

AFC ADVISORY CORPORATION

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THIRD QUARTER REPORT

TRUST AND FEAR

More than just the equity or bond markets, the very foundation of our economy is built upon a single word; trust. We, the American people trust the banks will handle their business wisely, make prudent loans and keep our financial system running smoothly and evenly. We trust the issuers of bonds, whether they be corporations, state, local or Federal government to pay the interest they have promised. We trust our government at all levels to regulate business enough to keep it stable but not to over regulate and stifle growth. We also trust the government to tax us enough to provide basic services but not to tax us into national poverty. Trust of business, the financial system, government and each other is what has kept our economy moving forward with very few hesitations for almost 70 years.

In many respects, fear is the lack of trust. During the Great Depression there was a significant amount of cash in the hands of both the citizenry and business, but too many people did not want to spend out of fear the bad

economy might cast them out of work, leaving them without savings. Many banks resisted loaning money out of fear the bad economy might prevent their borrowers from paying the loans back. Many bank runs were born of self-fulfilling prophecies when fear of not being able to get one's money would turn a solvent bank into a ruined husk in a matter of hours. Fear there might be another stock market crash prevented many from investing in the markets, thus denying business much needed capital, which in turn stifled economic growth. Many economists now believe that the Federal Government, fearing the potential of a worsening economy, over-regulated, sapping much needed resources from the private sector that could have led the nation out of the Depression much earlier than 1940 - 41.

The economic environment we are now navigating through, while not nearly as severe as that of the Great Depression, has many of the same fear driven traits. As we have discussed in previous writings, by late 2007 and early 2008, many leading economic indicators were pointing towards recession. It wasn't, however, until the demise of Lehman Brothers and the unraveling of several other financial giants last Fall began what has been termed a "Jump Condition" where rather than moving down hill, the economy went off a sudden and unexpected cliff, landing in a significantly altered and unanticipated state.

TECHNICALLY SPEAKING

On a consistent basis, we review all of our positions from both a top down (overall allocation) and bottom up (quality of the individual holding) basis. After rebalancing late first quarter, there have been no further trades and while we have not added any new sectors, we are keeping close watch on more than one.

MAJOR MARKET INDICES NINE MONTHS ENDING 9/30/09

- S&P 500 + 17.03%
- Russell 2000 + 20.99%
- NASDAQ Composite +34.58%

* An index is a portfolio of specific securities (common examples are the S&P 500, NASDAQ, Russell) the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged portfolios and investors cannot invest directly in an index. Past performance is not indicative of future results.

ECONOMIC INDICATORS

- Gross Domestic Product for 2nd quarter 2009 - <.7%>
- 3rd Quarter 2009 Job Growth:
 - July <304,000>
 - Aug <201,000>
 - Sept <263,000>
- 3rd Quarter 2009 Unemployment
 - July 9.4%
 - August 9.7%
 - September 9.8%
- Average Hourly Earnings
 - July + \$.05
 - Aug + \$.07
 - Sept + \$.01

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@ Market returns obtained through Worden Brothers Telechart 2000.

@@ Economic data obtained through the: US Department of Labor (Bureau of Labor Statistics), the US Department of Commerce (Bureau of Economic Analysis) the Federal Reserve Bank of New York, and Conference Board.

** Rebalancing investments may cause investor to incur transaction costs and, when rebalancing a non-retirement account, taxable events will be created that may increase your tax liability. Rebalancing a portfolio cannot assure a profit or protect against a loss in any given market environment.

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TRUST AND FEAR

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As a result, economic models used for forecasting have been thrown askew. When the stimulus was passed in February, based upon history the Federal Government estimated unemployment would top out near 8%. As of this writing, it has since risen to 10.2%, only the second time it has reached double digits since WWII. Jobs are a lagging indicator, and as we discussed in previous writings, we could see a recovering economy with increasing joblessness. This is typically because business only adds to staff once they see the economy improve through decreasing inventory and increasing orders for new goods. We have reached 22 consecutive months of job losses. While it is true the number of losses has slowed since the February high, some research suggests that the slowing is a result of business reaching a point where it has already cut to the bone. Excess jobs of the boom economy were shed first, and the jobs being lost now are more core, while many are the result of entire businesses simply closing their doors. As the economy begins to turn around, we may face the spectre of a jobless recovery. Part of it is fear, part may be hidden in a statistic.

At least prior to this era of bailouts, when the economy fell upon hard times, unlike the Federal Government, the private sector could not simply print money. As a result, there is often times fear the economy may either sink deeper into recession, or in the early stages of recovery, fear we might experience a double dip recession. As a result, business is slow to make new hires. Often, the first number that ticks up is productivity. This number measures the non-farm output per hour of the American worker, aka, Americans are working harder to produce more in the same amount of time. True to form,

productivity is increasing. Historically, job creation follows productivity increases because once the worker reaches capacity, in order to increase production, more people must be hired. However, we're facing something different this time around. The average number of hours worked has reached an all time recorded low at only 33 hours per week. In order to increase production, rather than hire, business may simply add to the hours of the average employee. As a result, we may see recovery without meaningful job creation.

Another issue that continues to fuel fear is the lack of available credit to both business and the consumer. Partly due to easily available credit, the Baby Boom for a time was spending, on average, 108% of income, which was obviously unsustainable long term. Foreclosures are still happening at a record pace, with Nevada leading the way, recording over 4% each quarter this year. Consumers and business both want to borrow, but without access to credit, they are afraid to spend. Massive new government programs being rapidly spun out of DC are causing uncertainty over taxes, and while government programs (such as Cash for Clunkers) may help short-term, they have yet to create lasting confidence. The pessimist may point to polls that indicate the American people have a lack of trust in both government and the economy. The optimist may look at the markets, a leading economic indicator, and point to this year's resurgent returns as a sign recovery is well under way. Fear or trust will determine whether the economy and markets retrench, or make a robust step up. We should know soon.

Sincerely,



Nick Markionni, CFP®, CFS, MBA
Executive Vice President