Nestlerode & Loy inc
investment advisors

Research-based Solutions • Personal Attention

A report designed for those whose portfolio(s) are managed by Nestlerode & Loy, Inc.

April 2010

General Commentary

The recovery in the stock market and the economy continues. Bottoming in March of 2009, the Federal Government threw its entire weight into the fray to support the markets and the economy. While we have had a terrific rise in stock prices, the economy is grudgingly gaining ground and I believe has not yet reached a point I would characterize as independently sustainable. That would be an economic recovery that no longer requires government intervention. Still, the various stimulus programs are winding down (Federal Reserve monetizing mortgages and treasury offerings for one and the tax credit for home buyers which ends April 2010) and the economy doesn't appear to be turning down. That's the good news. On a more sober front, unemployment remains stubbornly high, banks continue to hold a lot of dubious paper of dubious value, more mortgage defaults are on the horizon and the housing market is bouncing along at very low levels of activity.

Retail sales, the big chunk of our economy (70% or so by recent numbers) was surprisingly robust in the month of March as consumers continue to pay down debt and save more of their income. How did they pull off this amazing feat in the face of falling household incomes? Apparently, government stimulus programs have assisted consumers with lower tax rates and home buyer tax credits. Government is running up its own deficits even as business and consumers reduce debt and save more.

Our corporate sector has gotten the message quite clearly. They have scaled back and squeezed costs out of their products and services (one reason why unemployment is stubbornly high) and are reporting great results (sales and profits) even as I write this report. However, there is a great divergence between large corporations and small business. Our large companies see the future as brighter and are more optimistic, while small businesses (about half of our GDP and who do most of the hiring in the economy) continue to be pessimistic, holding back hiring, borrowing and capital spending until top line sales demonstrate considerably more proof that the recovery is sustainable. Credit also continues to be a problem for small business as banks buy no-risk treasuries with interest-free money borrowed from the Federal Reserve. Low interest rates are not stimulating bank lending or small business borrowing at this point in the recovery.

The stock market continues to climb without interruption since last March as investors put most of their funds into bonds rather than stocks (by a ratio of four to one). The rally in stock prices has been characterized as a volume-less rally. To technicians, sustainable rallies in stock prices must be accompanied with expanding volume of shares traded indicating deep buying demand for stocks. Stocks in this rally have gone up in price on very low volume. Still every recovery in the economy and rally in stock prices is different in some ways from historical recoveries. Perhaps my caution is not justified. Yet I see three important problems coming later this year that might end the party for investors and the economy.

First, RBC, our clearing firm owned by the Royal Bank of Canada, believes that the Federal Reserve will start increasing interest rates by the fourth quarter of this year and continue boosting them through 2011 to a level of 3.5 to 3.75% (from the current level of 0 to .25%). In this environment, money market funds will return to paying something (as opposed to darn near nothing), and bond prices will decline as interest rates rise. Second, the Federal Government will continue to finance and refinance a tremendous level of debt. I heard it mentioned on CNBC that Warren Buffet can borrow money for lower rates than the U.S. Treasury, a sign that Uncle Sam is testing his borrowing limits. Third, tax rates are to rise substantially as the Bush tax cuts expire and the recently passed health care reform taxes start kicking in next January.

Can the economy build enough momentum to keep growing in the face of these developments? That is the $64,000 question (for those of you old enough to remember that quiz show).

I believe we are approaching a new "normal" of slower economic growth and heavier debt levels at the Federal level, while businesses and consumers continue to pay down debt and deleverage. In this reality retail sales increases will stall and stock prices will eventually reflect the economic stagnation that I believe is ahead for us.

Picking the right investments in this environment will be critically important.

For those of you who are interested, I have enclosed a copy of the <u>Market Navigator</u> published by the RBC Wealth Management Investment Committee.

Our corporate tagline, "Research-based Solutions – Personal Attention" is reflected in the economic and investment market research we do to get it right for you.

Performance

Despite our cautious approach to the markets, we posted positive returns for the first quarter. We are still lagging behind the Standard & Poor's 500 stock market average for the quarter, although we did rather well in comparison in January when the markets declined. We continue to invest more fully in the stock market, all the while poised to sell quickly should the markets start to decline.

Account Objective	First Quarter 2010 Performances
Aggressive Growth	3.95%
Growth	2.24%
Growth and Income	2.07%
Aggressive Income	5.25%
Income	3.16%
ETF Portfolios	0.78%
Charities and Non Profits	3.44%
Trusts	4.69%
Standard & Poors' 500	4.87%
Value Line Geometric Average	8.28%
All Managed Portfolios	2.39%

Portfolios have investments in stocks, mutual funds, bonds and municipal bonds depending on investment objectives and our clients' individual predilections and holdings prior to an account being managed by our firm.

Company Update

Judy Loy became the majority shareholder in the corporation on January 4th, completing a process that began over a decade ago. A part of the transition of the management of the firm, Judy became President and CEO a while back and now has the authority by share ownership to call the shots. This allows me to concentrate my time on my clients, my research of both the economy and the investment markets and writing this newsletter.

Jody Berthold will head to Philadelphia shortly to complete the first of two week long courses at the Wharton School, University of Pennsylvania, for financial compliance officers. Jody was selected from a large group of applicants to receive a full tuition award for her excellent work. This will keep us on our toes as far as compliance issues are concerned.

Judy Loy heads out shortly to RBC's biannual conference for correspondents in Minneapolis, Minnesota. Hopefully it will be warm there and she will learn a lot about what other firms are providing their clients in services and investment ideas.

The rest of us are staying at the office and getting the work done while the bosses are away.

Food for Thought

As a rather conservative Republican (although sometimes they don't seem to represent me very well) in a family with wide ranging political views, we have had some spirited discussions about the health care bill, financial reform and regulation and the climate change debate. The other day, one of my investment sources published the cost of the census in the United States since 1790. The census is prescribed by our founding documents so that we are appropriately represented in Congress. Government has never outsourced the job to private industry or taken the route of having the lowest bidder do the job.
My concern is that government has demonstrated that it is not up to the job of cost control. Indeed, some programs are best if not run with cost in mind, but as the government manages more and more of the private economy, cost containment through proper pricing becomes ever more important as opposed to rationing. While the census will never bankrupt us, because we only do it

once every ten years, it does provide an insight as to the problems with bureaucrats managing a program over the long term where no one has any interest in cost containment or pricing that regularly occurs in the private economy. Of course, part of the inflation in the cost of counting might be related to make-work projects. Even so, regardless of which party was in charge at the time of the census, it has always cost more in total and per person counted.

Census Year	Population (millions)	Cost $$$	Average Cost per person
1800	5.308	66,109	$ 0.01
1850	23.191	1,423,351	$ 0.06
1900	76.303	11,854,000	$ 0.16
1950	151.326	91,462,000	$ 0.60
2000	281.422	4,500,000,000	$15.99
2010	308.983	7,800,000,000	$25.24

Do you care to estimate what the 2050 census will cost the taxpayers?

Who We Are

Judy Loy	jloy@nestlerode.com
Jody Berthold	jberthold@nestlerode.com
Brian Anderson	banderson@nestlerode.com
Kelly Walker	kgreer@nestlerode.com
Danan Sharer	dsharer@nestlerode.com
Tiffany Smarsh	tsmarsh@nestlerode.com
and	
Dan Nestlerode	danielj@nestlerode.com

Nestlerode & Loy, Inc.
430 West Irvin Avenue
State College, Pa. 16801
www.nestlerode.com

(814) 238-6249 (800) 922-7492 toll free