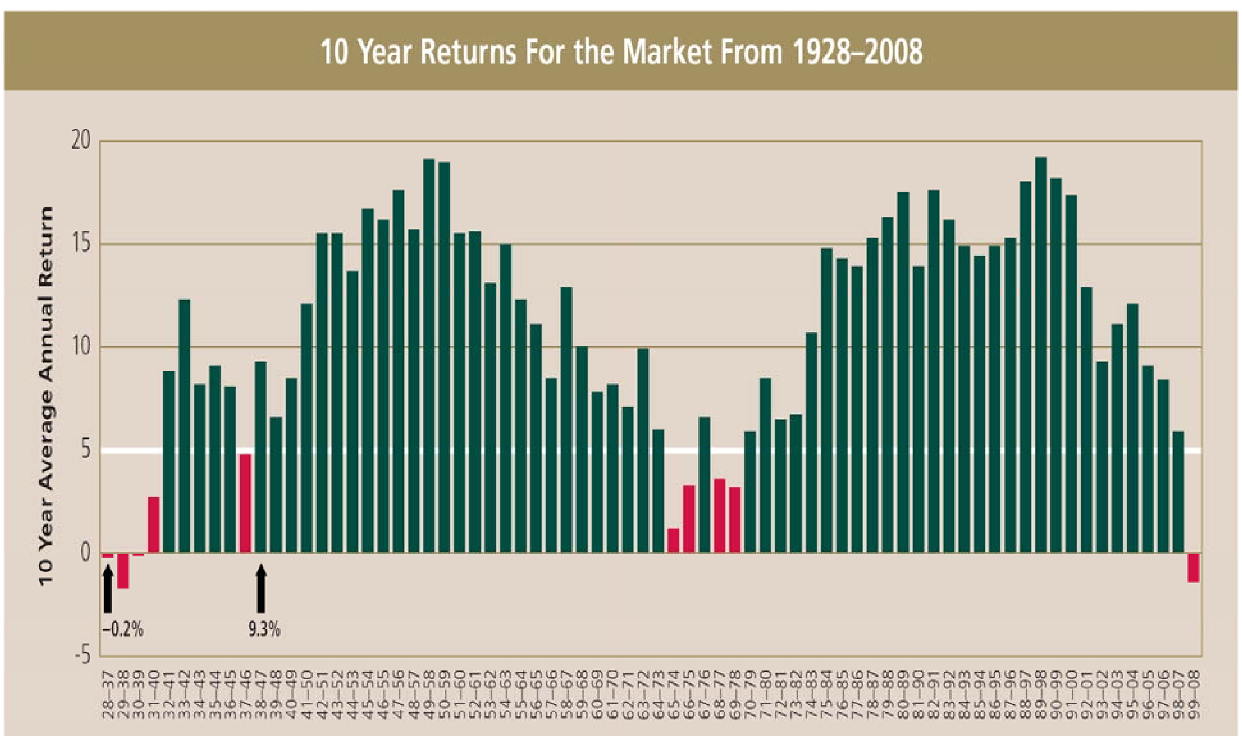
"By three methods we may learn wisdom: First, by reflection, which is the noblest; Second, by imitation, which is the easiest; and Third, by experience, which is the bitterest."

-Confucius

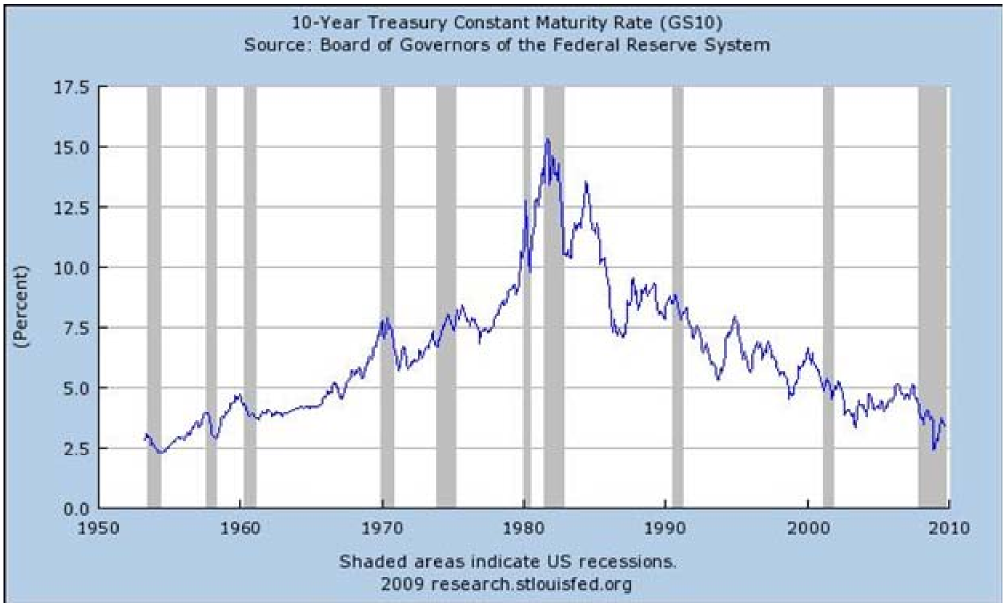
I have to admit, for Confucius, that quote is a tad pessimistic as it implies that more, rather than less, of the sum total of our experiences will be less than tasty. So, let's take the noble path and reflect for a bit. Mean regression (seriously, no pun intended...) is that over long periods data will trend towards its long term average, or mean valuation. What does that imply for the markets? Let's start with some factual observations. First, in contrast to the bitter reference above, the equity markets have significantly more positive periods than negative, which is the underlying rationale of the long term investor. Second, the long term historical return for domestic equities is about 9% which provides an investor a 3% risk premium above the long term average return of the 10 year Treasury. Mean regression. It can be good and bad, and so for some, perhaps we did intend the pun. More reflection to follow…

