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RE: 2<sup>nd</sup> Quarter – Guarded Optimism

Dear Client:

As we begin the Second Quarter of 2010, there's encouraging economic news that points toward an economic recovery in the months ahead. At the same time, though, there are still numerous "danger" signs that could bring more trouble ahead.

First, the recent economic news is hopeful. The worst of the economic downturn seems to be behind us. The time for ultra-guarded conservatism with investment portfolios has passed. We believe we're entering into the next phase which we refer to as "guarded optimism."

The bright spots continue to include an increase in manufacturing to replace depleted inventories. The low interest rates are still in place (but that could be changing soon). Exports are on the rise - an important sign of a strengthening economy. And, while unemployment is still a concern, the number of job losses appears to be leveling off and, in some cases, even declining.

All of this is positive news and supports what many have been predicting - that the nation has turned the corner on this global recession.

As we begin to emerge from these difficult financial times, it's important to recognize that there are several troubling situations that still exist - situations that can derail an economic recovery in an instant:

- There is a worldwide credit crisis with countries like Greece, Spain, Portugal, and Ireland feeling the brunt of the problem. While U.S. banks and investment companies are strengthening, they are not immune from future problems - Wall Street could face credit problems once again.
- There's a staggering \$1.4 Trillion dollars worth of commercial real estate loans that will be due over the next three years. Unfortunately, most of these loans are on properties that are worth substantially less than the outstanding loan balance.
- Federal spending continues unabated. The federal deficit is on track to set another record of nearly \$2 Trillion dollars this year. And to finance the debt, interest rates, which have been at historic lows, are likely to climb.

- The financial concerns facing the federal government have spilled over into the states. Every state is facing increasing financial pressure and many are unable to balance their own budgets. States like California and Michigan are essentially broke with a half dozen others right behind them.
- The stock market is behaving differently than it did at the height of the recession. There's less volatility now and some believe that means the stock market is back on track. But consider this: There was so little confidence in the stock market in the past year that investors pulled out much more than they actually invested. Many investors - including pension, mutual fund, and hedge fund managers - cashed out of equities. There was \$130 Billion dollars more coming out of the market than what was invested in stocks.

The concerns we raised at the beginning of the year are still valid today. And, the questions we posed then are still very relevant: Should we plan for a deflationary or inflationary environment going forward? Are the government actions setting us up for another 'boom-bust' cycle? The answers to those questions are not yet clear.

However, we do believe that we're beginning to emerge from a prolonged recession. Just what form that recovery takes, how strong it will be, and how fast it will occur depends on many variables, some of which was addressed above.

At Kapusta Financial Group, we remain dedicated to managing risk and taking advantage of investment opportunities as they arise. As we told you at the beginning of this update, our view for the Second Quarter of 2010 reflects "guarded optimism."

We're grateful to you for your trust and confidence in our work. We remain committed to providing you with sound investment advice.

If you have any questions, please don't hesitate to give us a call.

Sincerely,

*George*

George M. Kapusta, CFP  
President