

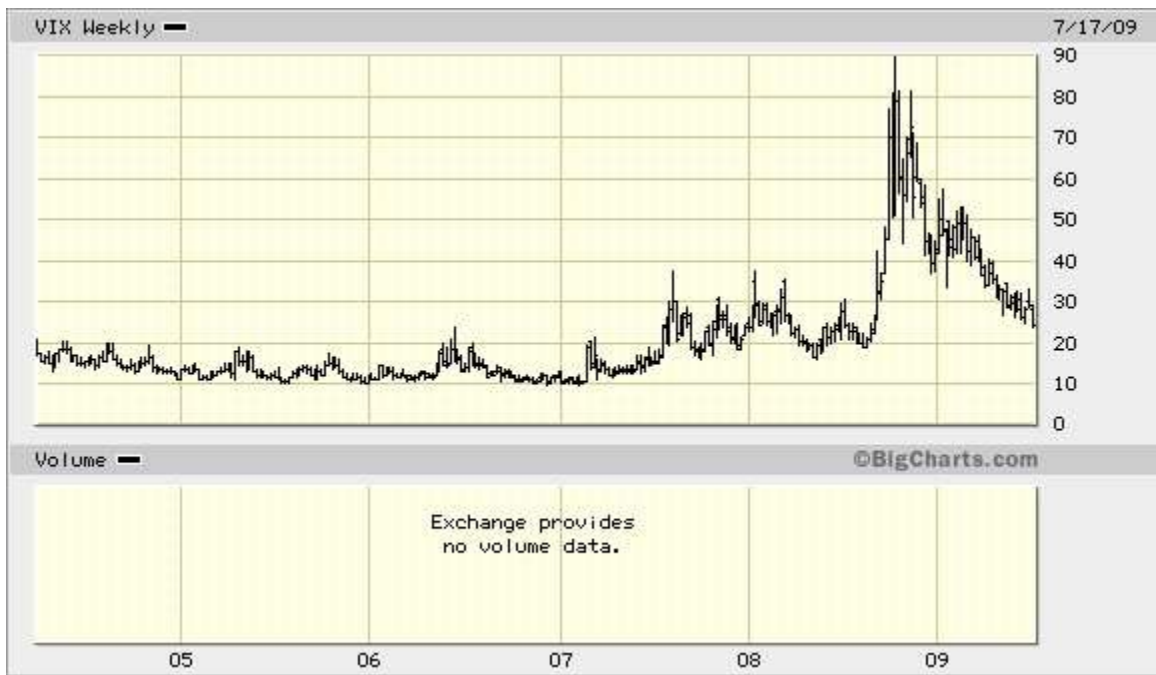
Schultz Financial Mgmt Corp - Investment Commentary Volume 9

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Dear Investors,

Since my last investment commentary on May 26th, stocks, bonds, and the US dollar have traded mostly sideways with stocks finishing this week near the higher end of its two and a half month trading range. This week stocks rallied, taking its queue from upbeat corporate earnings rather than proposed tax increases to fund health care reform. Crude oil and other commodities also bounced back a bit this week after selling off sharply in recent weeks.

The Volatility Index ("VIX"), a widely used gauge of stock market fear among investors has finally dropped below 25 and back within its normal historical range of 10-25 (see chart below). Reduced market volatility should encourage more investors to take cash off the sidelines and invest in stocks.



Current Market Perspective:

Stocks:

U.S. stocks experienced a tremendous three month rally off the lows hit March 9 to its recent high on June 11th. The move was largely a risk-seeking trade made by investors buying highly leveraged, or high-beta companies including bank stocks, commodity related stocks, industrials, and technology stocks in anticipation of an

economic recovery. However, after a loss of momentum, profit taking in those high-beta stocks pushed the S&P 500 down 7% through July 10th, ending the first wave of the new bull market which usually favors the most oversold stocks from the previous bear market.

