Stamper Capital & Investments, Inc.

“Focusing on Upside Potential with Downside Protection Since 1995.”

January 2011 Market Commentary

We believe we have found the proverbial "canary in a coal mine" - the CDO's of the 2007/2008 top and 2008/2009 financial collapse! But, unfortunately, for the next downcycle in the financial markets.

Our forecast for the normal municipal bond market is coming to fruition, unfortunately.

Of course, it makes sense that we would find the canary, as it is market for "normal" municipal bonds! Our clients know that we often purchase "normal" municipal bonds, especially at deep discount prices if we are expecting a market rally (as we did for our 1st place finish - High Yield Municipal Category, +4.11% Annual Return - 1999-2001; 56 High Yield Funds, Category Average Return: +1.47%, 3 year period – See our Performance & Awards page at http://www.risk-adjusted.com/Performance&Awards.html and out SCI In The News page at http://www.risk-adjusted.com/ExternalArticles.html) ; however, we are also experts at being defensive - purchasing special cushion bonds. Those distinctions being made, below is what has happened in the municipal bond market that we find so important, not only to that market but to forecasting other markets as well. These are some of the proxies for municipal bonds that we follow (drops are from peaks to January 2010 bottoms, so far):

2010 Municipal Bond Market Peak Indicators	**Peak**	**Drop**
Bloomberg Index Open-End Tax-Free Municipal Bond Funds	08/26/2010	6.9%
Bloomberg Index Closed-End Tax-Free Municipal Bond Funds	08/31/2010	16.7%
Bloomberg Index Closed-End CA & Fed Tax-Free Municipal Bond Funds	09/09/2010	18.6%
Wells Fargo Build America (Taxable Muni) Bond Index	09/29/2010	18.4%
Eaton Vance Municipal Bond Fund ("EIM")(Leveraged) Tax-Free ETF (note this one peaked only 3 cents lower, initially on 09/09/2010	10/04/2010	24.5%
Eaton Vance National Muni Open-End Fund ("EANAX")(Generally Long Munis)	08/27/2010	15.9%
Oppenheimer Rochester National Muni ("ORNAX")(Generally High Yield) (note this one peaked just lower, initially on 08/31/2010)	10/22/2010	14.9%
Market Vectors High Yield Muni ("HYD") ETF	10/25/2010	12.4%
I-Shares S&P National Tax-Free, AMT-Free Muni ("MUB") ETF	08/25/2010	10.2%

Using the Bloomberg Daily Generic OAS [Tax-Free Municipal] Yields Scale, we found the yield for the AAA-rated 30 year tax-free municipal bond double-bottomed at 4.08% 8-31-10 and then again on 9-9-10. As of 1-21-10 it has raised a whopping 104 basis points up to 5.12% - which of course is the inverse of the huge price drop from the peaks.

We note that hardly anyone was aware of the peak in the muni market as late as mid-October 2010, about a month and a half after the peak. Since then there has been a huge amount of denial about long term problems in the municipal market finance; however, we at Stamper Capita have been documenting the building problems and likely financial storm for years (please see In The News http://www.risk-adjusted.com/ExternalArticles.html and Market Comments http://www.risk-adjusted.com/InternalArticles.html).

Important to our highlighting the significance of this downturn as a forecasting agent is that the 4th quarter 2010 downturn in the municipal bond market is the worst since 1994 (when the Venture Muni (+) Plus, Inc. Fund that our head Portfolio Manager, B. Clark Stamper, managed (for 20 years - June 1990 to July 2010 and is now named the Wells Fargo Strategic Municipal Bond Fund), was ranked First of all 800 or so long term, intermediate term, short term, high yield and high grade municipal bond funds (see **"Managing Muni's from a Corporate Credit Perspective" THE BOND BUYER, September 21, 1994, and other articles in our In The News section** http://www.risk-adjusted.com/ExternalArticles.html).

Let us use the above information as a building block of our analysis of 2010 and our forecasts going forward.

2010 Review

As for 2010, after hitting the ball out of the park over the past few years in calling the "drop from the top," the early 2009 bottom, and the subsequent choppy partial retracement (of the drop), our forecasts for 2010 turned out to be a mixed bag; however, mostly likely just pre-mature.

