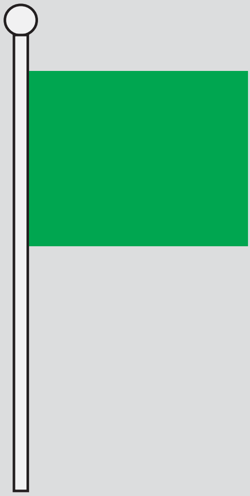
The Financial Research Center, Inc.

Money Forecast Letter



2010 SHOULD BE A YEAR OF ECONOMIC RECOVERY AND FINANCIAL PROSPERITY. IF ONLY WE CAN KEEP THE FEDERAL GOVERNMENT FROM MESSING THINGS UP.

FEBRUARY, 2010

Financial Research Center, Inc.

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February 2010

Holliston, Massachusetts - January 19, 2010

2010 SHOULD BE A YEAR OF ECONOMIC RECOVERY AND FINANCIAL PROSPERITY. IF ONLY WE CAN KEEP THE FEDERAL GOVERNMENT FROM MESSING THINGS UP.

The year is just beginning to unfold but it is already clear that 2010 should be a year filled with lots of good news. Led by a rebuilding of depleted inventories and increased exports the U.S. economy is at long last back on track. The official number for fourth quarter GDP won't be out for a couple of weeks, but it is generally assumed that 5% annual growth might have been achieved for the period and that growth might even be stronger during the first quarter of this year. Despite this good news there still seems to be an air of gloom hanging over the country. That gloom seems to be focused on the unemployment number. Currently

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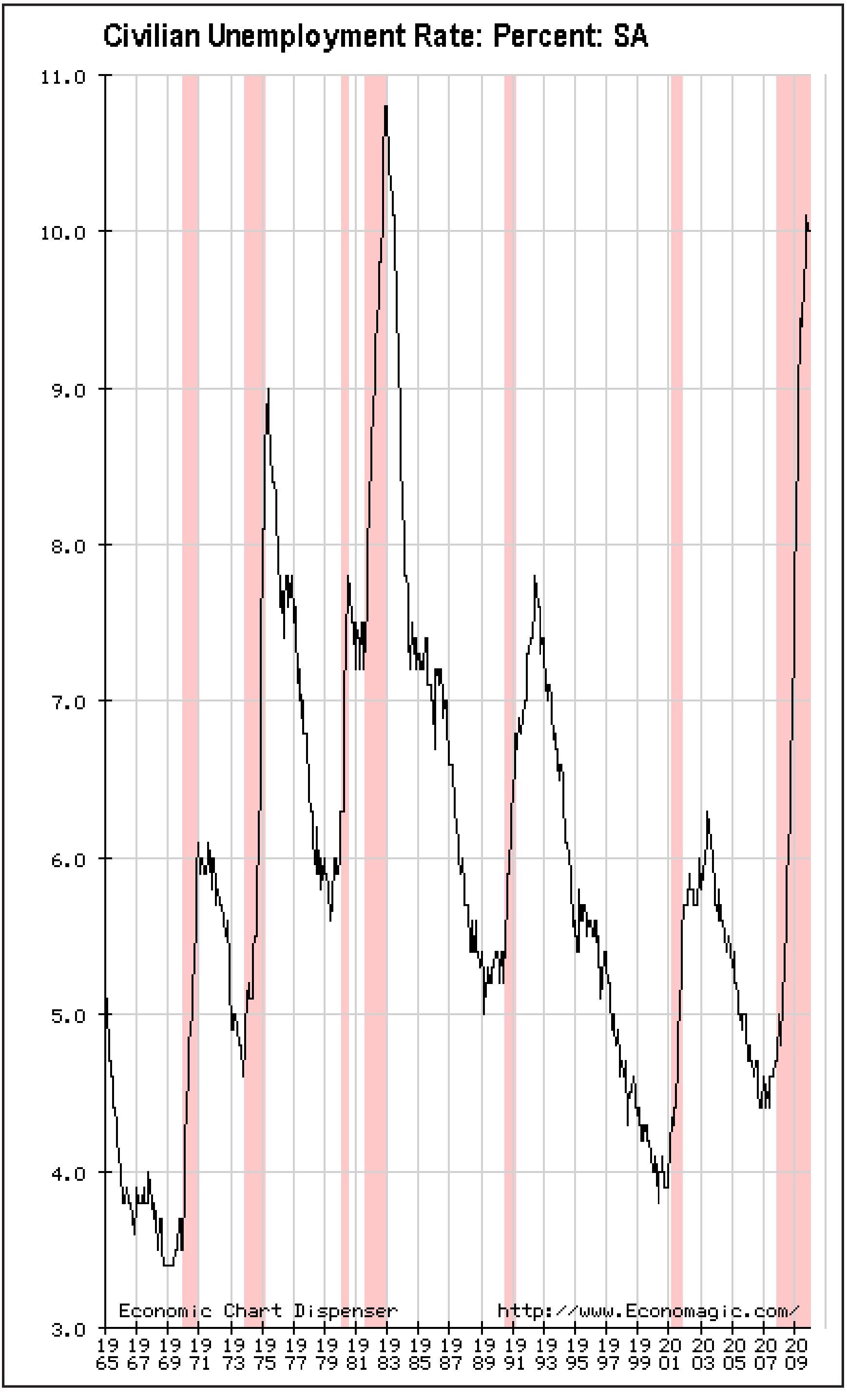
Civilian Unemployment Rate: Percent: SA
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
Economic Chart Dispenser
http://www.Economagic.com/
19 65
19 67
19 69
19 71
19 73
19 75
19 77
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19 81
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20 03
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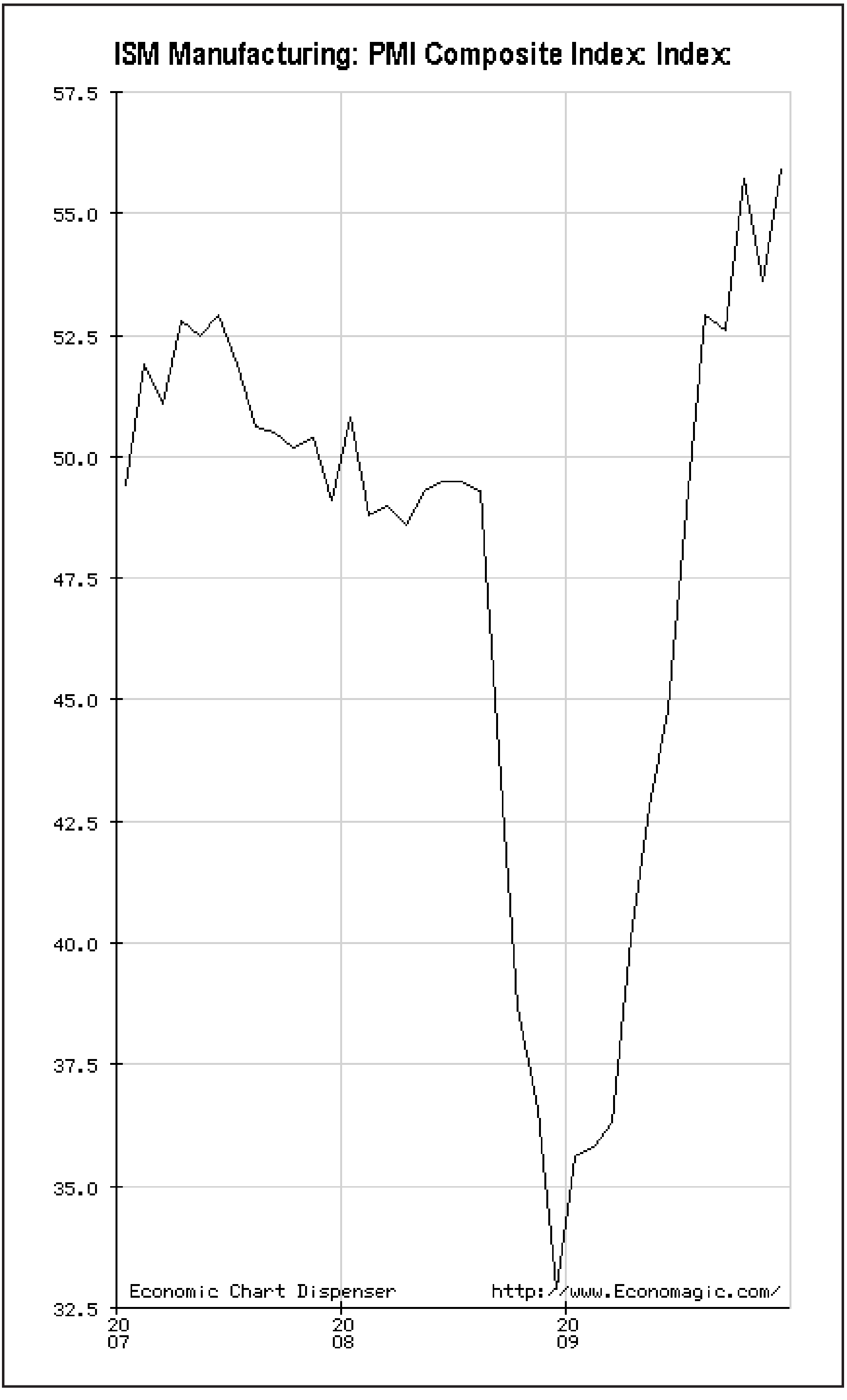
20 09

