

Financial Sense

Galecki Financial Management

First Quarter 2010

Quarterly Investment Commentary

| | Last Month | Last 3 Months | Last 12 Months |
|---|-------------|---------------|----------------|
| S & P 500 Index | 6.03 | 5.39 | 49.77 |
| Russell Midcap Index | 7.07 | 8.67 | 67.71 |
| Russell 2000 Index | 8.14 | 8.85 | 62.77 |
| Dow Jones Industrial Average | 5.31 | 4.82 | 46.93 |
| Morgan Stanley EAFE Index | 6.31 | 0.94 | 55.20 |
| Citigroup Intermediate Corporate | 0.14 | 2.65 | 20.60 |

Index Returns

After a very strong March, all domestic equity asset classes are now well into positive territory for the year. The S&P 500 Index was up 5.39% for the quarter, the Russell Midcap Index gained 7.07%, and the small-cap Russell 2000 gained 8.85%. International markets also posted strong gains in March and are now in the black for the year with the EAFE Index up 0.94%.

Turning to fixed income, the Citigroup Intermediate Corporate Bond index was fractionally positive in March, but is still up 2.65% on the year. The Barclay's Capital High Yield Index was up 3.13% in March taking the year-to-date return to 4.62%. Emerging-markets bonds gained an impressive 4% for the month (as measured by the JPMorgan GBI-EM Global Diversified Index), ending the quarter with a 5.4% return.

It has truly been a wild ride for long-term investors over the last few years. We survived a drop of 56% in the S&P 500 in an 18-month time frame. We have subsequently gone through a 77% rally in the same index in just over 12 months since March 9, 2009. This type of volatility was quite concerning for investors and advisors alike. While we are quite pleased with our portfolio returns over the last three years, the logical question is, "What do we expect going forward?"

In order to answer this question we think it is imperative that we have a mutual understanding of where we are from both an economic standpoint and a market standpoint.

Economic Review and Outlook

There are still plenty of concerns in the economy. The buildup of government (public) debt is significant. Estimates are that the U.S. debt could reach 100% of total GDP by 2019. While this might not be catastrophic, it will most certainly slow our annual growth potential. Households have continued to save, although the pace is slowing. The unemployment rate is still at 9.7% with the underemployed rate estimated to be around 17%. The financial sector is still healing and the housing sector is inching along with the new home credit set to expire at the end of April. A rising interest rate

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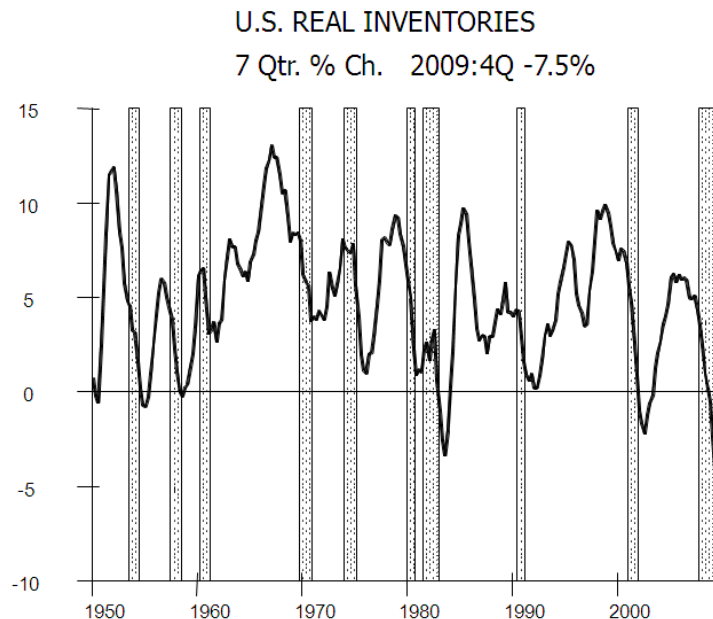
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environment and an increase in personal and corporate taxes could significantly slow this recovery. Finally, government involvement in multiple areas threatens to slow the overall private sector growth over the next few years.

There are some factors to get excited about that seem to avoid a lot of press. The U.S. created 162,000 jobs last month after two years of significant losses. Although the unemployment rate stayed at 9.7%, it actually could have increased. Many people, who stopped looking for jobs a year ago, are once again looking for jobs. These individuals factor back into the equation and could push the unemployment rate up fractionally for a few months before it continues its decline.

The American Recovery and Reinvestment Act of 2009 allocated \$787 Billion to spur economic growth. Much of this money will be spent in the 2nd and 3rd quarter of 2010. In fact, according to www.recovery.gov at the end of the quarter, \$310 Billion had been spent with \$477 Billion remaining. Discussing the necessity of the package is beyond our scope. What is apparent however is that a significant amount of money will hit our economy in 2010 giving it a significant tail-wind.



Business inventories are at a historic low, which suggests that we could be in for a massive inventory rebuild over the next 12-18 months. Corporations are sitting on a record amount of cash. Given the current inventory level, and stressed workforce, we believe that we will see a substantial increase in inventories in 2010 and a nice increase in non-farm payrolls as corporations begin to put this cash to work.