Municipals - Because of the huge drop in the forth quarter of 2010 we were correct in forecasting a drop in the municipal bond market for the year. In fact, almost amazingly, the municipal bond funds and indices we reported on above saw their January 2011 prices down sharply at levels last seen between 12-17-08 (for MUB) to 7-23-09 (for Bloomberg Index Closed-End Calif. & Fed. T-F Municipal Bond Funds) with the rest in between. From 1-1-10 to 1-21-11, the yield on the 30 year Tax-Free AAA-rated rose from a 4.47% to a 5.12% yield, or 65 basis points. Thus, we were very correct on the muni market.

U.S. Dollar - Our prediction that the 11-25-09 low was the low turned out to be correct. Since that low the U.S. Dollar rose almost 20% to its high 6-7-10. Since then it dropped and then rose for a net rise to January 2011 of 5%. We stated that we expected the U.S. Dollar to go up and for everything else to go down as was the case in 2008; however, it did not exactly happen that way in 2010 as we have detailed.

Real estate - The S&P Case-Shiller Home Price Index [of all 20 metropolitan markets] rose from January 2010, peaking July 31-10 and then falling 2.4% back down to the 1-31-10 (for no net progress) and back down to matching level of August 2009 (after its rally from the sharp April 2009 bottom). Thus, real estate prices, according to this index

(real estate is regional) are net unchanged but down from their July 2010 peak, back down to levels up just 4.4% from their drastic April 2009 bottom. Importantly, this drop also took the index below the level of its intermediate 9-30-09 top.

Interest Rates - As for interest rates, the yield on the U.S. Thirty Year Long Bond had a large drop in yield to a sharp bottom on 8-26-10 before a similarly large rise in yields to almost where they started the year.

Equities - For equities, we stated that we thought most market tops were in. While that turned out to not be true, the choppy partial retracement we had previously correctly forecasted from the March 2009 bottom has continued. For example, the Dow Jones Industrial Average rose 4.5% from its January 2010 high to its high in April 2010 before plummeting by 14% to its early July 2010 low. From there it rose by 23% to a January 2011 high, with a net gain from January 2010 to January 2011 of just under 11%. Most of the other major domestic equity indices have behaved similarly, with big drops and rises, and with respectable returns for the year; but, much less so when the risk that was taken and the risk that was experienced are taken into consideration.

Commodities - As for commodities, it was pretty much the same story. After correctly forecasting their major tops and their bottoms that accompanied the stock market in March 2009, we were early in forecasting their tops as being in January 2010. Their movement since last January has been similar to stocks over the same period but with larger rises and investor excitement in gold and silver, in particular, bordering on financial mania. For the year, gold was up 23% and silver was up 64%; however, the Thompson/Reuters/Jefferies CRB Commodity Index was up 14% and oil was up only 1%.

Forecast 2011

Importantly, as we have pointed out a few times before, tops in the financial markets are most often "fanned" with some indices topping earlier, some in the middle and some later while bottoms are usually pointed and sharp with most indices bottoming together as was the case in March 2009.

Markets that look like they have already put in their tops (as we discussed, in part, above) are:

Index of Prices of 24 Largest U.S. Banks - The KBW Bank Index's ("BKX") peak of April 23, 2010 is still intact. The index is 8.78% below its **4-23-2010 top**. This index might just be "the leader" of the current topping process.

The Housing Market - As we detailed above, the S&P Case-Shiller Home Price Index [of all 20 metropolitan markets] **topped July 2010** and dropped 2.4% to levels also below its 9-30-09 top and to a level just 4.4% above its huge April 2009 bottom.

Interest Rates - As reviewed above, the yield on the U.S. Thirty Year Long Bond had a large drop in yield to a sharp bottom on 8-26-10 before a similarly large rise in yields to almost where they started the year. Prices of bonds move inversely to interest rates, so the 30 Year had its **price top on 8-26-10** before its yield rose 104 basis points to January 2011 (remember, yields up, prices down).