standing at 10%, the unemployment number is quite high. Those who are quick to dismiss the turnaround in the economy can't resist pointing out that the real rate is closer to 17% when one adds in those who have become too discouraged to even look for a job and those who have settled for something short of full employment.

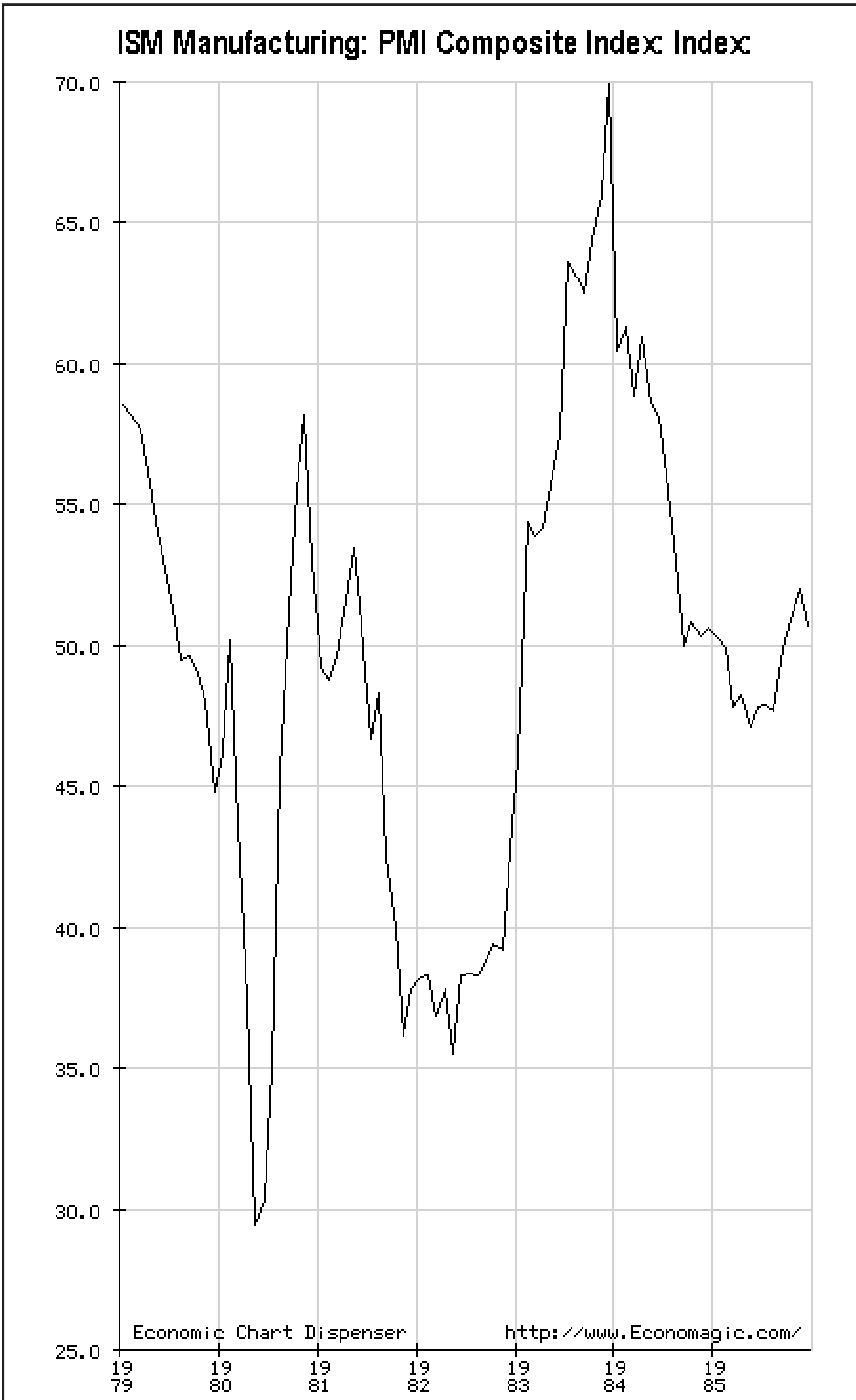
While I can sympathize with all those out of work or underemployed I must tell you that I am dismayed by all the attending sound and fury their condition has elicited from both the self-described experts on the television talk shows and the politicians around the country. Everybody, and I do mean everybody, who speaks of the persistence of high unemployment numbers is fully aware that the unemployment number is nearly meaningless when it comes to setting current Fed policy. Ben Bernanke and his fellow members of the Federal Reserve Open Market Committee have been telling us that every chance they get. Recently James Bullard, president of the St. Louis Federal Reserve Bank, gave a speech at the Global Interdependence Center. The December unemployment number had been released that morning and President Bullard was asked whether the jump in job losses would effect Fed policy. His response was illuminating: "It was different from expectations but not far enough to really change assessments of policy." He added that he believed it possible "that interest rates may remain low for quite some time." He further suggested that the risk of inflation from low interest rates might be two to four years off, giving the Fed plenty of time to wind down their efforts to save an economy that was in danger of being


ISM Manufacturing: PMI Composite Index: Index
57.5
55.0
52.5
50.0
47.5
45.0
42.5
40.0
37.5
35.0
32.5
Economic Chart Dispenser
http://www.Economagic.com/
2007
2008
2009

killed by the panic that struck the world's financial markets back in 2008.

