

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

June 3, 2009

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Are We In for a Double Dip Recession?

Last month and this, much talk and many articles have surfaced relating to the possibility that the US could face a double-dip recession. This concept evokes from me a simple question: When did we emerge from the recession that we are in?

The mere prospect fills me both with joy and optimism! Why? Before we can double-dip, wouldn't we have to first emerge? In order for one to assume the economy will double-dip, one would have to expect that emerging from the current recession is a given. You know what they say about those who assume...

Because stock markets have rallied from the mid-March lows, are we calling this a recovery? I don't know about you, but there seems to be so many different opinions espoused today that it must be hard for the average reader to understand what topic to be worried about. I've been studying this economic soap opera for a good many years now and it is almost a full-time effort to be able keep connecting the dots as to what seems most important and what is not.

Upon reading a sampling of articles each week, I try to gather enough info about the media's current momentum in an effort to determine how it might affect readers and the economy. Why do I do this? For me it all begins with consumer sentiment. When sentiment is in decline, businesses begin to feel a little pain. The worse consumer sentiment becomes, the worse the pain becomes and unemployment becomes a byproduct. In my mind, when sentiment improves, people begin to increase spending. When consumer spending begins to increase, businesses begin to see an increase in sales activity. When increased sales activity gathers momentum, we see an upward push in GDP. And when we see upward GDP momentum, we can expect unemployment to begin to decrease. The stock markets almost always to react positively with sentiment and upward momentum will continue upon seeing the progression of events just described.

For a more technical explanation of what I've articulated above, please read my February 2009 article "[Will Obama's \\$800 Billion Plan Stimulate](#)". When you read it, please pay particular attention to the concept of "velocity". It has everything to do with the importance of spending.

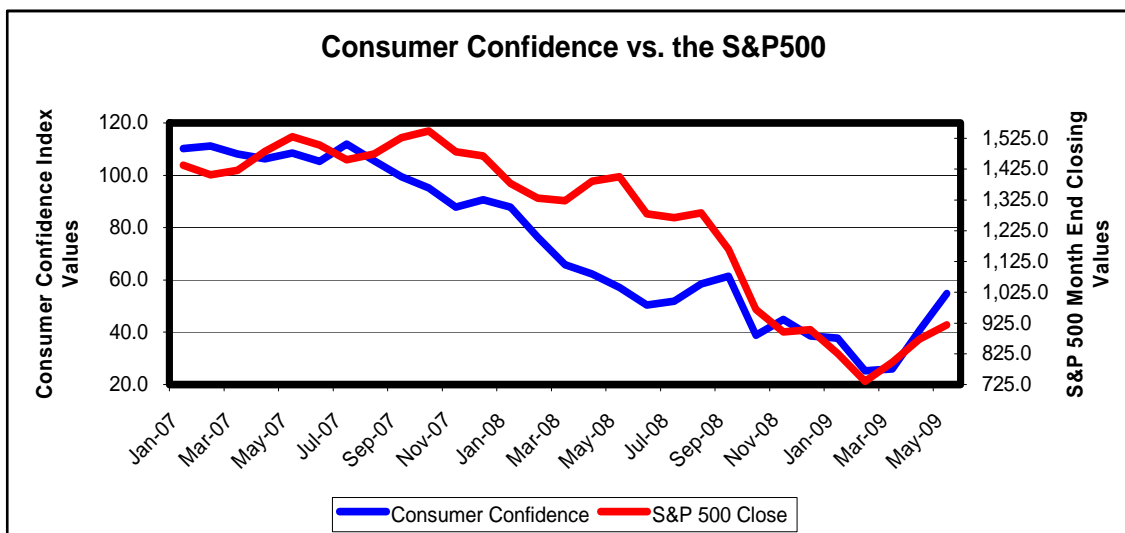
As we've only just begun to see consumer sentiment improve over these past couple of months, we may actually be on a path to recovery. I'm betting that the stock market's rebound had something to do with this. While it is commonly said that the stock market is a leading indicator of an economic recovery, it is a theory of mine that the stock market is more of catalyst than a predictor of recovery. When the stock market had sustained much of its gains from early April, it didn't take long to see some local lunch spots begin to fill up

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with lively celebrants. Now, we can only wait and see if positive sentiment will gather momentum.

Here's a chart of Consumer Confidence versus the S&P 500 since January 2007 to give you a sense of why I'm optimistic about a recovery:



Rather than suggest a double-dip recession, what might derail my hopes that we are beginning a recovery? Despite the claims of pundits, please don't think it would be due to "more job losses". Gentle reader, I want to suggest and reinforce that jobs are a lagging indicator and almost never a catalyst for recovery.

A couple of weeks ago, Barron's Gene Epstein wrote a very logical passage in his Economic Beat column about job creation in a recovery. In it, he wrote:

"Start with logic. When a recovery happens, business output stops contracting and starts to grow again. When this swing in output occurs, it is an unfortunate fact of life that additional hiring does not immediately follow. One key reason business is slow to rehire is that, during the period of downturn, it had been slow to fire. The present downturn has been no exception. As shocking as the recent layoffs have been, it still turns out that the contraction in output has been even greater.