The Municipal Bond Market - as we detailed above, interest rates of 30 year, AAA-rated, tax-free municipal bonds are up over 100 basis points since their late 3rd quarter of 2010 bottoms. Prices move inversely to interest rates, so this market topped **approximately August 2010**. This might be the most important early topper as its top may be sending a very significant message about the markets. One interesting item is that somewhat after the municipal bond market started melting down, well known bank analyst Meredith Whitney was interviewed based on a large research report she was getting ready to publish that indicated the municipal market had all kinds of problems with numerous and large defaults being highly likely in her opinion. The outcry from the brokerage community and municipal bond portfolio managers was very notable. The denial of even a hint of possibility of Whitney being correct was striking to us and reminded us of the denial that anything was wrong with the CDO market in early 2007. Of course, we've been sounding the alarm bells on the issues in the municipal bond market for several years now so what she said was not any shock to us - maybe verification; however, the entrenched and vehement denial maybe even more telling. That being said, we are, of course, watching the muni market very closely as a leading indicator of the rest of the financial markets.

Other Potential More Recent Tops - So far this month several markets/indices put in tops with notable declines. Both the Dow Transports and the Russell 2000 (small caps) had tops 1-18-2011. Since then, the Transports have dropped 4.6% and the Russell 2000 has dropped 4.4%. It may be that those rebound tops are; thus, already in. Of course, we will see.

General Forecast - We believe that those market tops (outline above) are significant and will hold. Those tops are already months ago and significantly higher than current levels, indicating, to us, a very large overall top in the financial markets is taking place, and that it will be "fanned" with different indices peaking at different times, as explained above. These tops and their dispersion with respect to each other, but more so with respect to other indices yet to top (in addition to the factors discussed below), gives us more confidence that the upside potential of most financial markets is low while the downside potential is high. For this reason and because all the other dominos we've outlined (see our previous **Annual Forecasts** http://www.risk-adjusted.com/AnnualForecasts.html) are still lined up, unfortunately, our previous forecast still holds. We are looking for significant drops in the prices of foreign and domestic equities, high yield bonds, general municipal bonds, and commodities including gold and silver. At the same time we are expecting the U.S. Dollar to continue to increase in value. Thus, as previously, we are expecting the U.S. Dollar to go up and pretty much everything else to go down. Accordingly, we are expecting deflationary pressures to resume with a full out deflation in this next down cycle. Unfortunately, we are expecting the levels of the 2008 and 2009

bottoms to be taken out by most prices and indices. As for interest rates, the yield of the U.S. 30 Year Long Bond has risen over 100 basis points from its 8-26-10 bottom; we believe that bottom in yields (high in price) will hold. We are more confident that the yields of lower quality bonds, including municipals and corporates will go up substantially as investors become more and more concerned with credit quality and "return of principal" than just "return on principal."

Our Long-Standing, Long Term "Right-tilted W Forecast" - As we have reviewed previously, our long-standing, long term forecast from 2002 for a huge formation of the prices of financial assets in a "right-titled W" structure has been fulfilled. The structure has the top left of the W being early 2000 (1998, if adjusted for inflation), the 2003 bottom being the first bottom point of the W, 2007 or so being the middle point of the W, and with the 2008/2009 lower low being the lower second bottom point of the W, making it right tilted, and the subsequent rebound to the current highs possibly finishing off the structure. However, as we have also recently stated in **'W'hat Goes Up Must Come Down: Stamper Capital & Investments Forecasts Become Reality** (published November 18th, 2010, http://www.risk-adjusted.com/InternalArticles.html) we do not believe the structure is finished. Given our forecast for continuing lower lows, we believe their will be a new lower low (possibly several up and downs with lower and lower lows before the final one) to the second bottom of the W. This situation fits with the approximate 18 year cycle in the financial markets that we have noted. We believe the top was 2000 or 1998 if adjusted by inflation. Eighteen years is 2016 or 2018. We have also said that while we will make a guess at the timing and level of the future major bottom, we likely will not really know until we are there, but we expect we will as we did at the late 2008 and early 2009 lows. Our educated guess right now is for the major bottom in equities and commodities and lower quality bonds to be in 2016 with real estate bottoming 18 to 24 months later, by 2018.

I have added the next comments from last year's Annual Forecast as I do believe they still very relevant to current and future environments:

> **Why the big drop?** We have spent a huge amount of ink over the years in our Annual Forecasts and Weblogs explaining the build up of the bubbles and why we expect them to pop, please see them for detail. - In "a nut shell," there are a couple of parts to the answer. First) valuation levels are still far too high. We are talking Price/Earnings ratio's, ratios of rents to asset prices for real estate and lower quality bonds, etc. that we have documented many times in the past. Another part of the answer) and it is related, is the still "off the charts" levels of debts and government promises (pensions, Medicare, Social Security, etc.) and, that in the cycles on the way up since say 1982, even in the troughs, you still had credit expanding or at least not contracting; however, now we are in a Credit/Debt Contraction. In fact, even in the large stock and commodity rebound of 2009, credit/debt was still contracting! - This is a key "tip off" of "what is different." When the cycle turns down again (like it is starting to do now), with credit

contracting even during the trough, we think it will be a doozy of a downturn, unfortunately.