The equity markets delivered a return in the high teens in the '90s. Then, just to give Confucius some legitimacy, we have just experienced the bitterness of a decade in which the market averages regressed, meanly. We have experienced this market's trough in March of '09. Since that point the market rose about 50%. Mean regression suggests that we have some way to travel to get to historical long term norms. And significantly, the activity and trends around the world put some dominoes in place that could provide the catalysts to make that occur. Unprecedented levels of stimulus, from 50 year lows in interest rates to massive spending initiatives, the likes of which the world has not witnessed, heretofore coupled with major population centers hell bent on achieving a higher standard of living are just some of the potential catalysts of change.



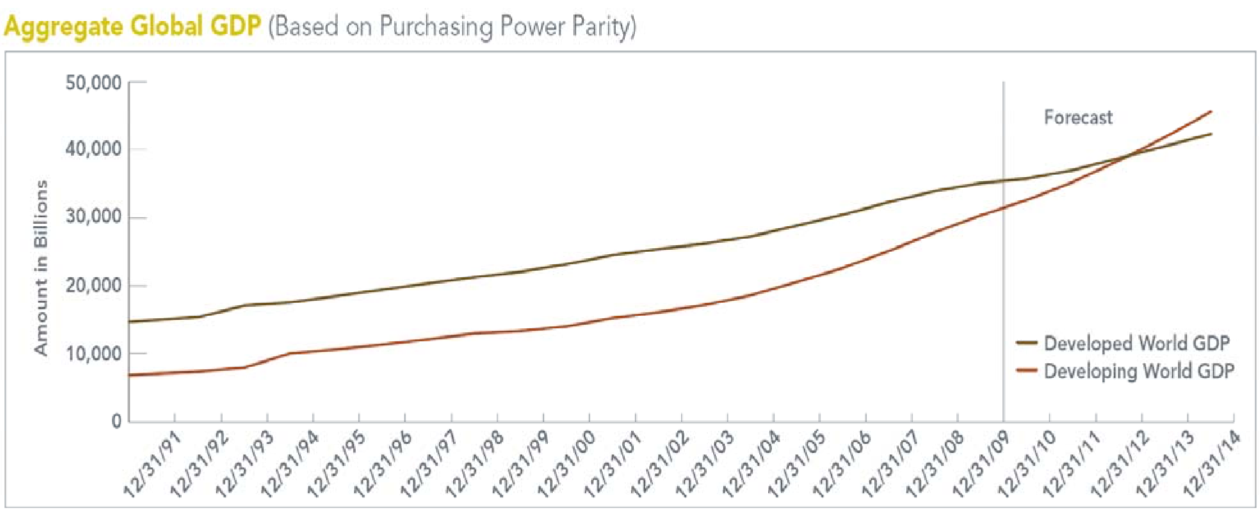
Source: Thomson Financial, Lipper and Bloomberg. Graph represents the S&P 500® Index from 1958 through 2008. Periods before 1958 are represented by the Dow Jones Industrial Average. **Past performance is not a guarantee of future results.**

Figure 2. 10 Year US Treasury yields



Mean regression. Let's begin with likely, the meanest. Bonds, especially of the government variety, have just completed a decade of substantially above average returns. Given the aforementioned catalysts, the fact that significant global recovery is underway, that we seem inexorably headed through at least some reflation & potentially some unknown degrees of inflation, and a marmoset could arrive at the conclusion that bonds are likely to regress, meanly. And, what's bad for them can be quite the contrary for growth and inflation based assets. Stocks, in a period of reflation can experience persistent long term periods of well above average performance as confidence rises, economies expand, earnings accelerate and p/e ratios reflect a return to sweetness. We should see this begin to manifest, and in some ways already have. Corporate returns have improved through cost-cutting, inventory rebuilding will provide a bridge to the earnings acceleration which should then be following by increasing consumption trends, globally. As this occurs, employers will resort to overtime to fulfill orders, till such time as this persistent increase in expense engenders the confidence requisite to begin bringing more workers back into the fold. As more workers are hired, more people are able to consume more, and so it continues to evolve. Only if we get to a situation of very tight labor markets both here and abroad should we experience the wage inflation that can be stubborn to control. This cycle and its effects have begun. In historical perspective, these periods can well take 3 to 7 years to unfold. This will be a quarter to quarter exercise to monitor these changes and make the requisite adjustments as our global recovery evolves.

Figure 3. Developing World GDP



Source: Citigroup Research. GDP is measured in billions, on PPP basis (PPP stands for purchasing power parity.)

In past issues we have talked about the potential of recoveries from significant events. In the dozen or so major recoveries, the catalysts have been wide-ranging. This time they do seem significant, especially in scope. For years we have discussed the potential of emerging markets and the sheer mass of those currently emerging. They may well be on a multi-decade trajectory of becoming more wealthy. In that they are simultaneously becoming more impactful, and while that impact will not always ensure to our glorious benefit, for now it makes the world do more business and more specifically grow more wealthy, at least on a mean basis…(pun intended this time…)…

We have discussed that it would be a quarter to quarter exercise to monitor the factors that will allow for a persistent and vigorous recovery. We are in the midst of a critically important earnings season and by this writing, more than 75% of companies have exceeded analysts' estimates. So far, so good. We'll talk to you soon…

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