

ASPERA REVIEW

Intelligent, Independent Investment Management

Fourth Quarter 2009 - Something Wicked This Way Comes

Aspera Financial, LLC is an independent registered investment advisor.

Aspera offers independent fee-only investment management and advisory services throughout the Triangle area and nationwide.

Every client portfolio is separately managed.

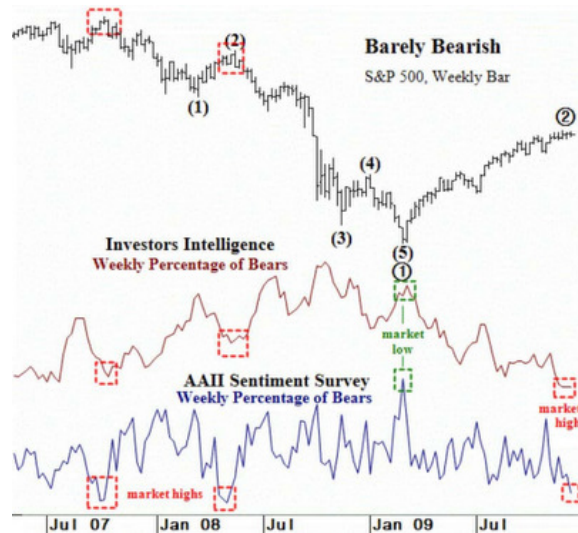
The securities and strategies discussed in this Bulletin may not apply to every client portfolio.

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If I ever need a vivid example of where my conviction lies when it comes to the equity and fixed income markets, I look at how I've positioned one relatively new and particularly aggressive "client." The available investment options in her account are limited to equity, fixed income, and balanced funds. There's no ability to buy individual securities, currencies, commodities, or gold, so the investment decision effectively boils down to how much exposure to the stock market she should have.

This client has a 17 year investment horizon and a very high risk tolerance. Technically, her risk tolerance is a little unclear since she opted to slowly and deliberately rip my Risk Questionnaire into strips and then giggle as she waved the strips over her head. Anecdotally, however, she's happy to dive head first off of the couch, eat Cheerios off of the floor, and try to bull ride her pet Chihuahua. If that doesn't qualify as "aggressive" then I don't know what does. Currently, her portfolio is 100% in cash.

So, although I don't want to spoil the "Outlook" section, the key takeaway remains the same. We are still not being adequately compensated to take much risk in our portfolios. Most markets are overvalued and there are fewer bears with each passing day, yet the intermediate-term fundamentals of the economy continue to deteriorate. As a result, our bias remains decidedly conservative and defensive across the board. At some point, that will change, but we'll need to see an improvement in valuation and/or the economic and earnings outlook. In the meantime, we'll take advantage of opportunities as they develop. Wealth preservation remains our primary focus for the time being.



It's A Mad Mad World

The past few years have been remarkably volatile. The insanity of the credit bubble and the magnitude of the ongoing collapse have been breathtaking. The response to the crisis by our leaders has bordered on the absurd, and the ever-increasing cancerous growth of Washington's control of our economy in light of their repeated failures is mind-boggling. Just a sampling:

- The government's solution to the largest debt bubble in history is...to massively increase borrowing? I could just stop right there.
- The economic growth prior to the collapse largely came from a massive increase in borrowing. Clearly, that isn't healthy or sustainable growth. The government's response? Increase government spending to offset the healthy decline of private sector borrowing in order to sustain this unsustainable level of activity.
- The SEC was handed overwhelming evidence about Bernie Madoff's ponzi activity over a period of many years for free by a very credible private citizen who worked as a forensic accountant. The SEC chose to ignore it. The penalty for such gross negligence? The SEC's 2010 budget will grow by 7%. Clearly, lack of money is not the problem when you can't spot the largest ponzi fraud in history even after it's laid out for you gratis.
- Our already substantial financial regulatory infrastructure completely failed to recognize the largest credit and housing bubble in the history of mankind. The penalty? More money, more agencies, more regulation, and a reshuffling of responsibility.
- The father of panty-bomber Umar Farouk Abdul Mutallab met with the CIA and warned them that his son might pose a danger. His own father was turning him in! Despite this and the untold billions being spent on Homeland Security, Umar was still allowed to board an international flight without a passport.
- The best candidate in the entire country for the job of Treasury Secretary is apparently a guy with no real-world experience who couldn't even accurately calculate his own income tax obligation.