It was the Credit/Debt Expansion that allowed (/pushed) valuation levels to get off the charts. It is the Credit/Debt Contraction that is going to first, bring valuation levels down to "fair value," and then, down below fair value, as markets most oven overshoot either too high or too low. Think of it this way, say you have $100,000 saved up and you want to purchase a house and financing is available at $900,000 so you can pay up to $1,000,000. But Now, financing is only available for that purchase up to $300,000 - in that case you can only pay $400,000. By the way, that was the old "rule of thumb" for purchasing real estate 25% equity or more down payment. Based on the old rules of thumb real estate is still grossly overvalued. (Again, we've gone through many of these over-valuation examples in our **Weblogs and Annual Forecasts**. http://www.risk-adjusted.com/AnalysisMarketOpinion.html)

In our previous forecasts we talked of the 2008 debacle being on Wall Street and of it rippling to Main Street - we also implied rippling to "Municipal Street." The effects of the Credit/Debt Contraction have been rippling, especially to municipalities who have seen their tax revenue slashed: income tax revenues, sales tax revenues, property tax revenues, gas tax revenues, etc. These effects have only just begun to ripple. Similarly and related to Credit Expansions and Credit Contractions, these effects are self-reinforcing. First credit contracts and we have some defaults and asset prices fall; then, the fat is cut and some salaries are reduced; then people tighten their belts and spend less and save more. So now you have incomes dropping and retail sales dropping. So, municipalities are receiving less property tax, less sales tax and less income tax, etc. Now, they have to cut fat and reduce salaries. And it continues and self-reinforces until all the waste and excessiveness is out of the system. If debt levels are not excessive, it isn't that much of a painful process; however, if debt levels are "off the charts" as they've been since the late 1990's, then you are going to have a much longer term problem (like Japan still deleveraging 20 years after its 1989 real estate/debt Super Top). Unfortunately, we believe this cycle is likely to wipe out the waste and excessiveness all the way back to the early 1980's (or maybe even earlier), the beginning of the huge Credit/Debt Expansion that has now ended; We believe we are now in a huge Credit/Debt Contraction.

Deflation and Investment Performance: We also believe the current diffuse deflation will morph into an obvious overall deflation (with the value of U.S. dollars going up, and prices of pretty much everything else going down resulting in massive credit/debt defaults, many of which have already started). Accordingly, because prices of pretty much everything will be dropping, we believe even a negative total return of say 5% will likely be a home run compared to stocks dropping say 50% or more and real estate dropping similarly, along with the costs of normal goods and services. Importantly, a drop in the price level will be a tax-free gain, for those who don't lose as much as the averages & prices drop.

We believe, in these tumultuous times, it is important to keep the perspective that even if you lose a bit, you are still ahead when everything else drops more, similarly to 2008.

As previously, for specific investments, we will continue to focus on our upside potential and downside protection analysis, that has worked well for us since 1990 and we believe we will continue to post top risk-adjusted returns in our specific category and against most other asset categories. Thus, we believe that right now, for all but the highest quality assets, the upside potential is very low and the downside possibility is exceptionally high.

In conclusion, we believe the prices of riskier assets, stocks, low quality bonds, and real estate and commodities are at peaks Now and will resume their down trends that began from earlier market tops (2000, 2007, and now). Please see our **Weblogs and Annual Forecasts** http://www.risk-adjusted.com/AnalysisMarketOpinion.html for more detailed information and to see how well we have been forecasting over the years - our previous forecasts still stand.

Thank you for your patronage,
Stamper Capital & Investments, Inc.

Since 2001, "Safety" was our watchword for the 2000-2009 decade. Unfortunately, "Safety" is still our watchword until we get to the final bottom, which we believe is still much lower.

(Posted January 24, 2011)

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Stamper Capital & Investments, Inc. has been the sub-adviser to this Fund since October 1995 and B. Clark Stamper, our President, has been its Portfolio Manager since June 1990.

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