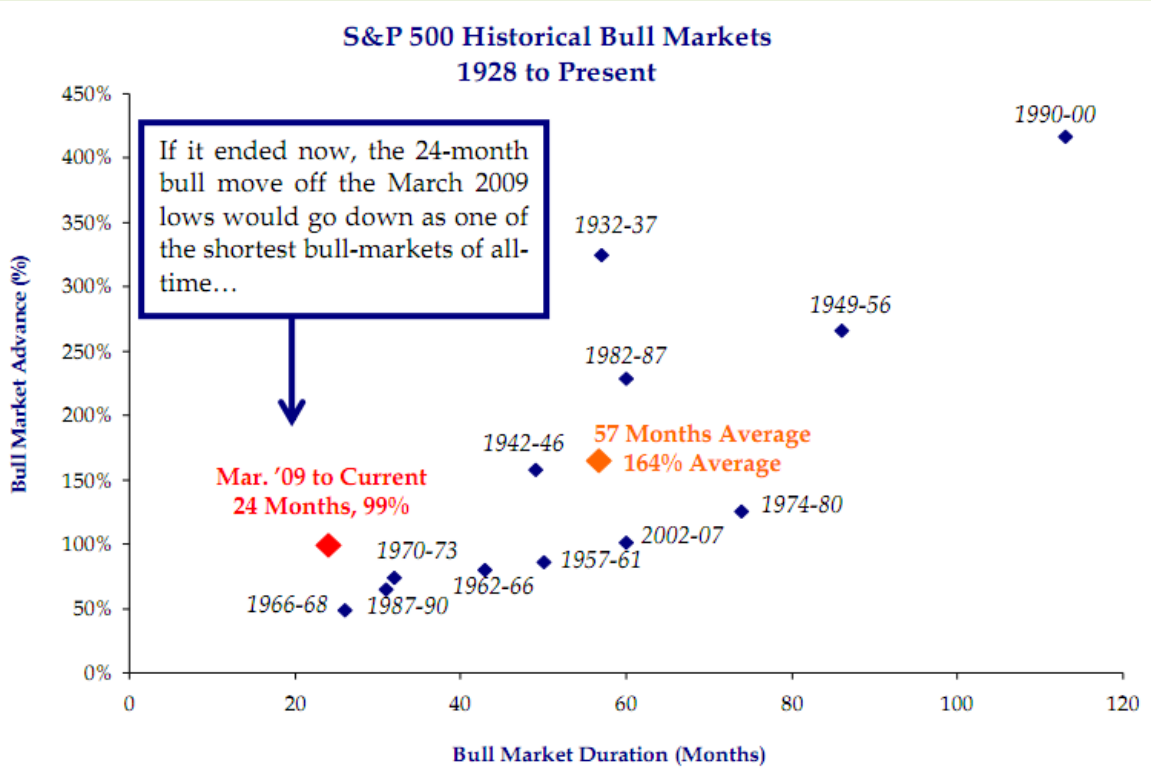
Markets Trends: Bullish, But How Long?

Mar 19th, 2011

Dear friends,

Some of you have recently asked for our opinion on the financial markets and trends. Let me present here our view.

Below is a chart that represents the historical bull market advancement periods with the y-axis representing the percentage advance and the x-axis representing the length of period for which, the advancement sustained.

