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Investment Commentary

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Here are my 10 guesses for how the financial markets will shape up in 2010.
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1. **Stock and bond market returns in the US will again be positive.**
2. **The US dollar is likely to meaningfully appreciate once market-driven short-term rates begin to rise.**
3. **US dollar “carry trades” could get killed as 2010 progresses and the US dollar appreciates.** Once accounting for leverage, hedge fund performance will likely trail long-only equity performance.
4. **The Fed will spend the second half of the year trying to catch up to, and flatten, the yield curve.** Short-term rates could increase more than investors currently think. Long-term rates could rise quite a bit in the first part of the year as inflation finally begins to appear, but are likely to fall during the second half of the year when the markets realize the Fed is serious about fighting inflation. The curve is likely to be much flatter one year from today than it is currently.
5. **Corporate profits are likely to explode to the upside during 2010.** Trailing four-quarter S&P 500 reported earnings growth could exceed 100%. Investors still seem to be under-estimating the operating and financial leverage that is built into corporate profits.
6. **Employment in the US will probably continue to improve.** Consumer Discretionary stocks will likely be among the best performing sectors.
7. **Treasuries will probably underperform stocks.** That underperformance is unfortunately likely to reinforce both individual and institutional investors' views that it is wise to be under-diversified.
8. **Small cap value, I think, will be the US's best performing size/style segment.** Small banks outperformance might be the biggest surprise for 2010.
9. **Financial regulation will progress, but the bull market will probably aid politicians' “forgetfulness”.** As a result, new regulation could be relatively meaningless. In my opinion, serious regulation won't occur until after the next downturn, which could be worse if no meaningful new regulation is implemented in 2010.

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10. I think the Democrats will do better in the 2010 mid-term elections than people currently think they will. It seems very likely to me that in December 2010, investors will look back on the year and realize that monetary and fiscal policy stimulus still works.

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