

MARKET COMMENTARY



In October, the market slowed significantly from the pace of growth we had seen starting in March. The chart at the left shows the Russell 200 Index which is representative of small business in the US. To see the change in character of the market we have only to look at the pattern of rising peaks (1-4) and the rising troughs (A-D). This sort of pattern is indicative of a bull market advance.

The change occurred in the last two weeks of October where the market established a new low (E) that is slightly lower than the previous low (D). This by itself

does not mean the bull market is over, but simply that the may be a change looming. We will not know for sure until the next peak is established. If the market forms a peak below point 4 and proceeds to a new low below E, then we will have confirmation of a top in the market.

Since we do not predict what the market should do, we have to wait and see what it actually does and then take appropriate action. As part of this, when the market moved to its new low as shown by E above, we liquidated any positions that were showing the same pattern. Unfortunately, as you can see in the chart above, the market has moved up from its low and it feels like we made the wrong decision, even though it felt right at the time. We will not know for sure until later this week or next and when the market establishes a new trend or confirms a continuation of the existing trend. Sometimes it is difficult to err on the conservative side, but it is also impossible to know for sure if the decline from 4 to E was an anomaly or the beginning of another decline like we saw last October.

While the Russell 200 only represents one segment of the market, the same patterns are evident in both the S&P 500 and the NASDAQ markets also. We will be watching all markets closely this week for early indications of what we can expect as we approach the end of the year and the holiday season. A lot of talk has been floating as to the strength or lack thereof in the American consumer and whether or not the often anticipated "Santa Clause" rally will be able to form this year or not. Either way our focus will remain just as much on protection of capital as on growth.

PRIME NUMBERS — Current Facts from Around the World

17.2% The decline in rail traffic for the week ended October 3, compared with the same period a year ago according to the Association of American Railroads.

69.6% The factory utilization rate in August. The average for the period from 1972 through 2008 was 80.9%.

30% The portion of foreclosures in July made up of homes in the top third of local housing values, almost double the level of three years ago, according to zillow .com real estate website.

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Dow Industrial Average (\$INDU)



S&P 500 Composite (SP-CP)



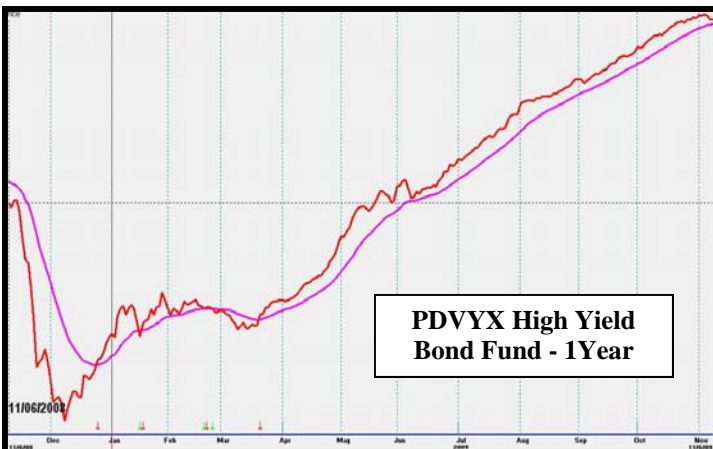
NASDAQ Composite (OTC-C)



Russell 2000 Index (RUT-I)

Above are one year charts of the four primary US market indexes shown with a 20 day moving average to show the general trend without the volatile daily moves. As you can see we have enjoyed a nice rebound since the March lows in all markets. However, in the last month, notice that the S&P 500, NASDAQ and the Russell 2000 all showed signs of change with the moving averages rolling over and new lows lower than the previous lows. This in and of itself does not mean the markets are heading down but rather that it may be taking a breather. We will not know if this change will continue until we see if the next peak is higher than the previous peak or lower. If it is higher, then we can assume this was simply a period of consolidation and the markets are resuming their upward trend. If however the next peak is lower, it may be a signal the recent bull market advance is over and we will go through a period of retracement.

The significance of the change will not be known until later, but we have to take note of the change and protect against losses which can develop very quickly as we saw last October. As always I will be watching these developments daily and will take decisive action as necessary to limit portfolio risk.



PDVYX High Yield Bond Fund - 1Year

PDVYX is a Putnam high yield bond fund we own in most accounts. While the time period is the same as the charts above, you can see that the trend of this fund has been much less volatile than the overall markets. This is a unique quality of this type of fund due to the market conditions we are currently in. While this trend will not continue forever, we want to try to take advantage of it while we can. Since high yield bonds tend to lag the market changes, if the trends in the overall markets mentioned above turn down, we should have enough notice to be able to avoid significant losses in the portfolios.