



2009 Year-End Investment Review and Outlook

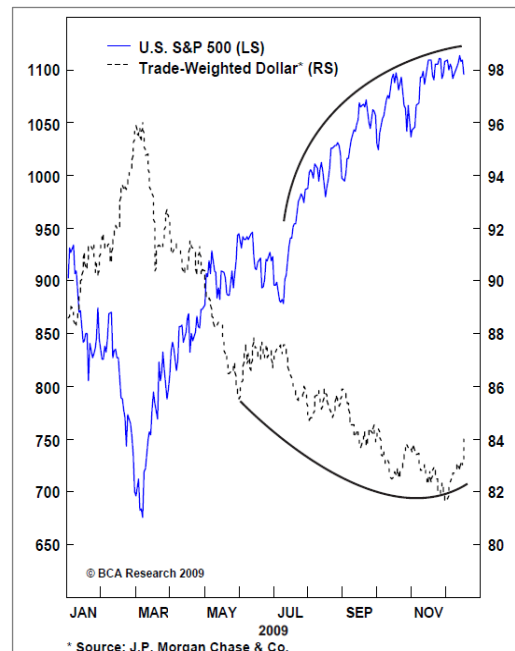
Market Review

Beginning in early March 2009, the stock market staged a strong rally. Investors' increased appetite for risk drove up prices of many financial assets, particularly high yield bonds and equities. As a result, major financial market indexes ended 2009 with their best yearly advance since 2003. Overall equity markets (except Asia and a few countries in South America) lagged the high yield bond market. High yield bonds (ML High Yield Master II Index) were up 57.51% in 2009 while the U.S. Equities (S&P 500 Index) and the world equity excluding the U.S. (MSCI World Ex USA Index) were up 26.46% and 33.67% respectively. A powerful rally in Asian equity markets (MSCI AC Asia Ex Japan Index) was remarkable by returning a positive 72.07%. This outstanding performance was led mostly by China, India, and South Korea.

Outperformance of the high yield market relative to the equity market in 2009 was likely due to the stunning difference in net cash flows among different asset classes and the carry trade activity. Cash outflows from equity and money market funds were the primary source of funds flowing into the high yield market. Year-to-date through November 2009, net new cash flows from the equity market into high yield fixed income mutual funds were \$22 billion. Carry trades originating from the U.S. low interest rates also became the favored funding source to the higher yield market.¹

The U.S. dollar declined due to rising fiscal and trade deficits, subpar economic growth, a reduction in the growth of capital flows, and falling interest rates. The price of gold was heightened as a demand for safe haven investment increased. The 2 - 10 year yield curve steepened mainly due to an improvement in expected future economic growth and a rise in inflation expectations on the longer-dated side.

	2009	2008
S&P 500 Index	26.46%	(36.99)%
S&P 400 Mid Cap Index	37.38%	(36.24)%
S&P 600 Small Cap Index	25.57%	(31.08)%
MSCI EAFE	31.78%	(43.07)%
MSCI World Ex USA	33.67%	(43.56)%
MSCI AC Asia Pacific	37.59%	(41.85)%
MSCI AC Asia Ex Japan	72.07%	(52.38)%
Barclay Aggregate Bond	5.93%	5.24%
ML High Yield Master II	57.51%	(26.39)%
S&P Global Infrastructure Index	25.28%	(38.98)%
S&P World REIT	33.53%	(45.16)%
S&P 500 Energy Sector	11.29%	(36.76)%
Amex Oil Index	9.04%	(37.19)%
Gold	25.04%	4.32%
Dow Jones UBS Commodity	18.71%	(36.76)%
Euro/U.S Exchange Rate	(7.33)%	7.76%
HFR FOF: Diversified Index	11.44%	(20.38)%

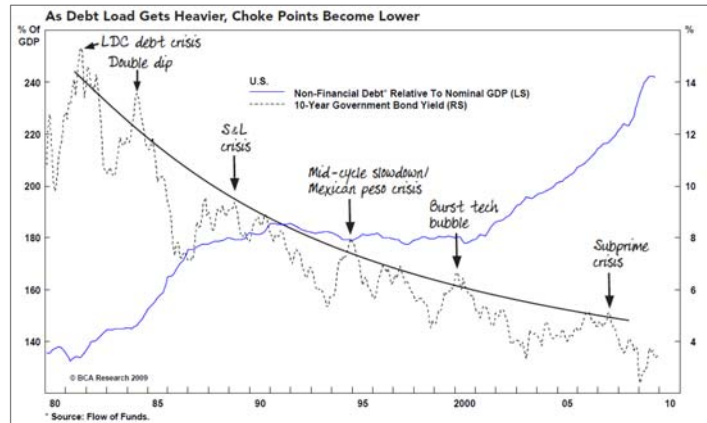


¹ Carry trades involve borrowing at low interest rate and investing the proceeds into higher yielding assets.