HISTORY SHOWS THAT THERE ARE TWO WAYS TO CREATE NEW JOBS AFTER A RECESSION: THE RIGHT WAY AND THE WRONG WAY.

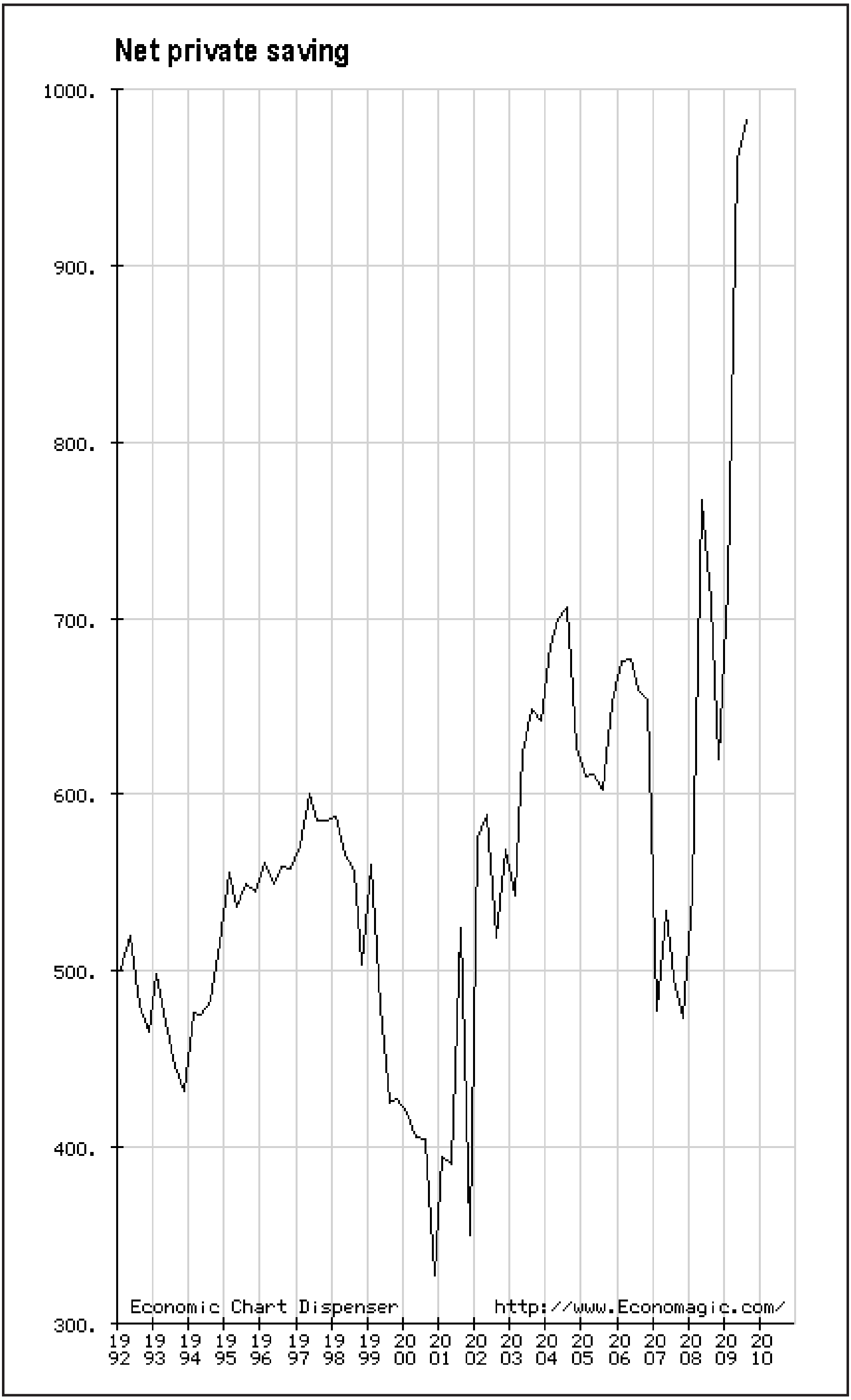
A look at the chart on page two quickly shows you why the Fed is not concerned about the unemployment numbers at this point in the recovery and why you shouldn't be either. When the economy contracts it is a fact of life that job creation is the last thing to take place during the recovery. Depending on the size of the contraction it can take years to bring the unemployment rate back down to where it was before the recession started. It is the natural instinct of politicians to shorten that period lest they be held accountable for the lack of jobs when it comes their time to face the voters. This fear is well founded. Rising unemployment played a major role in shaking up the balance of power in Washington, D.C. in 1974, 1980, 1992 and 2008. With the mid-term elections looming this November there are an awful lot of nervous politicians who feel the need to be "doing something" about unemployment before voters get a chance to be heard on the subject. Unfortunately the solutions that politicians favor for high unemployment are usually the wrong solutions. Expensive jobs bills make everybody appear like they are doing something but in the end they rarely create new jobs that last longer than the funding for the government programs created. Ronald Reagan, the only president ever to get a degree in economics, understood this very well.


ISM Manufacturing: PMI Composite Index Index
70.0
65.0
60.0
55.0
50.0
45.0
40.0
35.0
30.0
25.0
Economic Chart Dispenser
http://www.Economagic.com/
1979
1980
1981
1982
1983
1984
1985

Back in 1981 he allowed Fed Chairman Paul Volker to finish the work of slaying the inflation dragon that had been perverting economic decision making in the U.S. since Richard Nixon cut America loose from the gold standard back in 1971.

The war on inflation caused plenty of collateral damage. Unemployment jumped to nearly 11% by 1982. Democrats were calling for the president's head on a platter. That Fall the Republicans lost 27 House seats, nearly all that they had gained during the watershed election of 1980. President Reagan was not naïve. He knew his efforts to rebuild America would meet with failure if he did not first let Fed Chairman Paul Volker finish the job of killing off inflation, and more importantly killing the expectations that inflation would be allowed to return. By eschewing short term fixes that would have aided his party in the 1982 mid-terms, Ronald Reagan set the stage for years of prosperity here at home.