If you're a private citizen without political connections, this is fraud. Otherwise, this is a minor and understandable oversight. Let's not forget that the Treasury Department runs the IRS.

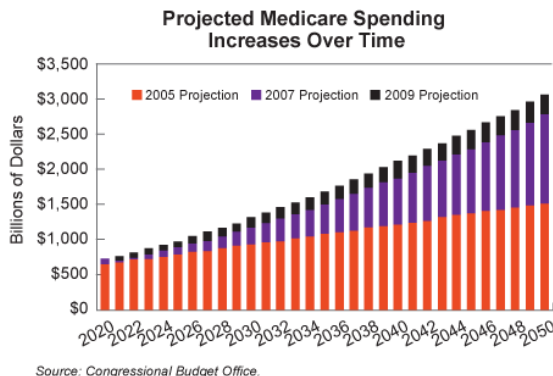
- Banks that contributed mightily to the crisis are being rewarded with free money (by the Fed) that they're leveraging and "investing" in Treasury securities and charging consumers usurious rates on. These bankers then reward themselves with huge bonuses for posting strong profits that a roomful of mentally-challenged chimpanzees could have generated. Most of these firms would today be insolvent were it not for the generosity of their friends at the Fed and in Washington.
- Banks are being bailed out by the same low short-term interest rates that are decimating savers and compelling risk-averse retirees to take on far-more risk than is prudent in order to generate some level of income.
- We lectured Japan for years about the failure of their go-slow approach to their crisis. Our solution? We're doing precisely what the Japanese have done, only they had domestic savings to finance their borrowing.
- The IMF (largely U.S.-controlled) lectures emerging markets to cut their spending and adopt austerity measures when faced with crisis. When it's our crisis, we simply ramp up the printing presses and borrow more.

We might expect that such colossal failure and thievery would result in some soul-searching from our leadership, but their hubris simply grows with each failure. Despite their abysmal track-record, our government now believes that it is well-qualified to control the temperature of the entire planet. Our bankrupt government which can't figure out how to turn a profit at Amtrak (which has no direct competition) is going to spend hundreds of billions of dollars to try and tweak the temperature of the planet?! 30 years ago, the concern was global cooling. Today, it's global warming. In 40 more years, we'll probably be worried that the temperature is staying too steady. If I'm wrong, at least I'll have a shorter trip to the beach. And would it really be that terrible if Washington (D.C.) found itself a foot or so under water? Pigs love the mud.

But why stop with controlling the globe's temperature when so much of healthcare can also be co-opted by our do-good government? Yes, we're still bankrupt, but why should that stop us, particularly when our leaders are able to tell us with straight faces that the \$900 billion cost of their grand plan will miraculously reduce the deficit. Well, if that's how the math works, I have to wonder why we aren't proposing a \$25 trillion health plan. Just imagine the deficit reduction!

History has proven a harsh critic of such grand government plans. The Journal of the American Enterprise Institute recently took a look at Medicare and found, "In 1967, long-run forecasts estimated that Medicare would cost about \$12 billion by 1990. In reality, it cost \$110 billion that year. Today, it costs \$500 billion."

The following chart illustrates how the estimate for Medicare spending from the neutral Congressional Budget Office has jumped in just the last 4 years. This is what always happens with government programs. Government gets a toehold and then programs are expanded as politicians buy votes, reward pals, and "establish their credentials."



Washington may claim a virtuous desire to save us from ourselves, but their "virtue" is steadily bankrupting all of us. I don't see how this will be voluntarily changed. The special interests, lobbyists, and banking and defense groups are just too powerful and entrenched.

It's very telling that Obama, who had a mandate and had promised change, has done nothing but perpetuate the status quo. He was supposedly an outsider who hadn't been in Washington long enough to be beholden to the special interests. Yet, as best as I can tell, the only change we've

had is a refocus of our military might from Iraq to the even more perilous Afghanistan. His economic and defense teams consist of essentially the same people who've been loitering the halls of Washington for years, in both Republican and Democratic administrations. [As always, let me stress that I'm an independent and find both parties equally repugnant militarily and fiscally. Neither party has been a responsible steward of our country's resources. If we're not going to employ those mentally-challenged chimpanzees in our banks, we should send them to Washington.]