So when this or any other recovery begins, business feels it has already hoarded enough labor to boost output without having to add workers right away. Besides, it probably hesitates to add labor before it is confident that the turnaround is real; that can wait until it truly sees the whites of the recovery's eyes."

If not due to job losses, what other significant factor might dash hopes for a recovery? The short answer is, not enough consumer spending.

Since last fall, the only segment of the US economy that increased spending was the US Government. And the spending out of Washington is at historically large levels; all under the guise that our elected officials are doing so to improve our economic conditions. But

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whose money are they spending? It is ours – the US taxpayer's money! The US Government has only one way to pay for its spending spree, by raising taxes.

You might ask, can't Washington just borrow money instead? Sure, they can borrow money! But that borrowed money will eventually have to be repaid with interest and those repayments will come from our tax dollars. So, they are borrowing against the future tax receipts they will collect from us.

Don't get me wrong. I'm not against Washington using the taxpayer's money to help stimulate the economy into recovery. However, it would be nice to get maximum impact for the money spent. And, I'm not sure we are getting our best bang for the buck!

Case in point. Last year, many taxpayers got a nice stimulus check that was supposed to encourage consumer spending and demand. Most taxpayer's took the checks and paid down debt. That outcome provided little help in reviving consumer demand.

On the other hand, another part of the US Government's economic stimulus plan provides an \$8,000 tax credit for new home buyers. In order to qualify for the credit, you (1) need to purchase your main home located in the USA after January 1, 2009, and before December 1, 2009; and, (2) you can not have owned any other main home during the 3-year period ending on the date of purchase. This kind of use it or lose it credit seems to make much more sense as it is tied to a consumer purchase.

Perhaps, Washington could create other additional tax incentives to stimulate consumer spending in other areas. Maybe incentives for purchasing US manufactured goods – like autos; or perhaps broader incentives promoting energy efficiency. Currently, the tax code provides modest incentives for improving the energy efficiency of existing homes. Maybe they could "beef-up" those credits.

In any event, let's not fixate on a double-dip recession until we get out of the one we're in. Unless, of course, we're worrying about a dip that might occur several years from now as a result of a government that has grown too big from too much of the wrong kind of spending!

Market Update

The stock markets have been reacting favorably to leading economic indicators that have ranged from slightly positive to very, like Consumer Confidence. We have yet to see any improvement in the jobs picture. Preliminary jobs data for May that came out this week reflected more than 500,000 jobs were lost last month. Yet the rate of job losses were less than for the month of April. Again, please consider that unemployment data is among the most lagging of indicators and we are normally well into an economic recovery before that trend reverses.

In today's letter from Weeden & Co.'s technical analyst, Steven Goldman, he reports: "...the S&P has been roughly tracking the trading pattern that existed in 1938. In 1938 after a gain of 36% over a nine week period, and 50% advance off their lows, stocks consolidated their gains for a couple of months. This time around the gains from the lows

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was under 40% which, as mentioned a few weeks ago, may suggest a consolidation phase though it may not be as long or as steep as in 1938. This time around after a nine week advance of roughly 38% the S&P consolidated for one month and experienced two 5% declines.” And in his summary, Goldman reflected: “The S&P moved above its 200 day moving average, a plus especially after a bear market decline. Overall, stock prices on an intermediate basis are still likely to continue to benefit from the momentum readings generated on the eighth week of the advance and the “normal” tendencies that follow before and after the end of the recession.”

During May, we noticed that our corporate bond positions were advancing while the market was experiencing one of the “5% declines” Goldman was writing about. We sold a small portion of our corporate bond holdings and redeployed some of that money into industrials. This was a direction we hinted at in last month’s letter and the timing worked out well as the industrials sector posted good gains by month’s end.

Our decision to move into stocks in the second half of March has worked out well. And our mix of stocks and corporate bonds has helped us outperform most broad market indices on a 3 month and year-to-date basis. As such, I am happy to report that – taken as a whole – our portfolios under management were UP 8.64% for the month of May. Here are some comparative numbers for you to review:

	May 2009	3 Month	Y-T-D	1 Year
ELF's ETF Strategy (net)	8.64%	32.80%	11.85%	-33.93%
S&P 500	5.31%	25.04%	1.76%	-34.36%
Russell 2000	2.88%	28.93%	0.43%	-32.97%
MSCI EAFE Index	11.09%	32.04%	6.46%	-38.60%
MSCI All County World	9.52%	31.80%	8.35%	-36.38%

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The ELF ETF Strategy returns presented herein represents a composite of actual results from all client portfolios managed by ELF. Currently, it is the only composite presented by ELF and separate client account portfolio positions are substantially similar, except as may be modified for retirement plan accounts and accounts with net equity of \$60,000 or less. There is no minimum account size for inclusion into ELF’s ETF Strategy composite and accounts with net equity of \$60,000 or less have a tendency to downwardly skew the combined results.

The performance data presented herein includes the reinvestment of dividends and capital gains; as well, ELF’s ETF Strategy composite returns are presented after deducting actual management fees, transaction costs or other expenses, if any. ELF charges an annual investment management fee as follows: 1.25% on the first \$250,000; 1.00% on the next \$750,000; 0.95% on the next \$4,000,000; and, 0.75% thereafter.

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