By contrast, the Obama administration and his Democratic allies in Congress seem determined to pass a jobs bill in the coming months that will do little more than provide political cover for members of Congress when they return home to run for re-election. I ask you to look again on the chart on page two. Notice what happened to the unemployment number after each of the five previous recessions. In 1971, 1975 and 2003 the unemployment rate failed to fall below the previous unemployment rate that existed before the preceding recessions. In 1983 and 1992 the economy was allowed to contract and recover naturally. This provided a


Net private saving
1000.
900.
800.
700.
600.
500.
400.
300.
Economic Chart Dispenser
http://www.Economagic.com/
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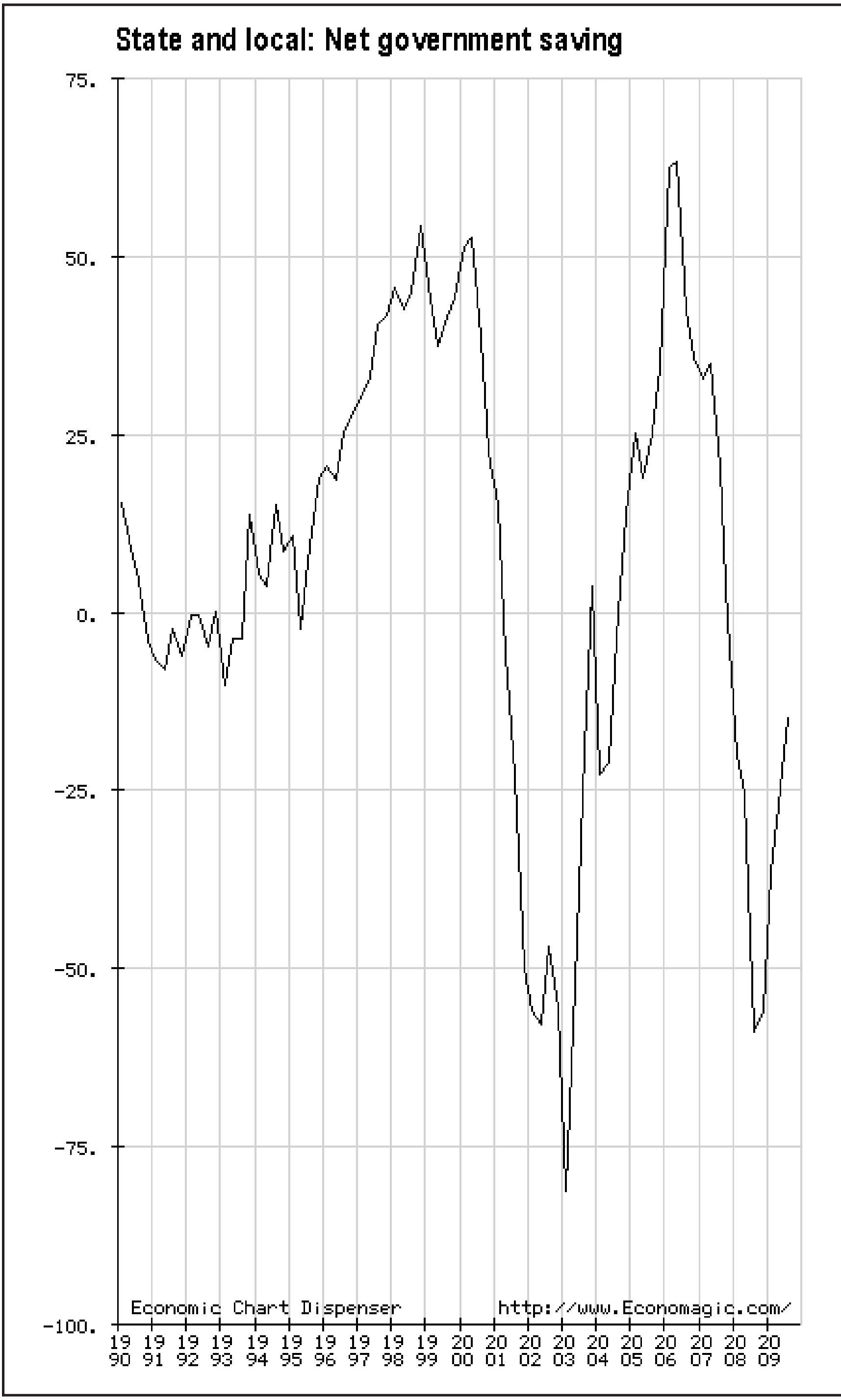
solid foundation on which to build the economy back up and eventually create well paying, long lasting employment for American workers. If President Obama and the Democrats want to increase their chances of long term electoral success, they would be wise to keep their hands off this recovery and wait for jobs to come back on their own. This letter goes to press before it can be determined who has won the Senate race in Massachusetts, but a close win for the Democrats there might convince them that high unemployment was the reason for their troubles. This might prompt them to pass a poorly crafted jobs bill so that it appears they are "doing something" about unemployment. I fear a close race which results in the Democrats keeping their filibuster-proof majority will allow this president to do the politically expedient thing instead of the right thing. This is why I am nervous that this recovery, while it can't be stopped, could still be short-circuited by a panicked Democratic party with the votes to do whatever it wants over the next ten to twelve months.

THIS IS ESPECIALLY MADDENING BECAUSE THE ECONOMY IS EVER SO CLOSE TO CREATING THOSE SOLID, LONG LASTING JOBS THAT EVERYONE IS LOOKING FOR.

Take a look at the chart on page 4; there you see the Institute for Supply Management's Purchasing Managers' Index for the manufacturing sector. Clearly U.S. factories are


