Marathon
Investment
Management

April 28, 2010

Dear Friends,

First Quarter and a Third

By now you have received and have had a chance to review your performance reports as well as the brief summary of the first quarter 2010. In this report I would like to provide a more in-depth review of the quarter as well as an up-to-date synopsis of the markets along with some current issues. Lastly, as we provided in the year-end letter, we will attempt to offer some possible questions of interest to you with answers that we feel are appropriate.

1st Quarter 2010

The first quarter of 2010 was a continuation of the "bull market" recovery of March 2009 through year-end. Most noteworthy was the Dow Jones Industrial Average (DJIA) closing above 11,000 Monday, April 12, 2010, for the first time since September 26, 2008[1]. This continuing trend of what we have called a "tortoise" rally resumed after a steep February sell-off. The Standard & Poors 500 (S&P 500) gained 6.19% in March to end the first quarter up 4.9%. All indices posted gains in the first quarter with the small-cap Russell 2000 in the lead, up 8.5%[2]. Please refer to the following table[3]:

Index	First Quarter 2010	3-Year Annualized Return
Dow Jones Industrial Average (DJIA)	4.1%	-4.2%
Total Stock Market (Wilshire 5000)	5.8%	-5.5%
NASDAQ Composite	5.7%	-0.3%
Standard and Poors 500 (S&P 500)	4.9%	-6.3%
Russell 2000	8.5%	-5.4%
Europe, Asia and Far East (EAFE),	0.2%	
Crude Oil @ $83.76/barrel	0.2%	
Natural Gas @ $3.869/mmt	-30.56%	
Gold @ $1,113.30/troy oz.	1.65%	

For the first quarter 2010 the following are the strongest returns in U.S. dollars of international indices:

Country	Return
Sweden	8.3%
Israel	7.3%
Venezuela	5.9%
Belgium	5.4%
Japan	5.2%
Switzerland	5.0%

The weakest markets (in U.S. dollars) in the first quarter included:

Country	Return
Spain	-9.0%
China	-5.1%
Taiwan	-3.3%
Hong Kong	-2.9%
Italy	-1.7%

Part of the weakness in the Chinese and related markets were due to Bejing's first steps to reverse its economic stimulus programs. European market weakness, especially in the "PIGS" nations (Portugal, Ireland, Greece and Spain), is the reaction to the beginning of the budget deficit crisis which has been more pronounced in April.

The best and worst U.S. stock sectors for the quarter were as follows[4]:

Best Performing Industry Groups		Worst Performing Industry Groups	
Consumer Electronics	30.3%	Renewable Energy Equipment	-13.0%
Automobiles	23.5%	Alternative Electricity	-12.8%
Recreational Services	23.3%	Farming & Fishing	-12.2%
Life Insurance	22.8%	Aluminum	-11.7%
Hotels	22.6%	Tires	-7.9%

For the bond market, the biggest "unknown" is how and when the U.S. government will wean markets from the financial support injected into the economy over the past year. In other words, when will the Federal Reserve begin to push interest rates higher.

As of April 1 Smart Money reported the following regarding Treasuries[5,6]:

Investment	Rate
3-month T Bill	.15%
6-month T Bill	.23%
2-year T Note	1.04%
5-year T Note	2.57%
10-year T Bond	3.85%
30-year T Bond	4.74%
6-month CD (insured)	.25%
1-year CD (insured)	.44%
5-year CD (insured)	1.99%

As of April 26 further positive returns include[7]:

Index	Value	Year-to-Date Return
DJIA	11,204	7.4%
Total Stock Market	12,945	10.9%
Nasdaq Composite	2,530	11.5%
S&P 500	1,217	9.2%
Russell 2000	741	18.6%
EAFE	1580	-.01%
Crude Oil	$85.15/bl	7.26%
Natural Gas	4.257/mmbtn	-23.6%
Gold	$1,153.10/Tr. Oz	5.29%

This is the highest close for the DJIA since September 19, 2008. On Friday April 23, the DJIA marked its eighth consecutive positive weekly return – the longest weekly winning streak since January 2004[8]. The NASDAQ Composite closed at 2,530, its highest closed since June 5, 2008[9]. And lastly, the S&P 500 closed at 1,217 marking its highest point since September 19, 2008[10].

Current Events

With 172 of the S&P 500 companies reporting, 83% have beaten earnings expectations, a record pace, according to Thomson Rueters[11]. Typically 61% of firms beat consensus forecasts. S&P 500 earnings are on track for a 50% gain for the first quarter 2010 versus 2009. Most profit gains in recent quarters came from aggressive cost-cutting. That trend is continuing but we are seeing lean firms with growing revenue appearing as well.

New-home sales jumped 27% in March to a seasonally adjusted annual rate of 411,000 according to the Census Bureau[12]. A Wall Street Journal article pointed out that there was a rush to qualify for a federal tax credit which may have moved some sales forward that otherwise would have occurred later in the year. There are reports that home builders have noted growing interest and demand in new-home developments. As mentioned in our year-end letter, strong demand from real estate investors for foreclosed homes along with an improving economy helps stabilize prices.

Also reported for March, the Federal Reserve reported that manufacturing output surged by 0.9%; led by gains in durable goods such as vehicles, furniture and appliances[13]. There are growing expectations that the manufacturing sector will lead the recovery by raising output and hiring workers. At 73.2% of capacity, U.S. industry is still operating well below normal averages[14].