This week, second quarter earning season kicked off with a bang as positive earning surprises from Goldman Sachs, Intel, and IBM propelled the market forward in high volume trading, signaling that a second wave of the new bull market may be under way. Historically, stocks with good price-to-earnings, price-to-book, and price-to-sales ratios perform better during this wave, which should make stock selection easier for us.

Signs of economic and financial recovery have emerged most prominently in Asia and more tentatively in Europe and the United States. Chinese manufacturing expanded in June for the fourth month in a row, and South Korean exports fell the least in eight months. Emerging Pacific countries including Taiwan, Korea, and China are currently leading the foreign stock markets higher.

Bonds:

Treasury bonds have moved mostly sideways over the last several weeks. Corporate bonds have gone from pricing in the possibility of depression last November to pricing in a bad recession. From a historical point of view, the excess yield in the high-yield and high-grade corporate bonds are still attractive relative to US treasury bonds or govt agency bonds (e.g, Fannie Maes). The most attractively priced bonds may be the California Municipal Bonds. The S&P California Municipal Bond ETF, an index basket of CA municipal bonds with a 13 year average weighted maturity has a current distribution yield of 5%.

Our Investment Styles:

Core - Dividend Income Stocks: Our core basket of twenty dividend income paying stocks is managed with the intention of staying fully invested throughout a full business cycle. Relative to the *Dow Jones Industrial Average*, we are overweight in financials, utilities, and consumer staples, and underweight industrials, technology, and energy stocks. The average annual dividend yield of our basket of stocks is 4.6%. Seven of our 20 holdings are foreign company stocks. The year-to-date return for this basket of stocks is approximately 1.5%, slightly ahead of our benchmark, the *Dow Jones Industrials Average*.

Trend Following Global ETFs: After having reduced our equity exposure in this basket to about 10% as most equity market ETFs slid into a downtrend in June, we now have increased our stock market exposure to about 65% in response to the renewed market up-trend. We are mostly invested in emerging pacific countries with the heaviest weights in Taiwan, China, and Korea. We continue to also hold about 25% in closed end bond funds and have an 8% position in a livestock ETF (e.g., cattle & hogs) which recently began a new up-trend after a lengthy decline, partly due to the swine flu scare. Our global basket of ETFs is up 19% year-to-date, compared to 12% for our benchmark, the *All Country World Index ("ACWI")*. The ACWI is a global stock market index that includes stocks of U.S., foreign developed and emerging market countries.

Trend Following Large Cap Stocks: In response to this week's resumed stock market up-trend we have increased our equity position from a 10% allocation to about 90%, with the balance invested in closed-end bond funds. In response to the quick surge in stock prices this week, we have added stocks with the market at generally higher levels from where we reduced our equity exposure during market weakness over the preceding month. This is an example of how a trend-following approach does not always work as well a buy-and-hold approach in sideways markets. Nevertheless, year-to-date, our basket of large cap stocks is still up over 11% year-to-date compared to 5.7% for the *S&P 500 Index*, our performance benchmark.

Trend Following Bonds: We remain fully invested in high yield corporate bond funds with yields currently in the 9% range. High yield bonds held strong, even as stocks declined from June 11 to July 10th. Our trend following bond investment style is up 19% year-to-date compared to 2.5% for our benchmark, the *Barclays Aggregate Bond Index*.

Our Current Outlook:

It is my opinion that that the long-term bear market is over. While a correction in this rally down to the 780-800 level in the S&P 500 index could still occur later this fall, I anticipate that the stock market should continue to climb higher through Labor Day as reduced market volatility should encourage more investors to take cash off the sidelines and invest in stocks.

High yield corporate bond funds have appreciated considerably, but are still attractive at these levels with yields near 9%. With respect to investment grade debt, short term corporate bonds yields have come down to the point where the shorter intermediate term paper (e.g., 5 year maturities) may provide better risk/reward opportunities. CA municipal bonds are attractive for long term investors who want to take a stab at making low bids for thinly traded bonds in the secondary market.

Please give me a call if you have questions or comments about this investment commentary or if you would like to discuss your investment allocations.

Sincerely,

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