State and local: Net government saving
75.
50.
25.
0.
-25.
-50.
-75.
-100.
Economic Chart Dispenser
http://www.Economagic.com/
19 90
19 91
19 92
19 93
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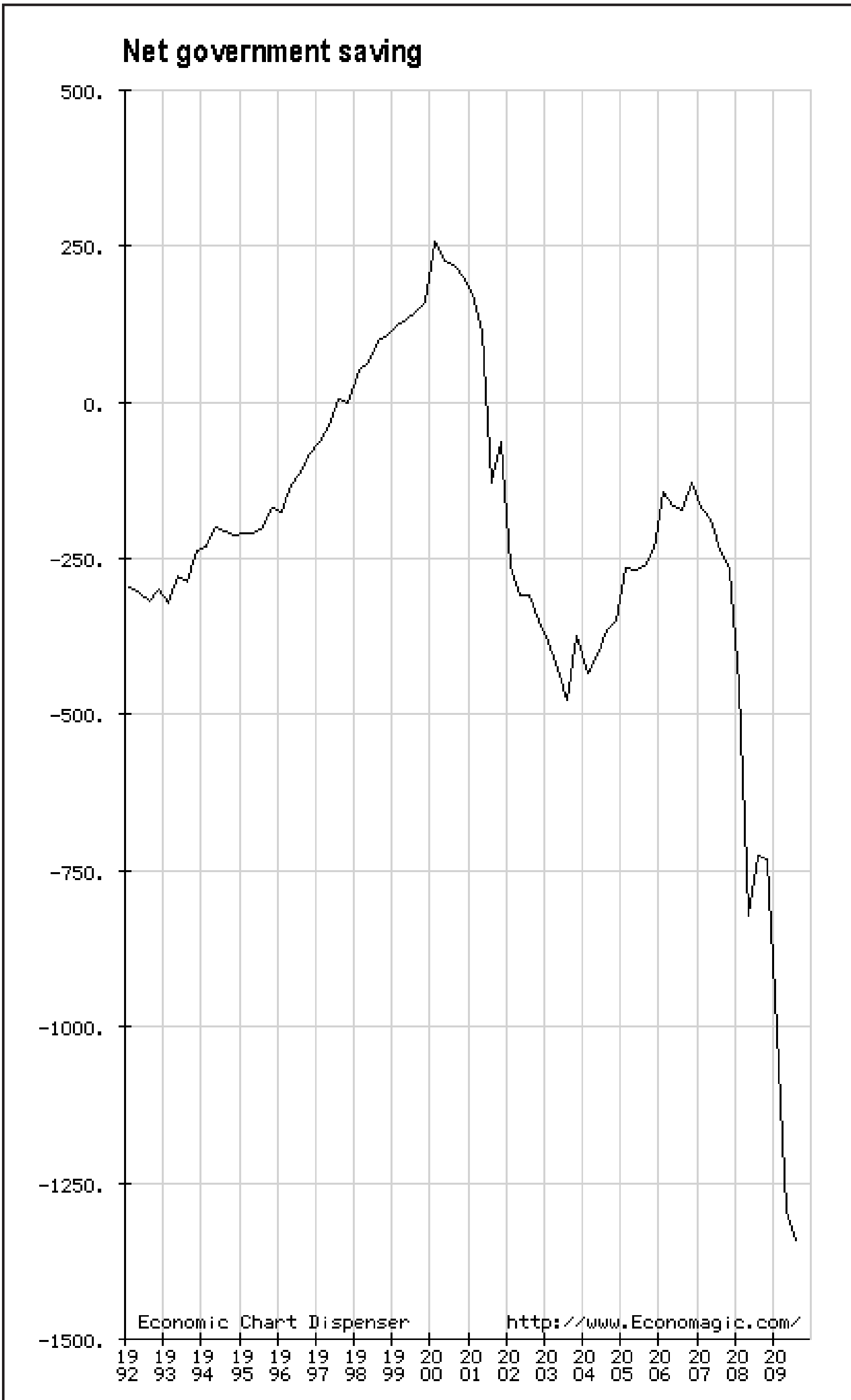
awakening. American business, scared into believing that the country was heading into another Great Depression, pulled the plug on new orders during the second half of 2008. The index signals growth when the number is above 50 and contraction when it is below that number. The panic of 2008 sent manufacturing into a tailspin, one it did not recover from for a full year. The PMI has been well above 50 for only five months now which suggests that the growing strength of this economy has not yet been reflected in the quarterly GDP numbers. On page six you can see what happened when the economy was recovering from the last truly serious recession we had, the one that ended in 1983. In the aftermath of that recession the PMI showed growth in the manufacturing sector for two full years before businesses found it necessary to stop stocking shelves with goods.

The reduction in inventories during this latest recession rivals the one seen back during the recession of 1981-82. Even with all the talk of overleveraged consumers it seems very likely to me that this current recovery in manufacturing will need to run on for another year or so before it thinks of slowing down. This kind of sustained boom in manufacturing is just what is needed if the country is to get it's unemployment rate back down to the 5% to 6% level that allows workers and politicians alike to stop worrying about losing their jobs.

The good news doesn't stop there either. On page eight you see what has been happening to savings in this country.


Net government saving
500.
250.
0.
-250.
-500.
-750.
-1000.
-1250.
-1500.
Economic Chart Dispenser
http://www.Economagic.com/
1992
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1994
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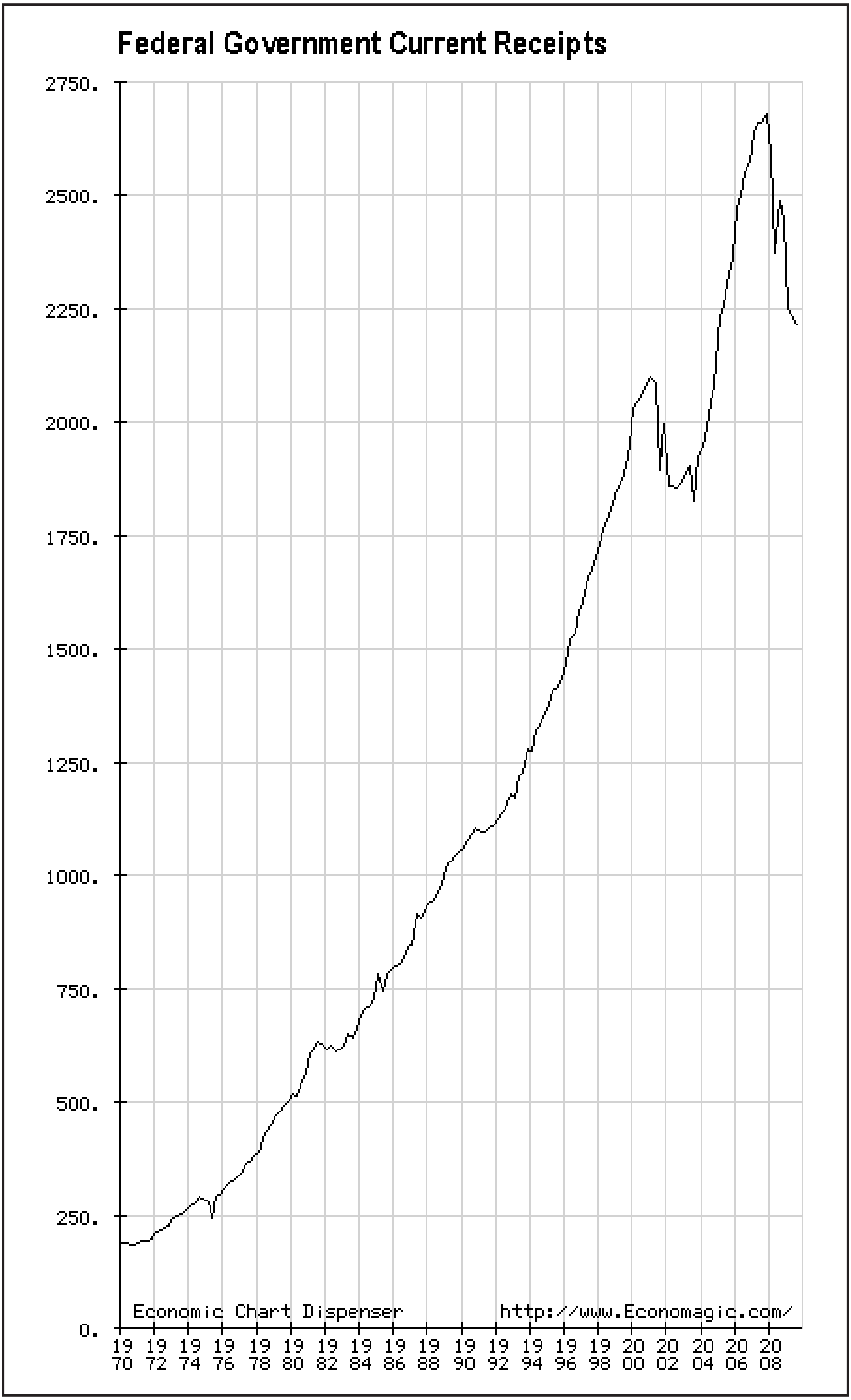
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009