If the masses understood what was happening to them there would be revolution. I have little doubt that change is coming, but it will not come from within. It will be forced upon us by the international community, and one of the key ways it will be effected is through higher interest rates. As more and more people begin to understand that our path is unsustainable and that a resurgence of new, strong, and imminent growth is not about to save us from our fiscal and monetary sins, there will be increasing questions and doubt as to how we will be able to fund our obligations.

The creditworthiness of the U.S. will increasingly be called into question as the reality sinks in that Washington will likely resort to increased inflation (printing money) to repay its debts. We either inflate away this debt or we suffer long-term sub-par economic growth as our resources must eventually be diverted from production to debt repayment.

This is not solely a U.S. problem. Governments throughout the world are relying on massive amounts of debt to fund their economies. It's fair to ask how long they will all be able to raise investor funds at such low interest rates.

Sub-par economic growth, excess industrial capacity, private sector deleveraging, and stubbornly high unemployment would traditionally lead to falling interest rates, but I believe the odds favor more of a stagflationary environment going forward. Increasing doubts as to U.S. creditworthiness, increased federal borrowing, decreased future Federal Reserve purchases (and eventual selling) of Treasuries, and a need for the Treasury to aggressively lengthen the duration of its debt are much more likely to result in higher future inflation and higher interest rates, even in a weak economy.

A Brief Review of 2009

It may be difficult to recall, but 2009 began with investors dumping risky assets. Fear ruled the day, bearishness was rampant, and investors were refilling their Ambien prescriptions, clutching their prayer beads, and pondering how much one of their kidneys would fetch. I, however, couldn't have been happier or more at ease. Equities were finally attractive, and we were adding risk to our portfolio at the time. In my year-end 2008 Quarterly Review (early January), I wrote the following:

Although the ultimate bottom in the stock market is still unknown, I am finding some of the best opportunities in my career these days. These investments may continue to come under pressure for some time still, but they offer the type of long-term return potential one seldom encounters. We may need to be patient with these names, but I'm confident that our patience will be rewarded.

We were rewarded but much sooner than I had hoped. The markets bottomed on March 9th, which coincidentally turned out to be our most active day of buying of the entire year. While the U.S. stock market lost 11.5% in the first quarter, all of our accounts posted modestly positive results.

Chart of the S&P 500



The rest of the year was marked by one of the strongest rallies in market history. Short covering, bottom fishing, the gradual reduction in the severity of bad news, and the eventual ramping of massive stimulus resulted in the re-assumption of risk-taking as the year progressed.

The higher the market climbed without a commensurate *real* improvement in the underlying fundamentals, however, the more expensive and risky it became. We gradually reduced portfolio risk during the latter half of 2009 as the markets (and risk) climbed.

2009 Performance

2009 was a very satisfying year in terms of performance. Considering my view that we remain in a low-return environment, 2009 provided something of a gift. Most satisfying is the fact that we achieved our results while incurring fairly little portfolio-level risk.

While our more aggressive accounts posted returns consistent with the U.S. equity market in 2009, we incurred far less risk than that of the market. For much of the year, we held healthy levels of cash as well as many defensive positions which were a drag on performance but which provided protection. In addition, we increased (bought) risk early in the year when the cost of that risk was cheap (valuation was attractive), and we reduced (sold) risk as the year progressed and the cost of risk was rising. It was quite gratifying to generate strong market-type results while incurring such little risk.

I'm equally content with the performance of our conservative and modest-risk portfolios. Again, we kept risk levels quite low during the year and were still able to generate strong double-digit returns which far exceeded our modeled target returns.

As is often the case, our performance was not exactly correlated with market returns. We generated a solid mid-single digit return (on average) in the first quarter of the year while the markets were falling apart. We increasingly lagged global equity markets as the year progressed. Given our focus on absolute returns instead of relative returns, our performance shouldn't be expected to track any particular market.

As satisfying as 2009 was, I need to caution that we remain in a low-return world, and we're most likely still in a secular bear market. As nice as a repeat of 2009 would be, I wouldn't expect it.

Fourth Quarter Performance

The fourth quarter again witnessed rising asset prices across most markets. While the torrid pace of the second and third quarter eased, U.S.

equities still posted a solid mid-single digit return. International equities performed similarly. Commodities, led by oil, rallied as hope for a global economic rebound grew. Despite giving up a good deal of its quarterly gain in December, gold still posted an 8.5% return.

