



MPI

INVESTMENT MANAGEMENT, INC.

YEAR END REVIEW

2010

Dear Friends:

The U.S. economy began to right itself in 2010, the first year after the “Great Recession”, in spite of a nonexistent housing recovery and persistently high unemployment. Markets worldwide climbed a classic wall of worry that also included two sovereign debt disasters in Europe and a near constant threat of double dip recession in the United States. Stock markets around the world closed the year up 12.5% as measured by the Dow Jones Global Index. Stocks pushed higher for the second year following the financial crisis of 2008 and seem poised for continued gains in 2011. Historical efforts by central banks and governments around the world forced the recapitalization of banks and injected massive deficit spending, saving the world from a 1930’s style depression.

The year’s gains certainly were not without trials and tribulations. In March, a 2700 page health care legislation bill was signed into law and in April, the Gulf Coast experienced the worst oil spill in US History from a BP offshore oil accident. In May, the European Union and the International Monetary Fund had to save Greece from bankruptcy with a \$140 billion bailout package. Investors were ready to throw in the towel by July when the markets hit the low for the year at 9,686 down 13.6% from the April high. In late August Fed Chairman Bernanke made a reference to a possible second round of quantitative easing pushing the equity markets higher and in November the bond market began to sell off. U.S. stocks advanced 10.4% in September proving to be the best performing September since 1939. November ushered in the biggest upset election in decades giving the Republicans control of Congress and long term mortgage rates hit an all time low of 4.17%. The Fed formally announced a \$600 billion dollar second round of economic stimulus in the form of an 8 month government bond buying program. The stock market continued higher and the bond market sold off. In December, the Obama administration negotiated a compromise with the new Republican Congress and signed a bill extending Bush era tax cuts for 2 more years. The DJIA and the S&P moved up over 5% for the month and the markets ended the year up 20% from the July lows. The S&P 500 closed at 1257.88 rising 14.82% for the year, the DJIA closed at 11,557 up 11% and the Nasdaq composite closed at 2662.98 up 18% for 2010. The dollar index inched up 1.5% primarily due to the “flight to safety” influence of the European financial woes and the Dow Jones/UBS Commodity Index was up 16.8%.

The fixed income markets finished 2010 with positive returns across all maturities and asset classes, but not without significant volatility. Rising Treasury rates in the fourth quarter punished both the government and municipal markets. On average, both markets gave back over 4% of their 2010 gains in the 4th quarter. The long maturity municipal market was hit hard declining over 7%. A nearly 2 year massive net inflow of dollars into bonds funds was reversed and the last seven weeks of the year investors fled to the sell window. Treasury yields finished the year significantly higher from the summer lows but still lower than the beginning of the year. The U.S. 10 year benchmark Treasury advanced in yield 78 basis points in the fourth quarter to 3.29% but still yielded less than the 3.84 % on 1-1-2010. The \$2.8 trillion municipal market finished the year with yields at 18 month highs, giving back much of their 2010 gains. Volatility was most severe in the

longer maturities which were driven down by higher U.S. Treasury rates and the end of the popular municipal Build America Bond (BABS) Government subsidy program which expired December 31st.

MPI managed fixed income accounts, both taxable and tax free, had positive returns for the year. Average maturities are in the 2-5 year range depending on individual portfolio requirements. Taxable portfolios continue to underweight straight Treasuries and had concentrations in Agency Mortgage Backs and TIP's. Tax free municipal portfolios continue to emphasize high quality general obligation and essential service issues. The short durations in portfolios produced competitive returns and provided a welcomed level of lower volatility in municipal portfolios during the difficult 4th quarter. The average MPI fixed income account in 2010 finished ahead of its performance benchmark. On three occasions during the year; in March, September and November, MPI published papers that cautioned investors against high interest rates and a possible bubble in fixed income bond funds. These concerns all played out at year end and MPI's conservative fixed income style paid dividends once again.

MPI equity portfolios enjoyed solid above market returns which was accomplished by diversified asset allocation that included small cap, international and natural resource components.

As we enter 2011 the markets will certainly face several headwinds. The housing recovery has stalled with the September home price number declining for the third month in a row. Home prices on average for 2010 will most likely finish flat or down slightly for the year. Homeowners, that owe more on their homes than what they are worth, now total 10.8 million or 22% of all mortgages outstanding. Over a million homes are in the foreclosure pipeline. The housing outlook for the year ahead is sideways at best.

Although the unemployment rate in December fell to its lowest point in 19 months and stands at 9.4% the current recovery rate is too slow to significantly improve the employment picture. Payrolls increased by 103,000 in December, a number well below expectations. At this rate it will take 70 months to regain the jobs lost in this recession.

The sovereign debt problems in Europe are still looming and the U.S. will hit its debt ceiling of \$14.3 trillion in late spring which most certainly will become another political quagmire. Interest rates are trending higher, inflation in developing countries is gaining momentum and municipalities will continue struggling to balance their budgets. All these factors will influence the 2011 markets.

On a positive note, according to Standard & Poors' chief investment strategist, since the 1930's Depression, the average bull market has averaged 45 months, which leaves the current market move a lot of upside. Also, since 1900, during the third year of a presidential administration the S&P 500 has averaged 11% growth. Asset allocation in MPI equity portfolios is well diversified and positioned for continued global growth in 2011.

In 2011 MPI fixed income portfolios will continue to be focused on the specter of future rising rates and durations will remain short and inside 5 years. Over the course of the next several months durations could even shorten if rising rate momentum increases. In the municipal arena, careful consideration will be given to security selection. The recent volatility has created opportunities but a high degree of due diligence is a must. As always, general obligation and essential service issues are preferred. MPI bond portfolios are structured to protect principal and walk up portfolio yield in a rising interest rate environment. MPI's focus on quality and active management of the short duration segment of the market continues to produce positive low risk returns.

As MPI enters its 25th year as an independent investment advisor Brad, Matt and I want to sincerely thank our clients and associates for helping make our company a success. We wish you a prosperous 2011 and please feel free to contact us at anytime.

Sincerely,

David W. Pequet, President/CEO