I am constantly dismayed by the fact that so few people understand just how much money American's are saving these days. In the past two years we as a people have tucked an extra $500 million dollars into our savings accounts. This is not money being made in the stock market, which while nice, is not considered savings by economists. This is just the cash that we have tucked into the bank as economic fears mounted over the past couple of years. While the doom and gloom crowd would paint a picture of America going hat in hand to the Chinese, begging them to finance our debt, Americans are quietly changing from a debtor nation to a nation of savers. The chart on page ten shows that state and local governments have also been hard at work putting their financial house in order. Most states are required by law to balance their budgets. Unlike the Federal government, the states cannot keep issuing debt instruments to make up for their lack of fiscal discipline, at least not without eventually destroying their credit rating. The quick onset of the financial panic and recession in 2008 caught the states unprepared for a major drop off in revenues. In 2009 they began the process of bringing their budgets back into balance. Because state governments do not expect the Federal government to come to their aid again in 2010 the way it did in 2009 most are abandoning the practice of automatically increasing spending without a thought as to what the effect will be on their budget deficits. With the economy now recovering it is obvious that revenue streams will be moving higher as new growth generates higher tax revenues. This higher revenue should make it easier for the states to balance their budgets without help from the federal


Federal Government Current Receipts
2750.
2500.
2250.
2000.
1750.
1500.
1250.
1000.
750.
500.
250.
0.
Economic Chart Dispenser
http://www.Economagic.com/
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008

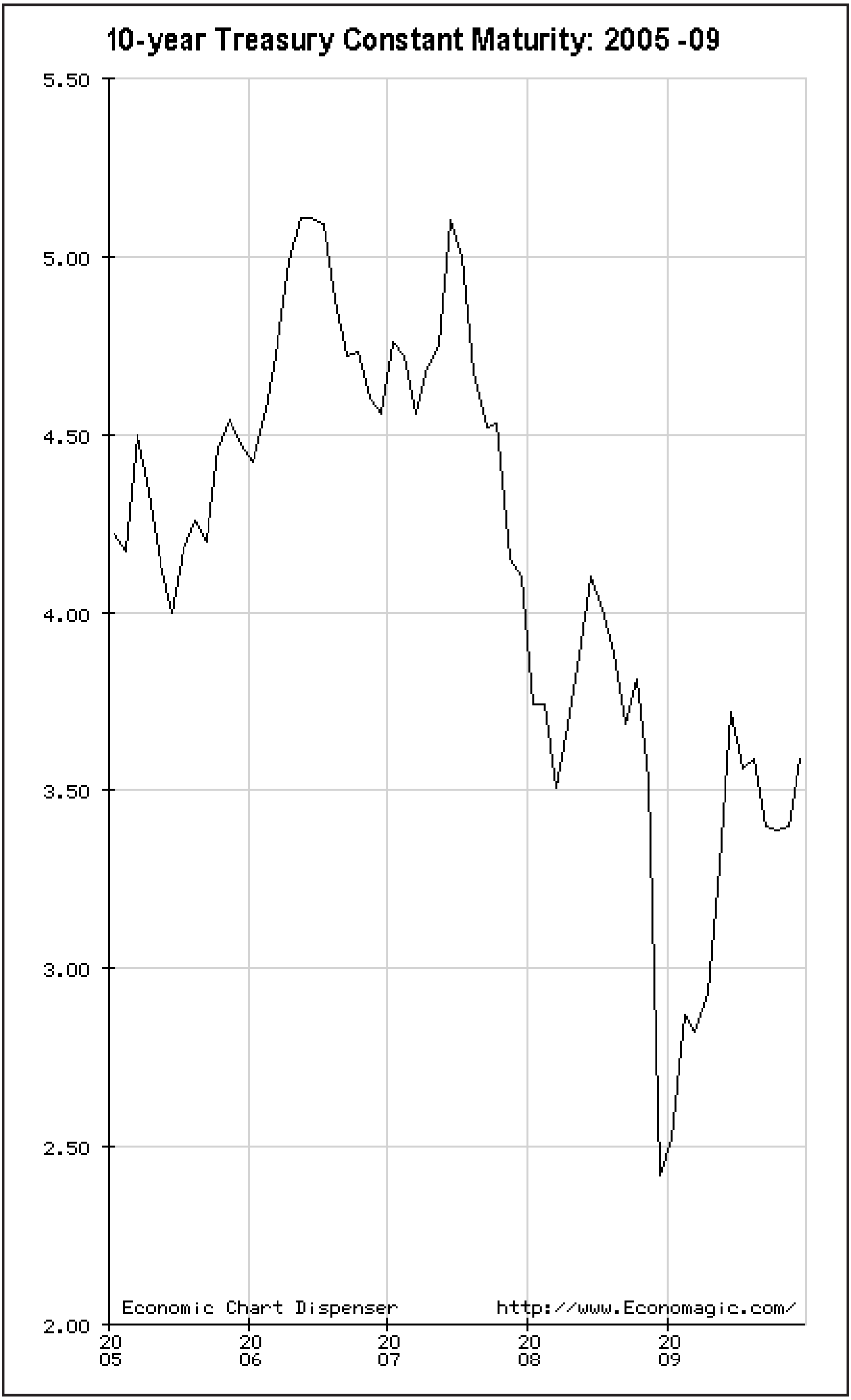
government.

ONLY THE FEDERAL GOVERNMENT IS UNWILLING TO GET WITH THE PROGRAM

The chart on page 12 shows you that there is only one party that refuses to join the rest of the country in this era of living within our means. That party is the Federal government. As the chart shows, the Bush administration had committed itself, early on, to bring down the budget deficit. As 2007 began the yearly deficits had been reduced by more than 50%. But George W. Bush couldn't stay committed to deficit reduction. As the country grew tired of his war in Iraq and the polls started to suggest that Republicans would be facing tough reelection campaigns in 2008, the president and his followers in Congress decided to throw fiscal sanity out the window in a desperate and hopeless attempt to buy voter loyalty with heavy doses of government spending.

Bush's expanded Medicare drug plan marked the start of the renewed indifference to deficits and it was only aggravated by the need to pass a $700 billion bailout plan in late 2008 when it became apparent that massive government intervention would be needed to keep the banking system from melting down and taking the rest of the economy with it.

