



GERALD L. RAY
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Investment Advisors

THE RAY REPORT

January 25, 2010

Earnings Leverage

The S&P 500 was up 26.5% in 2009, while the Russell 1000 Growth, NASDAQ and many foreign markets were up even more. The weak economy, high unemployment, endless talk of stimulus packages and health-care reform created a numbing backdrop where the Federal Reserve has been able to keep interest rates near zero percent without significant talk of overheating and inflation. The rally of 2009 seemed to signify, at least in the short-term, that investors could take the "Apocalypse" scenario off the table. Remember where we were at the end of 2008. AIG was gone, as was Fannie Mae and Freddie Mac. Bear Stearns' exit was followed by Merrill's rescue. Citigroup was on the ropes. Banks would not lend to each other, much less to anyone else. The financial system was on the verge of collapse or so it seemed.

Today, the story is different. There is very little consumer lending, but frankly banks have not been rewarded to take risks. The equity and debt markets are alive and the deal making of corporations is strategic, albeit slow. Real estate, jobs and lending issues remain, but the talk of recovery is what type and how strong, not if there will be one.

Markets continue to try to assess whether the rally has further to go. The bears look to the gains of last year, the known problems, an administration that looks increasingly

non-business friendly along with the specter of problems in commercial real estate.

There are, however, reasons for optimism and more importantly there is evidence to suggest that last year's rally can continue in 2010. While 4Q earnings have been okay, it is difficult to deny the enormous leverage at many companies. Small sales growth has resulted in outsized earnings gains especially in technology and industrial companies. Intel, Microsoft and others have shown that any sales growth is very profitable. While we do not believe significant sales growth is likely this year, companies have enormous earnings leverage should sales pick up in 2010. Earnings for this cycle just as in previous cycles, seems likely to rebound

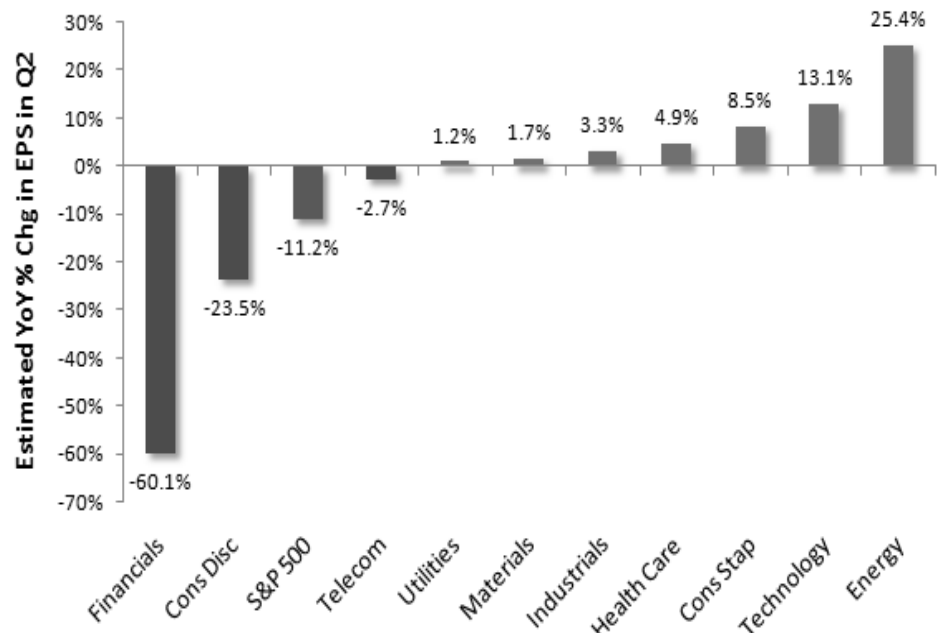
Market Performance For The December 2009 Quarterly Period	
<i>Dow Jones Industrials</i>	8.09%
<i>Standard & Poor's 500</i>	6.01%
<i>Russell 1000 Growth</i>	7.49%

more than Wall Street currently assumes.

There is of course risk to the earnings leverage story. The economy remains fragile. Unemployment remains high and unlike the previous recessions, fiscal policy remains unlikely to help a strapped consumer. Congress and the Administration seem to want to penalize the same financial institutions for not making the risky loans they made only two years earlier. Yet, earnings drive

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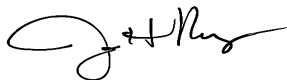
Expected 2nd Quarter YoY EPS Growth (%) for S&P 500 Sectors



Courtesy of: seekingalpha.com

stock prices and 2010 could end up being a positive surprise which could extend the rally longer than anyone expects.

Sincerely,



Joseph H. Ray,
President

The War on “Wall Street”

As I write this, President Obama who spent his first year on crusade to reform healthcare only to see it thwarted by a former state senator from Massachusetts has responded to that setback by vilifying the one industry he needs to really accelerate the recovery—the financial industry. In an effort to sound populist, President Obama proposes restraints on “Fat Cat Bankers” (his words). The only problem with this approach is that if the goal is to increase lending and provide capital for business, this rhetoric and the resulting regulations will do the opposite and cause lenders to entrench. What the Harvard educated populists of Washington fail to under-

stand is that a simple increase in reserve requirements and a reduction of permissible leverage ratios will do the same thing. Clearly, banks took advantage of permissible rules and help create the disasters of 2008-2009. That said, this seems like an unlikely way to move the economy forward and create jobs. Ultimately, job creation or the lack of, will determine who may be looking for work this November.

Exchange Traded Funds

Exchange traded funds, or ETF's are a low cost alternative to mutual funds. Exchange traded funds have proliferated in the last few years and are likely to surpass \$1 trillion by 2011. By comparison, mutual funds manage nearly \$10 trillion in assets. ETF's, which are generally more passively invested than a mutual fund also have expenses that are one third to one half less than the average fund. ETFs are diversified and can mimic an index like the S&P 500 or NASDAQ or can allow for diversified investment in a specific sector, commodity or international markets. The exponential growth in ETFs, as well as, the proliferation of vendors means that not all ETFs are

created equal. It is important to look at the composition of the assets inside the ETF, as well as its liquidity and size. If you are curious about ETFs and their role in your portfolio, please give us a call.

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Prompt Review of Gerald L. Ray & Associates, Ltd. Reports and Custodian Statements Advised

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This is a reminder to our clients to promptly review the reports and statements that they receive both from us and from the custodians of their assets. If you have authorized the payment of your advisory and/or bookkeeping fees directly from your custodian you should also review the copies of those invoices for completeness and accuracy. If a discrepancy, error or omission is found, please notify us immediately.

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The Ray Report is published and mailed to each client on a quarterly basis