The Commerce Department reported that retail sales rose more than expected in March, while consumer prices were little changed. The report said sales at clothing, electronics, and other stores climbed 1.6% while Wall Street analysts expected a 1.2% gain[15]. Sales climbed 7.6% versus a year ago, the biggest jump in more than four years[16]. In line with expectations, consumer prices rose just 0.1% in March while core prices, which exclude energy and food, were flat according to the Labor Department.

The most recent jobless claims report was also hopeful and positive for the market. The Labor Department reported April 22 that the number of people filling an initial claim for unemployment benefits declined by 24,000 for the second week in April. Initial claims are essentially unchanged for January but are down 27% from a year ago[17].

The most recent Gallup Job Creation Index estimates that more than 1.5 million Americans who were underemployed became employed to full capacity during March. Gallup's 30-day average underemployment measure declined to 19.2% on April 18 – an improvement from the 20.2% reported on March 21[18]. One benefit of more Americans having full-time work is they have more money to spend. The Gallup report showed that spending increased 15% for the second week of April over the same period a year ago.

A Few Questions and Answers

Q: George, the S&P 500 is at 1,576 as of April 23, up 82.7% from its March 6, 2009 low of 666. Why?

A: In a nutshell the major factors as we see them are:

1. An accommodative Federal Reserve that has kept interest rates exceptionally low;
2. Inflation has been tame;
3. Economic reports have been improving;
4. Earnings reports are recovering, as mentioned earlier;
5. Corporations have been accumulating cash that will eventually be employed towards capital investment and employment;
6. Merger and acquisition activity is increasing, i.e. Qwest and Century Telephone, etc.;
7. The growth and significance of trade with emerging markets, which now make up 35% of global gross domestic product (GDP) – this includes Latin America, Eastern Europe, India and of course the "Tiger" countries such as South Korea, Taiwan, Vietnam, etc.;
8. Consumer confidence is recovering, and
9. Most important, the natural dynamics of the entrepreneurial free enterprise system, which is why we show clients the annual Ibbotson mountain charts of gradual market appreciation over time (which shows a 9.8% per year return from 1920-2009).

Q: George, what are your client concerns going forward?

A: Trying to be brief, there are two primary concerns:

1. Iran and the proliferation of nuclear weaponry;
2. National (and global) debt along with avoidance of the growing unfunded liabilities of social security, Medicare, and Medicaid. We must, along with our Western trading partners, learn from the current Greek debt crisis where their debt is now 113% of their GDP. The U.S. debt is currently about 63% of our GDP – a postwar record. According to the New York Times, the Congressional Budget Office stated this year the social security system will pay out more in benefits than it receives in payroll taxes[19]. There is a potential "bond bubble" here – between deteriorating credit quality, mounting debt, and possible inflation.

Q: George, regarding income investing, what are the best opportunities?
A: I would limit exposure to long-term bonds. For fixed income consider TIPS, high-grade municipal bonds, high-grade international corporate obligations, and dividend paying stocks – domestic and foreign. Also for some clients, income Master Limited Partnerships and trusts based on essential commodities may be appropriate.

Q: George, for growth, what are the best investments?
A: We have been investing in the markets – both domestic and international – throughout the recovery – as well as during the crash. Caution and flexibility are key. Perhaps U.S. stocks may be the best opportunities. Our GDP should rise by 3.4% this year while Japan's economy is expected to grow 2.3%. Western Europe is expected to grow by just 1.6%[20]. China, India and the "Tiger" countries are applying the fiscal and monetary brakes to slow inflation. Have you been watching Warren Buffet and his acquisitions lately?

We remain cautiously upbeat, but continue to monitor the markets' P/E, and other value ratios which are still increasing. Again, being both flexible and alert in approach is our focus here. We are also watching for changes in tax policy that will affect economic growth.

We wish you, our client, a wonderful Spring and early Summer. We are here answer your questions, address you concerns, and maximize your investment gains!

Best regards,

George Gumbiner
President

Footnotes:
1. Wall Street Journal, Dow Brake Through 11,000, 4/13/10, page A1
2. No Load Fund X, Markets – Best 1st Quarter Since 1999, page 1
3. Wall Street Journal, Stocks, Currencies and Commodities, page C4
4. Wall Street Journal, Best and Worst U.S. Stock Sectors, 4/1/10, page C10
5. www.smartmoney.com, April 1, 2010
6. Value Line Selection and Opinion, April 9, 2010, page 2953
7. Wall Street Journal, Stocks, Currencies and Commodities, April 26, 2010, page C4
8. Wall Street Journal, Blue Chips Hit 17-Month High, 4/24/10, page B2

[9.] ibid
[10.] ibid
[11.] Investors Business Daily, Story Q1 Earnings Trouncing Forcasts, 4/28/10, page A1
[12.] Wall Street Journal, Tax Credit Lifts New-Home Sales 27%, 4/24/10, page A5
[13.] Wall Street Journal, Factory Output Surged, 4/16/10, page A2
[14.] ibid
[15.] Investors Business Daily, Fed and Economy Mending in Most of U.S., 4/15/10, page A1
[16.] ibid
[17.] www.marketwatch.com, Jobless Claims Fall 24,000 to 456,000, 4/22/10
[18.] www.gallup.com, Gallup Tracking Shows Signs of Economic Improvement, 4/22/10
[19.] www.nytimes.com, Social Security to See Payout Exceed Pay-In This Year, 3/26/10
[20.] Denver Post, For Now, U.S. Stocks May Be the Best Bargains, 3/14/10, page A1