January 2011

2010 . . . 2011

As we reflect on 2010, we are struck by the seeming disconnect between what people (experts, pundits, analysts and the like) thought would happen and what really happened, in the financial markets. A brief recap of the events of the year, and the results in the financial markets, is in order.

First, Congress passed sweeping legislation that, regardless of one's political views, was widely expected to dramatically affect the 1/6 of the U.S. economy that is driven by the healthcare industry. Next, the Deepwater Horizon oil platform tragedy, and the resulting oil spill, was expected to adversely affect the environment, and economies, of the gulf shore states for years, or even decades, to come. On top of that, some analysts questioned the viability of British Petroleum as a company due to the massive costs associated with the clean up, and just as damaging to the company, public relations gaffs.

In quick succession the rest of the year gave us:

- The nation of Greece coming incredibly close to defaulting on its bonds.
- Other European nations requiring bailouts of one sort or another.
- A historic shift in the balance of power in Congress.
- Continuously rising commodity prices (especially oil and food).
- Continued high unemployment (reported at 9.5%, but effectively closer to 16%)
- A weak and further weakening, housing market.
- North Korea firing on South Korea.
- And so on, and so on . . . .

All of this resulted in historically low inflation rates and bond yields, the S&P 500 stock index up 15.06%, intermediate Treasury bonds up 5.3%, long-term Treasury bonds up 9.4% (after falling 12.9% in 2009), and dramatic improvements in the balance sheets of both businesses and individuals.

How did the economy, both U.S. and worldwide, show such resilience during this year of turmoil? The first answer is globalization. As much of the developed world was struggling, emerging economies (including China and India) continued their exceptional growth and kept the worldwide engine of economic growth churning.

The second answer, and possibly the more important one, is government intervention. In addition to the European bailouts, the U.S. continued its policy of accommodation, both through maintaining low interest rates on what it can control, as well as direct stimulus programs such as Quantitative Easing Part 2 (QE II).

QE I, from December 2008 through March 2010, saw the Federal Reserve purchase $1.7 trillion of Treasury bonds. QE II is a commitment to purchase an addition $600 billion in Treasury bonds. The goal of the action is to keep longer-term rates low in order to stimulate economic activity, create jobs, and have the economy grow out of its current malaise.

If it works, great; we should see stronger economic growth, lower unemployment, and more long-term investments during 2011. If it doesn't, then what? Is there a QE III on the horizon? How would the U.S. pay for it? Are the emerging economies large enough to keep commerce flowing even as the developed nations stay in their economic funks?

We remain convinced that even during times of economic uncertainty, our long-held philosophy of conservative, security based analysis and investment is effective and efficient. We trust that you feel the same way.

Thank you for choosing Paragon as your investment management partner. As always, we are actively seeking new clients, so feel free to pass our names on to anyone who you feel might benefit from our services.

Regards,

Howard, Ward, Elizabeth, Ethel & Craig

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