FERGUSON ASSET MANAGEMENT, INC.

Investment Counseling & Asset Management for Individuals & Institutions

Quarterly Report and Commentary
October 2009

The third quarter that just ended witnessed improving retail sales, higher resale in the housing market, reduced jobless claims, and gains across the board in the security and bond markets.

Changes for the quarter of July-September were as follows:	
S & P 500	+15%
Dow 30	+14.9%
NASDAQ	+15.7%
S & P Midcap	+19.5%
China Index	+15.5%
Emerging Mkts Index	+13%
World Silver Index	+22.9%
World Gold Index	+8.6%

The iShares Aggregate Bond Index gained 2.6% and has a yield of 4%.
The Treasury Inflation Protected (TIP) Bond fund gained 1.2% and had a yield of 3.9%.

Fixed income yields are down across the board and negatively impacting those who rely on those investments to cover their living expenses.

Bond Returns:

Type	Maturity	Yield
US Treasury Bonds	6 month	0.15%
US Treasury	3 year	1.40%
US Treasury	10 year	3.30%

Municipal AAA	5 year	1.67%
Corporate AA	2 year	1.60%
Corporate AA	20 year	4.80%

Unemployment has inched higher, but has historically been one of the last indicators in a recovery to show a reversal.

Recover, according to my Thesaurus, is to mend, salvage, regain, and improve. When we are ill, we expect to eventually recuperate, and when our assets decline, we should expect to eventually recoup what was lost unless, of course, it was stolen.

The stealing part is, I suppose, only unconscionable to those with a conscious. Madoff comes to mind, as does Marc Drier, the Manhattan lawyer who recently was on "60 Minutes" discussing his $400 million Ponzi scheme. Then we have accused Milowe Brost and his $900 million scheme, Westgate Capital of New York and their $900 million, and Robert Allen Stanford and his high yield Stanford International Bank alleged fraud of $8 billion. Poor Daren Palmer is a mere piker accused of only taking $40 million on his 7% a month return scheme.

My dear wife, Kathleen, reminds me that it takes two to tango and P. T. Barnum informed us, "There's a sucker born every minute." Part of our gullibility, I believe, stems in part from our attitude that "we" have used our money to invest in situations to which the less sophisticated of us have not been privy. We are just a tad smarter than Mr. and Mrs. Average, and we like that feeling, until those schemes unravel!

After such losses, as those from market declines and crooks, some of us become so gun shy that we wait until the all clear signal is sounded before getting our investment feet wet again. Some pundits have already sounded the "all clear." The recession is over and a "V" recovery is underway, they say. Others, dubbed by some as experts, say they expect a "W" recovery. The V and the W refer to the shape of the market action. In a V, you go down, as the market did from the last quarter of 2007 through the first quarter of 2009, and then you go roaring up in the V shape.

A W is different in that you go down, then up, then back down again. This is not the shape of the market any of us want to see occurring any time soon. Those investors who are on the sidelines and out of the markets may be expecting a W, perhaps the new Scarlet Letter.

A look at returns following significant market declines.

Since 1925 there have been nearly two dozen separate bull or bear markets. The bull markets usually last about 2 ½ years, and the bear markets about a third as long. Historically, the greatest recovery returns come from the small-capitalized asset classes, and emerging international markets.

Returns in the smallest asset classes following a bear market often are two, even three times greater than the return of the Standard & Poor's 500 Index for one year, two and a half year, and five year time periods. The risk, to be sure, is also greater, so asset allocation and portfolio monitoring become especially important in a market recovery.

How we monitor portfolios.

In general, we have an Investment Policy for each client. Our approach to portfolio management takes into consideration your unique circumstances, time horizons, tolerance for risk, and objectives.

We have come to believe, through hard evidence, that active stock selection does not beat passive or engineered indices. Research shows that in 3,5 , and 10 year periods only a very small minority of stock pickers and stock picking mutual funds actually equal the very indices to which they compare themselves.
We use Dimensional, Vanguard, and exchange traded funds (ETFs) for our core equity holdings. Our holdings are priced every morning based on the previous day's close. This occurs about 6 AM in the morning. We review, usually by 9:30 AM, any new client deposits or withdrawals, dividends, bonds that have matured, and general account activity. We have graphic data for all of our equity holdings, and this information may be analyzed throughout the day. In the case of fixed income or bond holdings, any daily rating changes are monitored. On a weekly basis we review our portfolios for their allocation mix, relative to the investment policy of each client, and the performance of the account relative to various benchmark indices.