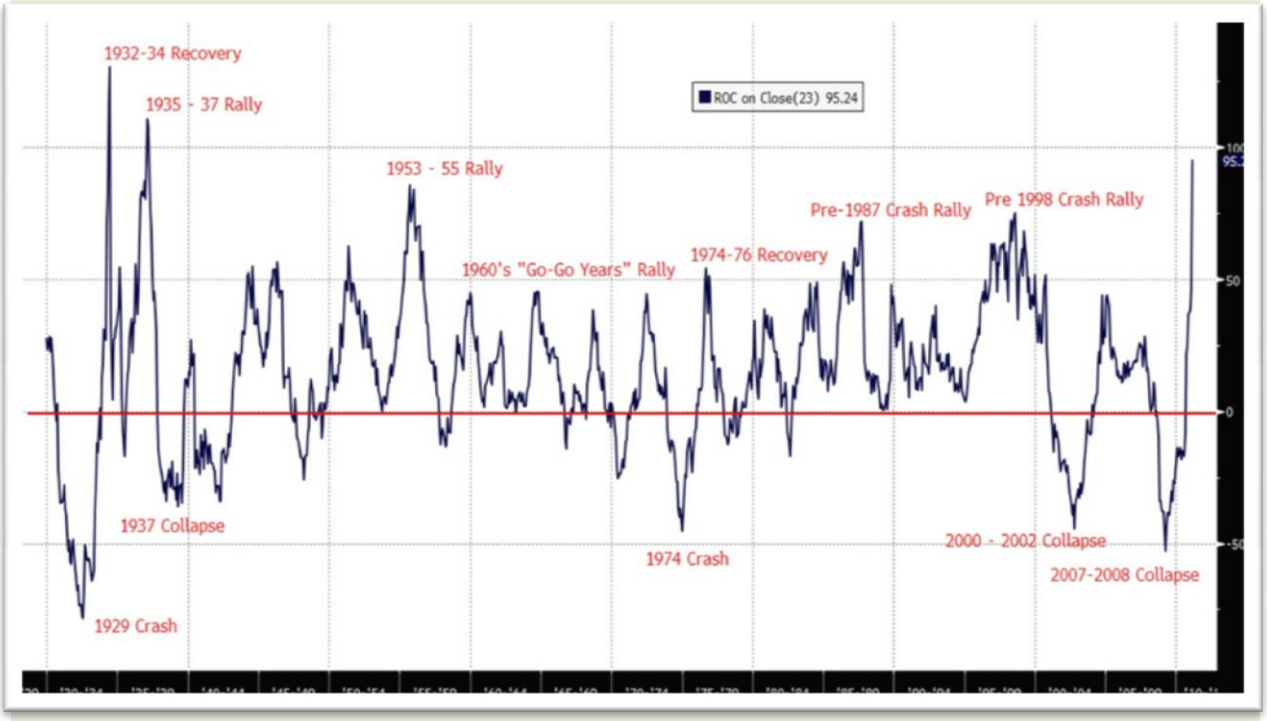


Source: Strategas

- *As you can see on the chart above, the S&P 500 has almost doubled since its bottom on March 9th, 2009.*
- *Also note that the average bull market lasts 57 months with a 164% average increase.*

Here is another chart:

The chart below shows the 23-month Percentage Rate of Change (RoC) in the S&P500 index across time (as of February 9th 2011).



Source:Sincereco

- *24 months ago, the SPX index bottomed on March 9th 2009, a closing basis at 676.53.*
- *The S&P 500 index (SPX) has increased by over 90+% since.*
- *The current rally represents the 3rd greatest percentage gain for any 23 month period in the index's history (as of 02/2011), with the gain standing at 90+%. It was preceded by the 2nd worst 23 month drawdown, only bettered by the 1929 – 1932 crash and the index is still actually lower than it was 46 months ago (it closed at 1444.61 on April 9th 2007), meaning that this drawdown is yet to be fully repaired, while both corporate earnings and outlooks are much healthier at present.*

Here are some thoughts:

Bull View:	The market should continue to rise in the next couple of years due to good valuation vs. bonds/cash, the market has a free cash flow yield close to 7%, which is the highest in history and balance sheets and has never been better. Furthermore, confidence, consumer spending, hiring, and the availability of credit are increasing and equity funds would see inflows.
Bear View:	Structural issues in our economy like debt, unemployment, real estate prices would most likely persist. Rising oil and commodity prices may be due in part by the additional liquidity provided by the quantitative easing 2 of the Federal Reserve.
Overall View:	As a believer in reversion to the mean, we think that the next decade should be a positive one for stocks though return opportunities are not what they were two years ago. For the next three to five years, returns on an annualized basis may not be as good as the last two years. There will be corrections which should create opportunities to increase our equities exposure. So while we think that returns will remain positive, volatility will be present.