Index/Market	Q4	2009
S&P 500	5.49%	23.45%
DJIA	7.37%	18.82%
Nasdaq	6.91%	43.89%
Vanguard Total Stock Market (VTI)	5.19%	25.99%
China - Shanghai A Share Index	17.85%	79.80%
Emerging Markets (VWO)	6.41%	73.95%
iShares Aggregate Bond (AGG)	-1.33%	1.36%
DJ Commodity Index (DJP)	9.60%	20.09%
DPDR Gold Trust (GLD)	8.56%	24.03%
Oil	11.94%	76.84%
U.S. Dollar (UUP)	1.27%	-6.52%

China, which was in the process of rolling over as we began the quarter, staged another strong move and was the star of the fourth quarter.



Aspera performance in this latest quarter was as expected. As I've hopefully made clear, for the time being we are positioned defensively and will underperform advancing equity markets. Most of our accounts were flat for the quarter, give or take a couple of percent. For the most part, returns lagged equities but outperformed fixed income.

The fixed income markets finally weakened last quarter as interest rates started moving up. I've been warning about this for some time now. It's too early to know if this is the start of a trend or just another head fake. Long-term, the risk is for bond prices to fall as yields rise, but another near-term credit/deflation scare could lead to yet another bond rally.

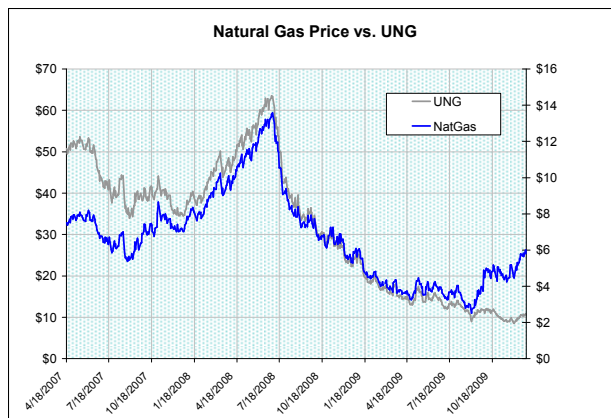
As is always the case, we had strong and weak performers in our portfolios in this latest period. Our weakest performers were our hedge positions

(most notably our put options, VXX, and SZK). These are defensive positions designed to provide short-term protection to portfolios. These should be thought of as insurance. You own insurance on your home in case of a fire, but you clearly hope you never have to collect on it. Still, you gladly pay your monthly premium. Many of our put option and short positions are similar. They serve a purpose in that they add insurance to our portfolios. We don't typically expect them to perform well when our other long positions perform well.

Otherwise, our notable laggards in the quarter included UNG and UXG. I'll take it as a complete coincidence that they share two of the same three letters. Both were down 14% last quarter. UXG is a junior gold miner that we added one month ago after it pulled back 20% from its recent high. The stock has continued to pullback another 14% since then. Such moves are commonplace for the very volatile junior mining firms. UXG is up 150% for the year and should continue to move higher over time if we're right about the direction of gold.

Although my enthusiasm for natural gas is looking prescient, UNG has been disappointing. You can see in the chart below that natural gas prices actually bottomed in late August and early September and have doubled since that time. You can also see that UNG did not keep pace. Because UNG buys near-month futures contracts and keeps rolling them forward, it doesn't participate in natural gas price increases that are already baked into the futures curve.

Due to a steepening of the futures curve over the past few months, some of the upside I'd expected from UNG has been reduced. As a result, we sold a portion of our position during the quarter at a loss. Should the shape of the curve become more favorable, I'll consider adding again.



Fortunately, we didn't put all of our natural gas eggs into just UNG. While UNG has disappointed, our NBR holding is up 150% in 2009, PTEN is up 60-90% in various accounts, and our purchase of APL earlier this year has jumped 160%. Our purchases of CHK, MCF, KMP, and EPD earlier this year have also been solid contributors.

Despite most of our hedge positions hurting performance this past quarter, a few of them actually performed well. Our puts on PALM paid off nicely, with a gain of 200% in about 6 weeks. Our short on PALM also performed well, returning 42% in the quarter. We had shorted FSLR back in June and covered in November for a 30% gain. We shorted APOL back in February and covered in November for a 30% gain. To have any shorts perform well during this powerful market rally has been a nice bonus.