■ Reality Check

Even though the financial market had a great year in 2009 and the expectation of future economic growth has improved, the investment outlook seems gloomy due to the economic reality which still remains in our system.

The first and the most concerning problem is the exploding federal deficits associated with massive government spending. In order to create liquidity and stimulate the economy, the government sold the U.S. government debt to foreign and domestic investors. The government initiated various stimulus programs (e.g. first time home buyer credits, cash for clunkers, etc.) to support the economy. As a result, the financial system has indeed stabilized and the U.S. economy is out of the recession as the real GDP in the third quarter of 2009 was up 2.24%. However, this rebound seems temporary. The created money is still not circulating because banks are reluctant to lend – they are more concerned with rebuilding their own balance sheet strength and still face a mountain of rotting credit card and commercial real estate loans. Consumer spending, which accounts for about 70% of the U.S. GDP, did not rebound strongly as the unemployment rate continued to hover around 10%. The rising saving rate further detracted consumer spending.



The structural imbalance derived from an aging population is also an issue that makes the investment outlook unknown. This could result in a crisis of Medicare and Social Security expenses with fewer younger workers available to support the cadre of aging retirees. Unfortunately, Congress and the administration failed to address the issue of health care costs when drafting recent health care reform legislation. This cynical attempt at reform will certainly add to our long-term structural deficits for years to come.

The other issue associated with the current monetary easing and fiscal stimulus is whether these actions will spark inflation and a rise in the short-term interest rates. The Federal Reserve will not leave the federal funds rate near zero for too long as inflation expectations are creeping up due to surge in commodity prices across the spectrum. While the Fed has been signaling that rates would remain near current levels for an extended period of time, the bond market does not agree, having pushed long-term rates higher. The yield curve has steepened sharply.

Some 23% of all mortgages in this country are still under water. While house prices have recently showed signs of stabilizing, they are not likely to rise sharply. In fact, the market expects another wave of foreclosures which would dump a new supply of houses on the market further depressing housing prices. Furthermore, it is expected that many states will raise taxes as state and local budgets are in shambles, resulting in spending cut-backs across the nation. This would have a dampening effect on local economies.



■ Conclusion

Looking out over the next year, we would like you to be aware that there are still a number of issues weighing on investor sentiment during 2010. For example:

- ◆ Huge uncertainties remain about the strength and sustainability of the U.S. economic recovery since the policy stimulus supported this recovery. It remains to be seen how well the system will adjust without this support.
- ◆ Lingering high unemployment and low inflation suggest that the Fed will not hike rates until 2011. At the other extreme, however, some predict a very strong expansion, raising the risk that the Fed will be under pressure to tighten policy sooner rather than later.
- ◆ A possible double dip in the housing market and the unwinding in the commercial real estate sector may make the whole economy vulnerable. In fact, a lot of option adjustable rate mortgages are due in 2010 and 2011.
- ◆ Soaring public sector debt and deficits raise the prospect of the U.S. and many European countries' fiscal crisis in the years ahead. Problems in Greece and some other euro-area economies warn of the consequences of uncontrolled government profligacy.
- ◆ There are also fears that the Chinese economic boom could turn to bust if the authorities are forced to crack down on growth in order to head off inflation and rising asset prices.
- ◆ Political issues are threatening to wrap around the throat of the financial sector with the Obama Administration's banking proposals. A political backlash against the financial sector was inevitable and banks face a squeeze on profits. Financial sector reforms are on the way and they will have serious adverse macro-economic consequences.

The point is that the markets will face a challenging year in 2010 and the investment decision will be more complex. We will continue to closely monitor the above issues and the other macro economic variables in order to decide how to allocate and/or diversify your investment portfolios. We are currently preparing a white paper to discuss the investments in each asset class. Thank you for the trust you have placed in us. We wish you all a prosperous 2010. If you have any questions, feel free to contact us.

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