Japan Disaster Thoughts

First, we offer our most heartfelt condolences to all those who lost their lives, to their families, and to all those now in unbearable circumstances. Placing numerical values on the economic losses is an intolerable insult to all those who lost their lives and to their families and relatives, and is morally indefensible.

- **Uncertainty** is the operative word in Japan, but as we take a step back and think about the broader economic impact, it's worth noting that this natural disaster is happening at a time when the **U.S. data looks solid** (good valuation vs. bonds/cash, the market has a free cash flow yield close to 7%, among the highest in history, and balance sheets have never been better, confidence, consumer spending, hiring, and the availability of credit are increasing, and equity funds see inflows).

- Here is a summary table of the markets movement from last Friday March 11th to March 16th:

Closing Price	11-Mar	16-Mar	Variation
MSCI Japan	4,681.64	4,288.94	**-8.39%**
MSCI World	4,425.87	4,241.80	-4.16%
S&P 500	1,304.28	1,256.88	**-3.63%**
MSCI Europe	1,483.83	1,410.87	-4.92%

- The Yen at one point had strengthened to post WW II high but has started to weaken on speculation the G7 will intervene.

- It is very difficult to quantify the long term impact of the Japanese disasters at this stage. Hence **we should not make any formal changes to portfolios at this point**. The portfolio managers of the international funds you may be invested in, are making changes in the funds if they believe they are necessary.

- We recognize that there may be extensive electricity supply disruptions that could lead to a 0.5 percentage point fall in Japanese GDP this year, cutting growth from 1.4 per cent to 0.9 per cent (HSBC forecasts). In a bad scenario, there may be a broader radiation contamination, affecting the Tokyo metropolitan area. This scenario could cut GDP by 1 percentage point this year. We may see lower production due to damage to factories, weaker economic growth because of electricity supply shortages, deteriorating consumer and business sentiment leading to slower consumer spending and capital investment, blackouts in the coming weeks.

- Some fund managers are spotting buying opportunities. Chuck de Lardemelle says the roughly $9 billion in the International Value Advisors Worldwide Fund he co-manages currently has a 14% exposure to Japanese equities. "Parts of an already cheap market may have gotten cheaper," he says.

- Japan today accounts for a smaller share of the global economy than at any time since the 1970s – 5.8%, compared to 7.5% a decade ago and more than 9% in the early 1990s (Source: IMF, WSJ).

- US send 7% of exported goods and services to Japan (one-fifth as much as European Union exports). The entirety of American exports to Japan account for less than 1% of the total U.S. economy. (Source: U.S. Department of Commerce, WSJ)

- Japan's stock market, which twenty years ago was the most valuable in the world, today accounts for a smaller share of global equity values than at any time in decades. On the eve of the Kobe earthquake in 1995, it accounted for nearly 30% of world stock market values. Today? Just 7.5%. (Source: WSJ)

- It may be more of a human story than a big economic story (like 1929-1945-1973-1987-2001-2008…).

Feel free to contact us if you have any questions regarding the contents of this newsletter.

PS: Please find below a link for a video on the surprising truth about what motivates us

http://www.youtube.com/watch?v=u6XAPnuFjJc

Sincerely,

Patrick Bourbon, CFA

Bourbon Financial Management, LLC
Excellence. Experience. Ethics.
616 W. Fulton St., Suite 411, Chicago, IL 60661
+1 312 - 909 - 6539 - Patrick@BourbonFM.com
www.bourbonfm.com
www.linkedin.com/in/patrickbourbon

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