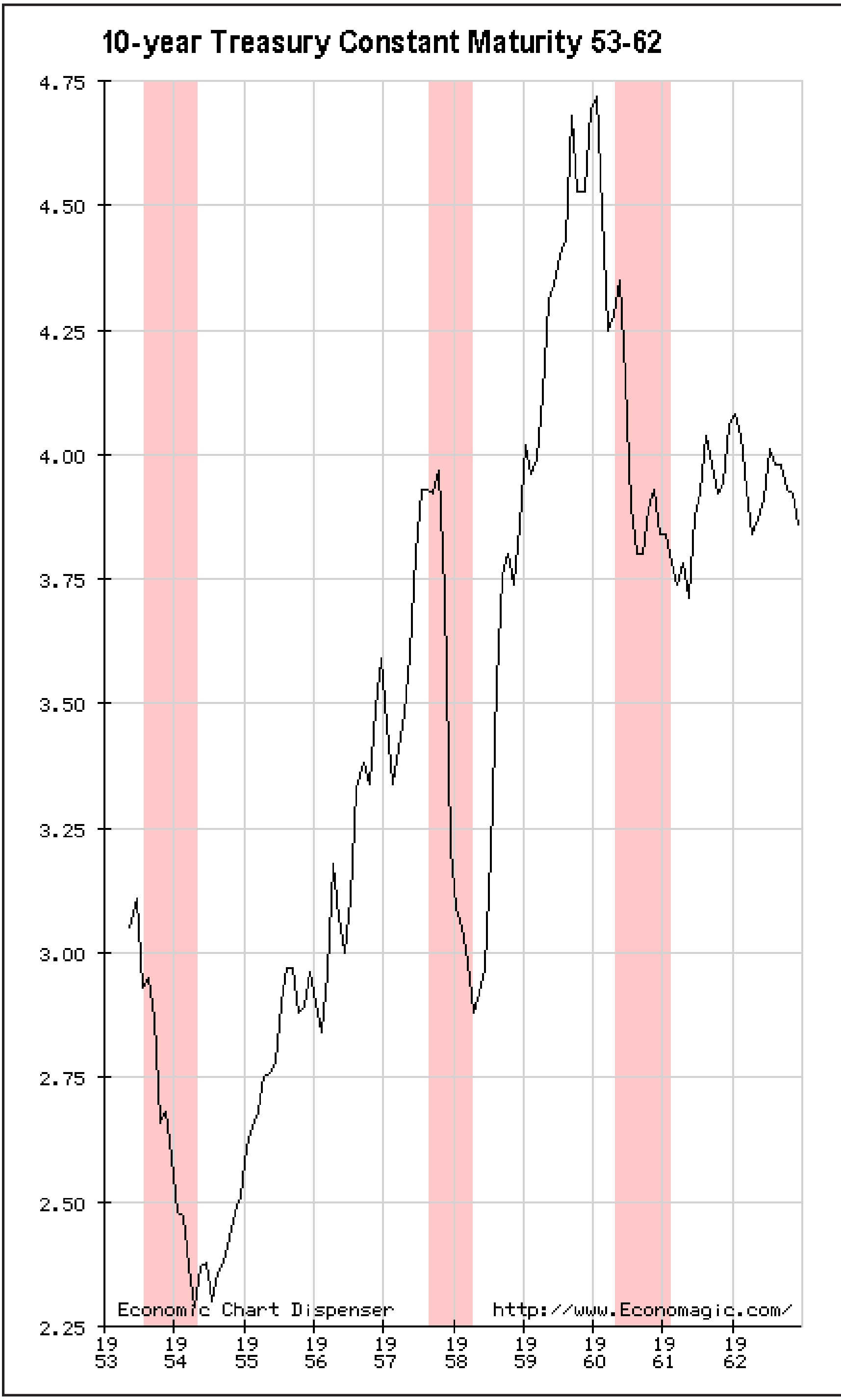
With President Obama Things Went From Bad To Worse


10-year Treasury Constant Maturity: 2005 -09
5.50
5.00
4.50
4.00
3.50
3.00
2.50
2.00
2005
2006
2007
2008
2009
Economic Chart Dispenser
http://www.Economagic.com/

Even before the new president took the oath of office the Democrats in the House and Senate began crafting a "stimulus plan" which they claimed was needed to turn the economy around. It didn't really matter to them if the stimulus package helped turn the economy around or not, the real reason for the stimulus bill was to pay back their political supporters. The Republicans, who had lost any moral high ground they might have had on the subject of deficit spending by not bothering to produce even one balanced budget in the previous eight years, had to stand by and watch as the Democrats raised deficit spending to levels undreamed of just two years ago. Worse still, if the president gets his way these deficits will not end when the economy is in full recovery mode and government revenues begin to increase again.

The chart on page 14 shows that while government revenues are down from their peak in 2007, they are not down enough to explain annual deficits that are forecast to exceed $1 trillion dollars a year for the next ten years. With the economy growing again in 2010 we can expect to see more revenues flowing into government coffers this year than last. The Obama administration wants to spend that money not use it to reduce the structural deficit.

As I said, this letter must go to press before the polls close in Massachusetts. So I can't say whether the voters, by electing the first Republican to a Massachusetts Senate seat in nearly 40 years, have sent a messages to the politicians in Washington that the time has come to end this foolish practice