We rebalance the individual portfolio when the range of our predetermined asset class mix is exceeded. For example, we may allocate 20 % of assets to international holdings with a 5% + – tolerance. Then, if the asset class group reaches 25% of the account value, we may monitor that specific portfolio on a daily basis with the intention of rebalancing and reducing the international holdings on a timely basis. The less sophisticated investor might sell their underperforming holdings and put more money into the asset class that is doing so well. Big mistake, as allocation within the various asset classes is the key to risk management.

We have weekly meetings to review accounts and market activity, and to brainstorm about what ifs and what might be. Personally, I am not much for other "professional" opinions. With just a tad of effort I could spend the day finding conflicting expert opinions on just about everything. On the old Dragnet television show, Sergeant Friday would quip, "Just the facts, Ma'am." That is what we look for, just the facts.

Ni hao. Ni hao ma?

The words above are Mandarin Chinese for hello and how are you today. If you are under forty, and even for the rest of us, it might behoove us all to know the basics of the language. China is estimated to hold foreign exchange reserves of between 2 and 2 1/2 trillion dollars, or roughly \$7,000-\$8,000 for every man, woman, and child in the US. This is about \$22-\$25,000 per family.

To put this in perspective, the total consumer credit outstanding at the end of August 2009 was $2.4 trillion dollars*. This included car loans at commercial banks and auto finance companies, monies owed to commercial banks, finance companies, credit unions, Sallie Mae, and nonfinancial businesses.

China is so much more than a supplier to Wal-Mart and our largest creditor. The World Development Bank's various projections show China will surpass our GDP (Gross Domestic Product-The output of goods and services produced by labor and property located within that country.) sometime between 2015 and 2025. That means they are growing at a rate 3 times faster than we are. Fortunately, many Chinese companies are included in the portfolios of our emerging market funds.

*according to an October 7, 2009 Federal Reserve Statistical Release.

Active versus Passive Management

On page number 2, I referenced the performance of active versus passive management. The RS Emerging Markets A Fund is an active management fund that has an above average Morningstar return rating, and ranks in their top 10 best year-to-date returns.

The screen criteria I initially used to search for actively managed funds was: emerging markets, top 30% in 1 year performance, above average returns, up more than 50% year-to-date, minimum investment of $2,500, no load or front end commission charges greater than 4%, and a total expense ratio less than 1%. Oops, there were no funds like that. Two main reasons were funds charging higher commission fees and expense ratios.

The RS Emerging Markets fund was a top actively managed fund with a y-t-d performance of 78.17%. Dimensional funds passively managed emerging markets value portfolio, which we have in many accounts, was up 83.15%. So much for those who travel the world looking for investment opportunities and trying to beat the indices to which they compare themselves.

Tidbits

We will have more information for you in early 2010 on the IRA to Roth conversion opportunity. We will be communicating with your accountant regarding the desirability of such a conversion for you. We have the 12 months of 2010 to effect this conversion, as it does not need to be done on January 1. Until then, we want to fund as much as is allowed to you for this year's IRA contribution.

Social security benefit payments will not go up in 2010 unless Congress acts. For the first time in 25 years many social security checks will actually go down. There will be no cost of living upward increase. There will be combined Medicare part D and C increases, probably averaging 7%. No wonder more folks are postponing retirement.

Jim Rogers, a well know commodity expert, says "A catastrophe is looming in agricultural products." Some parts of the world, he contends, will not be able to get food at any price. He suggests, "instead of an MBA get a degree in farming." Perhaps I should look at my potting shed with greater affection!

In the past we have recommended Joan Appel, owner of Mark Twain Travel, as a travel agent you should consider, especially when planning an international trip or cruise. Several of our clients, including me, have benefited from Joan's extensive knowledge and expertise. I mention her again for our new clients, and because I just had a conversation with someone praising Joan for arranging a trip from which they just returned. Joan@marktwaintravel.com or 607-734-4131.

We wish you all a pleasant fall season and a profitable fourth quarter.

John Ferguson