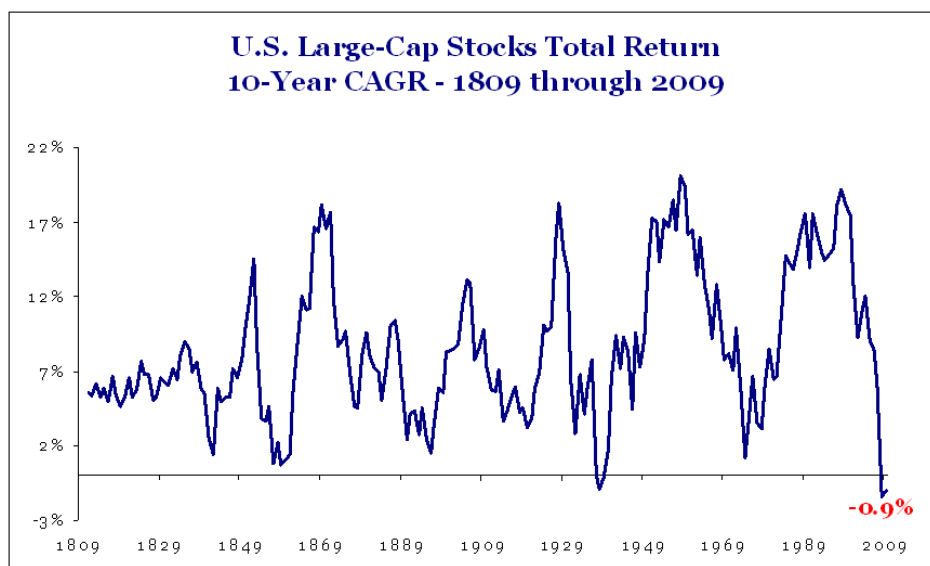
Inflation is relatively tame with the year-over-year change in the CPI at 2.39% in March. Inflation is strong enough to quiet any fears of deflation, and yet not high enough to warrant the Federal Reserve to increase short-term rates. This has created a very steep yield curve, which has historically been a very good environment for corporate profits and subsequently market returns.

There are still many people who do not ‘buy into’ this recovery. As contrarian thinkers, we view this as another reason to be positive. Although GDP has risen from a decline of 6.4% in 2009’s first quarter to a gain of 5.6% in the fourth quarter, there are still many non-believers.

Equity and Bond Markets

Since 1926, there have been three time periods where 20-year bond returns outpaced equity returns. The end of 2009 marked the third occasion. When equities have underperformed bonds for the 20-year period, such as we just experienced, the average S&P 500 return for the following 10-year period is 19.8%. The average return for the 10-year Treasury is 1.3% for the same time period.¹

In addition, since 1809 there have only been two occasions when the 10-Year rolling Large-Cap stock returns were negative. The first such occasion was 1929-1938, and the next just occurred during the period ending in 2009.² We believe the probability of fixed-income outperformance versus equities over the next 10-year period is quite low.



Portfolio Management

Although we remain relatively optimistic about the current market levels and what lies ahead over the next 12-18 months, it is important to keep your portfolio in line with your acceptable equity to fixed income ratio. The equity growth over the last 12 months has been substantial and it is important to review and rebalance your allocation at least annually. The market will continue to be volatile and corrections will routinely occur. Clients of GFM have seen numerous transactions over the last few months as we have continued to diversify our holdings.

A global real estate position was added in mid-December to increase diversification and it has already appreciated more than 10% this year. After an incredible run in our high yield bond funds that

¹ Source: Calamos Advisors LLC

² Source: Federated Investors

we purchased in May of 2009, we recently decided to cut the position in half. These funds were used to purchase a new global bond fund on the fixed income side of the portfolio just weeks ago.

The equity side of the portfolio saw impressive returns in 2009 as well. The 18-month JP Morgan S&P Expander note that we purchased when the S&P 500 was at 938, matures on April 22, 2010. We are happy to say that with only a week left, it looks like we will max out on this note and realize a 42% return. The Investment Committee has decided that half of this money will remain in domestic large-cap value with the other half adding to our global real estate position and a new International core equity fund.

Financial Planning

We recently received an alert from the Allen County Recorder's Office that we thought we would pass along.

According to the FBI, Property and Mortgage fraud is the fastest growing white-collar crime in the United States. Unfortunately, it has become all too easy for a criminal to record a fraudulent deed, making it appear as if they own your home. Once this step is complete, they can use your home as collateral on a mortgage or even attempt to sell your home to an unsuspecting buyer.

Although this type of crime is rare in Indiana, it is on the rise nationwide. The Allen County Recorder's Office has taken a proactive step to provide you with one tool for staying ahead of criminals who prey on property owners.

*[Property Fraud Alert](#) is an internet-based system that automatically alerts you via email or phone, each time a document that includes your name is recorded in the **Allen County (Indiana) Recorder's Office**. Here is the best part...The service is **free**. No strings attached. Over 7,500 of your neighbors in Allen County are already taking advantage of this service. You can be next!*

Here is the web address to sign up: <http://www.propertyfraudalert.com/allenin/>

Employee Spotlight

We have had some employee changes in the first quarter of 2010. After two years of excellent work for our firm, Kyle Galecki recently got engaged and moved to Indianapolis to be closer to his fiancée. He has already accepted a new job in Indianapolis. Not only will we miss Kyle's work and tremendous personality, we know that our clients will miss him as well.

To help fill the void, we have recently hired Kristine Letz. Kris will be working on special projects in the asset management and financial planning departments. We will have a more detailed look at Kris in our next newsletter. Meanwhile, we are very excited to have her on board.

- Galecki Financial Management Investment Committee