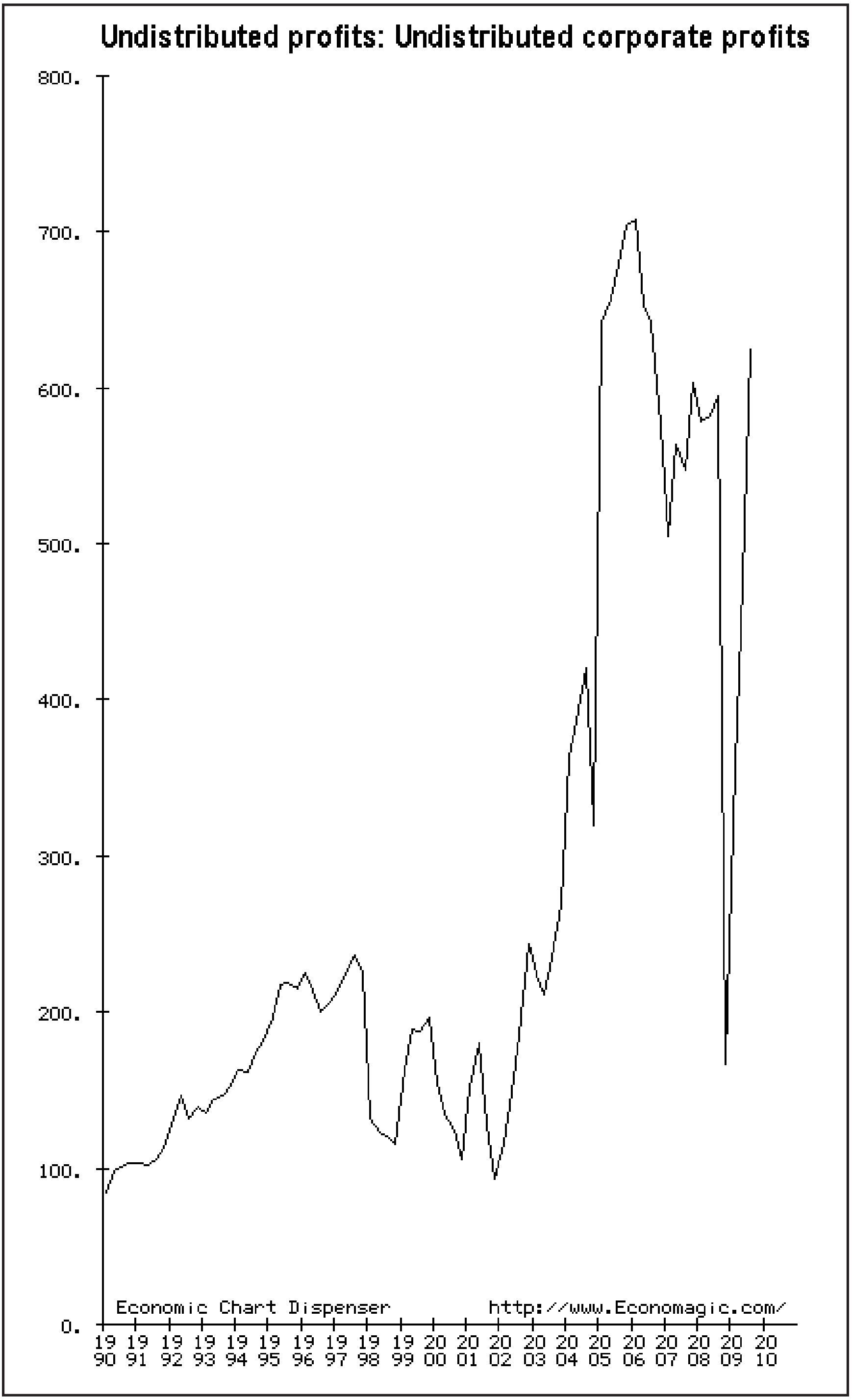


10-year Treasury Constant Maturity 53-62
4.75
4.50
4.25
4.00
3.75
3.50
3.25
3.00
2.75
2.50
2.25
Economic Chart Dispenser
http://www.Economagic.com/
19 53
19 54
19 55
19 56
19 57
19 58
19 59
19 60
19 61
19 62

of letting the U.S. government continue to live way beyond its means. Most private citizens have already made the switch. The state and local governments, having seen the writing on the wall, are bowing to voter pressure to stop mindlessly expanding spending and have started putting together budgets that make tough choices. If Scott Brown, the Republican running to fill the Ted Kennedy's seat, successfully upsets his opponent, a woman who has made it plain she wants to go to Washington to help the president pass all of his massive government spending programs and intrusive new regulations, then it is possible that we will look back at this election as a watershed event. The moment that the new era of big government ended before it really got a chance to start.

This does not, by itself, assure us that a new age of economic prosperity will dawn on the country, but it is a very important first step. The economy, while growing again, needs smart policies to nurture this growth. Step one in achieving this is to stop the far left in this country from passing legislation that would do real and lasting damage to the economy. Step two will be to end the ideologically motivated witch hunt designed to punish those whom the administration thinks are making too much money for their own good (an anti-American stance if there ever was one). Step three will be to put in place real reforms in healthcare, financial regulation, and energy policies that promote growth. And I mean real growth – the kind that is not dependent on government subsidies to favored groups and industries.

It was until recently, my belief that this could not take place


Undistributed profits: Undistributed corporate profits
800.
700.
600.
500.
400.
300.
200.
100.
0.
Economic Chart Dispenser
http://www.Economagic.com/
1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

until the elections in November when it was widely expected that Republicans would make enough gains in the House and Senate to force real debate over the issues facing the country. I had hoped that the Senate race in Massachusetts would be close enough to force the more moderate Democrats in Congress to rethink their support of this recent lurch to the left. However, with the polls now showing that the Republican has a chance to upset the once prohibitive favorite, I am more convinced than ever that Congress will at last yield to the will of the people and pass sensible legislation that will allow this nascent recovery to take root. This can lead to the kind of lasting prosperity we last saw back in the Reagan administration. A time when the U.S. economy created some 17 million new jobs.

NEWS OF A MOVE BACK TOWARDS THE POLITICAL CENTER SHOULD BE GOOD NEWS FOR STOCKS. BUT NOTHING I FEAR CAN HELP THE BOND MARKET THIS YEAR.

On page 16 you can see what has been happening to the 10-year government bond yield over the past few years. 2007 and 2008 were very good years to be holding bonds because interest rates fell by more than 50%. But it is the last year of the chart I want you to look at most closely. With rates climbing all year bond holders lost money in 2009, about 3% on average. This compares quite unfavorably to stock investors who saw gains of more than 20%.

It is my belief that this economy will continue to show "surprising" strength all year. Regardless of what the Fed decides to do with short term rates, it means that the long bond yield is likely headed higher. That translates into lower bond prices. How high can bond rates rise? If history is any guide, and I find that it often is, then it's possible that the interest rate on the 10-year bond could rise at least another point in the coming year. The chart on page 18 shows you what happened during periods of recession and recovery back in the 1950's. One needs to go that far back to find a time when inflation expectations were not artificially inflating bond rates in this country. Back in the 50's inflation was low, much like today. That meant that interest rates were a true reflection of economic conditions. You can see that rates spiked during the recovery that followed the recession of 1953-54 and again after the recession of 1957-58. The good news is that higher rates in 2010 need not be an impediment to strong growth. The chart on page 20 shows you just how many dollars the businesses in this country have been squirreling away over the past year. Despite the economic slowdown and the accompanying drop in profits, American businesses have managed to sock an extra half-trillion dollars away in their savings accounts. This money is available to finance growth without going to the bond market. This will help soften the blow as America transitions back to a more normal interest rate environment.

—Adrian Van Eck

ADRIAN VAN ECK EXPLAINS WHY HE OFFERS HOTLINES

In the summer of 1990 , Adrian finished His monthly Money Forecast Letter, Put it in the mail and flew off to Washington, D.C. for an appointment.

Adrian was in the office of the Secretary of Treasury when an aide rushed in and breathlessly announced that Iraqi armor and troops had just crossed the border of Kuwait. Needless to say, the planned meeting was cancelled, as first President George Bush summoned his cabinet officers to an emergency meeting at the White House.

The economy was suddenly turning upside down and Adrian wished he had a way to communicate with his readers. On the flight back to Boston, he decided it was time to supplement the in-depth analysis and forecasts in his monthly letter with a time-value weekly hotline.

At first he provided a voice message. That proved impractical and it was soon replaced by a fax version. More recently he added an E-Mail version, which is today the choice of 5 out of 6 hotline subscribers.

If you do not yet take Adrian's hotline on Money and the Economy, please turn over and sign up now.

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