Our other star performers included junior gold miner XRA which posted a 55% jump in the quarter and new addition MGN (junior silver miner) which climbed 32%. APL, a natural gas limited partnership with a weak balance sheet, jumped 34% in the quarter as natural gas prices moved higher. These are all volatile names. 20% moves in either direction in a 3-month span is far from atypical.

Trading Activity

Trading activity was somewhat elevated during the quarter due to tax loss selling. I liquidated a number of our short/defensive positions with losses and added some offsetting defensive positions to maintain our conservative positioning. Our goal is to maximize after-tax returns as best as possible, so trading activity is always likely to be a bit higher in the fourth quarter for those with taxable accounts.

I plan to spend more time in 2010 discussing specific security trades, so for now I'll summarize the fourth quarter activity not previously mentioned in the "Performance" section:

- We liquidated a number of hedge positions at losses (tax selling) and added defensive positions in SEF, SKF, PPD, VXX, an index put option, and a put option on GRMN.
- We added to the precious metals space (EGI, MGN, GDXJ, UXG, AEM, SLV).

- In Conservative accounts, we added AMJ, a natural gas-focused limited partnership ETN yielding 6.5%. We also added to BIP on a pullback. BIP is an infrastructure limited partnership yielding over 6%.

Outlook

One year ago, fear ruled and investors were dumping risky assets, but we were beginning to see the best opportunities in nearly two decades. What a difference a year makes. Today, complacency is rampant, valuation is no longer compelling, investors are overreacting to perceived economic improvement, and it's very difficult to find attractive investment opportunities.

Still, as I've been cautioning for the past couple of quarters, overvalued markets can always go higher. Increased Fed liquidity, another stimulus package, additional multiple expansion, and inflation-hedging could certainly result in higher equity prices in 2010.

A healthy economy is most definitely not a prerequisite for the stock market to move higher, particularly in the near-term. For an extreme example, just look at Zimbabwe where the stock market grew by 322,111 percent in 2007. Yes, that's over 300,000%. Sounds good, but inflation was running at an annual pace of 24,000% by the end of the year. Be careful what you wish for.

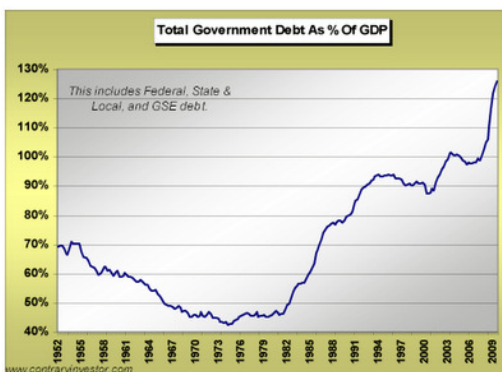
Although risky assets may certainly keep climbing, investing in them (generally) is much more akin to gambling than investing given current elevated valuation levels. Quite simply, we are not getting paid to take much risk in our portfolios, so we won't. Whether the markets keep climbing in the near-term isn't relevant for long-term performance. Making sure that we take prudent risks is relevant.

2010 is unlikely to be dull. There was a dramatic split between reality and expectations early last year. We still have such a split, but the divergence has flipped. This is best illustrated in the following chart which measures consumer confidence. Confidence in the present is near its lows while confidence in the future has rebounded strongly in 2009. This will narrow, and I doubt it will all come from an improvement in the Present Situation index.



There are far too many risks to fully discuss here, but the following are some of the more important ones I'll be watching this year.

- Valuation remains unattractive. We're not in bubble territory but future returns tend to be poor from such elevated levels. Attractive valuation can offset plenty of other risks, but we're far from such levels.
- The 30-year bond bull market is much closer to its end than beginning. The shift to higher rates will be a huge secular trend with tremendous ramifications.
- While the private sector has begun to deleverage, this has been more than offset by the public sector. This can not continue indefinitely. We risk a debt death spiral if it continues and a relapse into recession when it ends.



- The risk of competitive devaluation is still high as countries try to defend their export sectors.
- China is currently the darling of the world, but imbalances in China are growing. Recent economic growth is largely owed to massive fiscal stimulus and

tremendous loan growth, neither of which is sustainable. Global demand growth and domestic consumer growth are unlikely to absorb increasing excess manufacturing capacity. Increased credit is also flowing into the stock market and creating a real estate bubble. Unless policy is changed, a bust is becoming increasingly likely. We'll be an aggressive buyer if/when it happens.

