

## Market & Wealth Management Update

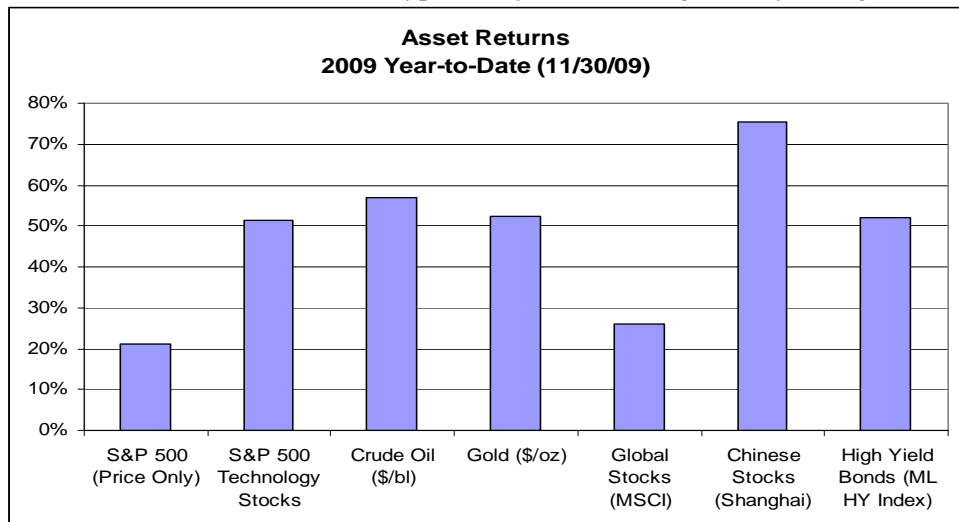
November 30, 2009

### Global Stock Markets Advance, Talk of Asset Bubbles Increases

Global markets advanced solidly in November after U.S. Federal Reserve officials indicated that they would keep short term interest rates low for the foreseeable future given the still weak economic conditions. Partly as a result of the Fed, the U.S. dollar fell 5% for the month, attracting foreign and institutional investors to buy further into the U.S. market and commodities. U.S. stocks rose as much as the dollar fell, climbing 5.4% as measured by the S&P 500. Interest rates declined, as seen in bonds like the five year Treasury note which dropped a third of one percent. Bond investors, including foreign countries and U.S. financial institutions, continue to show strong demand for safe assets for portions of their balance sheets, despite the increased risk-taking by other investors.

As discussed below, low interest rates, a declining U.S. dollar, and rising asset prices are well connected and are adding to the risk level for investing. Combined with expanding risk tolerances, these factors are cause for concern about asset price bubbles that could one day burst. We have watched risk increase in markets since the mid-year because of poor earnings growth for stocks, and now we are also seeing more risk in price levels of assets globally. The chart below shows the year-to-date returns of various asset types this year, reflecting broadly strong returns:

<i>Market Statistics</i>		
<u>November 30, 2009</u>		
	Level	Year-to-Date %
Dow Jones	10,345	+17.9%
S&P 500	1,095	+21.3%
NASDAQ	2,144	+36.0%
MSCI EAFE	1,532	+23.9%
Oil (WTI) \$/bbl		+72.7%
Barclays Agg Bond Index		+7.6%
Federal Funds Rate		0-0.25%
6 Mos Treasury Bill		0.15%
2 Year Treasury Note		0.66%
5 Year Treasury Note		2.00%
10 Year Treasury Note		3.20%



### Market & Economic News in November – Ho Hum Results in the Early Ho Ho Ho Shopping Season

Economic data in November reflected moderating conditions, such as the level of home prices and initial jobless claims. However, the absolute levels of nearly every indicator still reflect recessionary levels heading into the holiday season. Initial retail sales data from the early holiday shopping season showed that while more people hit the stores than last year, their spending level was less, resulting in an overall level of flat aggregate sales compared to a very weak 2008. Pre-holiday shopping surveys also showed a preference to spend cash over credit, highlighting both the thriftiness of consumers and the lack of credit available. Retailers seemed to be ready for this year's lackluster sales, starting their discounting earlier and cutting expenses heavily to help the bottom line should holiday results be weak. In our view, the initial holiday results are not surprising given the consumer's high debt levels and still rising levels of unemployment. We watch the information regarding holiday spending as a barometer for the earnings of companies most exposed to consumer activity. Many such stocks are already at vulnerably high prices and could become at risk of new volatility.

Other news in November validated our concerns about commercial real estate, global debt levels and the financial sector. Dubai announced that the country's main financial holding company, Dubai World, needed to restructure or delay repayment of its \$60 billion in debt. This sent a minor shockwave through the markets worldwide at the end of the month. From our perspective, the issue in Dubai is similar to that seen in the U.S. both in residential and in the future for commercial real estate. The speculative over-building financed by debt from many of the world's largest financial institutions has yet to be worked out of the system. We believe that challenges in the

commercial real estate markets around the world, including China, Dubai, Greece and some Eastern European countries along with the U.S. will be significant. There was too much commercial debt extended all over the world and such loans will need to be refinanced by reluctant lenders. The effect on debt holders and credit default insurers, many of whom are major financial institutions, could become significant once again.

For stocks, the S&P 500's gain of 5.4% in November marked a return to positive results after October's pause. Sectors leading the charge were both leaders and laggards in 2009. One of the biggest gainers in 2009, Materials stocks, rose over 11% while one of the year's more tepid sectors, Health Care, turned in a solid increase of 9%. For 2009, Technology stocks remain the best sector, up a remarkable 52%. Since March 9<sup>th</sup>, the bear market's low-point, only 13 stocks in the S&P 500 have declined and for the entire year only 97 are negative overall.

### Tiny Bubbles?

Global market fundamentals, including economic data, earnings, trading volume, and inflows into stock mutual funds have not yet fully validated the sustainability of the stock market's upward pace. The issue of trading volume is an important one. While data indicate that money market fund balances have declined from \$4 trillion to \$3.3 trillion in the U.S., half of the decline has gone into bond funds and the remainder has been into assets other than U.S. stock funds, such as emerging markets, gold and junk bonds, according to Business Week. It's becoming ever more critical that expectations for robust earnings growth are met in 2010 since retail investor capitulation could otherwise imply a market top. Earnings disappointments will be taken more negatively now. In other assets, the question is more of whether the dynamics leading to bubbles in November will cool off any time soon. The combination of global stimulus, low interest rates and rising risk appetites is causing many assets, such as U.S. high yield bonds, gold, REITs, emerging markets and foreign lending, to approach bubble levels:



Chart courtesy of Stockcharts.com



### Investment Strategy

Stock valuation levels remain high relative to our earnings expectations, based on our stock by stock analysis, as compared with Wall Street's very optimistic economic and earnings scenarios. Recommendations by stock analysts on Wall Street are increasingly being based on earnings estimates further into the future, 2012 and even out to 2013. This is a sign of how much earnings growth for 2010 is already priced into the market. However, given low bond and money market yields, we still seek good dividend paying stocks with stable outlooks and reasonable valuations as preferable options to cash. Overall, the investing environment is unfavorable for many asset types based on valuation, making risk control and active management paramount for managed portfolios. As always we look forward to our next meetings with you and appreciate your support and referrals to our company.

*Christopher H. Lyford*

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