- Japan is close to a debt death spiral, with debt approaching 200% of GDP. Japan has been able to get away with this for years due to the high level of domestic savings, but those savers will soon be retiring, and that domestic savings pool will soon start shrinking. Interest rates in Japan are headed higher, and Japan will be one more competitor for debt funding on a crowded global stage.
- The ability of the Fed to unwind its massive stimulus is highly suspect. The Fed has become the buyer of last resort for mortgage-backed securities. When this ends in March (unless extended), who in their right mind will buy these securities at current yields? Look at what recently happened to Treasury yields once the Fed ended its purchases. The Fed can't keep the lid on rates forever.
- The European Union is at risk. A unified monetary policy is struggling to adequately support both the basket cases of southern Europe (Greece and Spain) and also the relatively stronger northern countries. I expect to see increased discord within the Union in 2010.

2010 is bound to be volatile. Expectations remain much more robust than warranted in my view. Something has to give. Maybe the private sector will come roaring back, the Fed will be able to seamlessly remove its stimulus without impacting interest rates, the Treasury will be able to lengthen the duration of its debt portfolio without impacting yields, Washington will be able to get the deficit under control, the emerging markets will continue to grow exponentially and help absorb global excess capacity, and corporate earnings and margins will reach new records. And maybe the price of gold is rising for no reason, interest rates can stay at zero forever, and Tiger Woods is a wonderful and faithful husband.

Strategy

Currently, our portfolios remain defensive, with a significant position in gold, silver, and precious metals securities. So long as the authorities continue to mismanage the currency and economy, we'll maintain a healthy weighting to this space.

Our net equity exposure consists primarily of precious metals and energy stocks. This has been the case for quite some time, and these two sectors continue to offer the best opportunities on the long side. We also maintain solid exposure to commodities with a focus on gold, silver, cotton, and an ETF which tracks a basket of four agricultural commodities (DBA). Our currency position is currently modest with some exposure to the Yuan and a small tactical position in the dollar.

Our fixed income strategy remains cautious. We maintain a solid TIPs exposure in our more conservative portfolios, we continue to hold BSV (shorter-term high-quality corporate bond ETF), and we still hold our short position in Treasuries (TBT) in all portfolios. We've been able to add yield through our limited partnership exposures which should also provide protection from future inflation. To the degree that we add any non-TIP fixed exposure, it will be shorter duration and high quality in order to minimize default and interest rate risk.

We have no emerging market exposure at the moment. These markets have had tremendous moves in 2009, and of course, everyone now loves them. I find them dangerously overvalued at these levels. This emerging market enthusiasm is hardly new, and this bout too shall pass. We owned India and China for a little while last year and did very well with them. I'm looking forward to owning them again, but we'll continue to patiently wait for a better entry point.

There will always be attractive opportunities, and we own a number of them, but our overall portfolio risk will remain modest until better opportunities arise. There is a time to focus on wealth preservation and there is a time to focus on growth. This remains a time to focus on wealth preservation.

I'll offer my typical recent warning. If the markets continue to run, and they very well could, we will lag those returns in the near-term. We will increase risk only when we are being adequately compensated to do so.

Housekeeping

Those of you who follow my writing have probably noticed a sharp drop-off in Market Rubbernecker production. I've found that I'm just not interested in posting trading ideas or portfolio strategy in such an open format. Frankly, that leaves me perplexed as to what function it should serve, if any.

For the time being, I plan to step away from the Rubbernecker and devote a little more time to the Bulletins which are currently only distributed to clients. I've added a new "Archives" section to the website for easy access to past writing. I have a long backlog of topics I'd like to cover, so a little extra time should prove helpful. Some of the topics that I'll be focusing on come directly from our conversations and your questions, so keep up the good work.

As a reminder, we're shifting to a biannual billing cycle with invoices being sent out in mid-January and mid-July. Some of you may be receiving an invoice for a stub period in the next week or so in order to get you onto this new cycle.

Finally, thank you all for the trust you continue to place in me and the opportunity you've given me to work with you this past year. I'm very fortunate to have such terrific clients who understand and appreciate the non-traditional approach I take to risk and the markets. I don't know what 2010 holds in store, but you can be sure that I'll continue to manage your portfolio as though I was your beneficiary.

All the best in 2010,

Ken Bell, CFA, CFP
President
Aspera Financial, LLC

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