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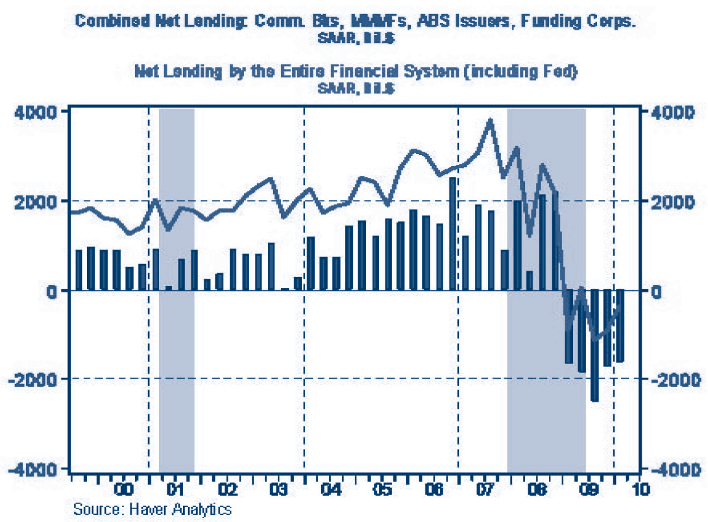
Is credit an issue? As the following graph shows, net lending in the entire financial system has declined since 2008. Since this measure began in the early 1950s, net lending had never declined.

Because the recession began with a financial crisis infecting the banking system, capital in that sector eroded, and the ability and willingness to lend went with it. Gross irresponsibility in lending was replaced by rectitude born of fear. It is perhaps fortuitous that demand for borrowing has fallen at the same time.



Much of the preceding commentary has been devoted to blaming excessive borrowing for the economy's retreat. Too much time hanging around the punch bowl can cause a hangover. Consumers, trying to repair their balance sheets, are less willing to borrow, major corporations have no need to borrow, and younger, riskier businesses are often being snubbed by lenders. No doubt this situation is inhibiting economic growth.

Is there any sunshine? It's no wonder that stock markets have wandered aimlessly. Mirroring the economy, nothing terrible has happened, but good news has been sparse. So far this year the S&P 500 has been as high as 9% above year end and as low as -8%. The average price this year is little different from last year's end.

Yet publicly traded corporations are a source of good news. While most economic measures remain below their pre-recession highs, corporate profits have been surging. Profits at S&P 500 companies are flirting with an all time record. In more normal times this would bring rising stock prices, but today the rest of the economic environment is holding markets back.

The only cure is the passage of time. In time political uncertainty will lessen, consumer spending will grow more rapidly, businesses will invest and hire, the desire to borrow will grow, and the willingness to lend will improve. With corporate profits already strong, a little visibility in other components of the economy will go a long way.

News From HeadInvest

We describe ourselves as both investment managers and investment counselors, and the counseling role is of increasing importance. As counselors we help clients and prospective clients understand the dynamics of using their assets most efficiently in their lives. Think of this activity as asset-based financial planning. If deeper attention to this kind of planning would be useful to you, give us a call.

We reported earlier this year that **Ken Blaschke** joined us in portfolio management and research. Now we are pleased to welcome **Steve Poulos** as a portfolio manager and **Chris Wiers** in technology and operations. Steve is well known to many in the greater Portland area and originally hails from Bath. Chris comes to us by way of Spinnaker Trust and Maine Bank & Trust.

As always, our goal is serving our clients better and meeting the challenges of increasingly complex financial markets. We will continue to use the right combination of brainpower, personal service, and technology to help our clients reach their financial goals. If you, or someone you know, could benefit from our services, please contact us.

At HeadInvest, we bring our breadth of experience to a disciplined investment process focused on achieving success for our clients.

HEAD INVEST

Market Comment

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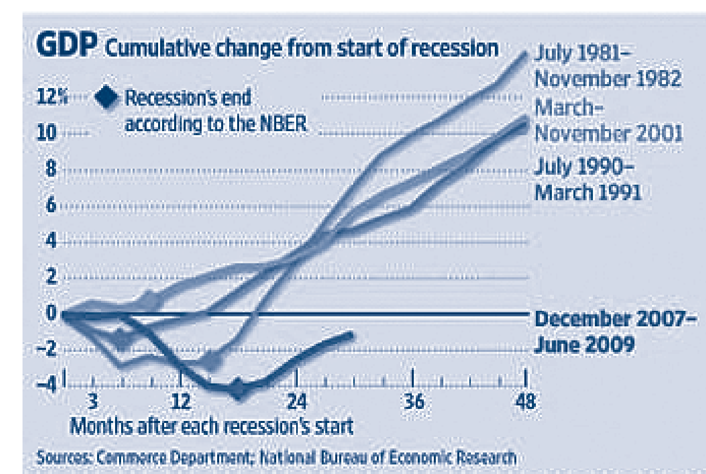
THE RECESSION IS OVER!?!

The Business Cycle Dating Committee of the National Bureau of Economic Research declared recently that the trough in the business cycle - the bottom of the recession - occurred in June, 2009, and the U.S. economy has been recovering since.

The recession that began in December, 2007, lasted eighteen months, making it the longest since World War II. Unfortunately, the pace of recovery is also the slowest. The graph below compares the recession and recovery phases of recent business cycles.



National Bureau of Economic Research

Why is this recovery slower than others? The nature of this downturn and the policy responses to it have formed the nature of the recovery. To recap, a good part of the economic growth from 2002-2007 was fueled by aggressive consumer borrowing, often through home equity. We all know what happened next. The decline in house prices left many homeowners with negative equity after their mortgages, and many if not most homeowners were unnerved by the decline in their net worth. These shocks led consumers to begin de-leveraging. The University of Michigan Consumer Confidence Survey fluctuated between 80 and 100 from 2002 through 2007, fell to a low of 55 in early 2009, and is now in the mid-sixties.

Some of the Federal policy responses have created further uncertainty. Beginning in the Bush administration, Federal deficits increased and have continued to grow under President Obama. While economic stimulus through increased government spending may be a proper prescription for an ailing economy, an overdose is worrisome to many. Many people - including business owners who can help reduce unemployment - are further concerned about unknown costs and other consequences of both health care and financial regulation legislation. Both these new bodies of law leave a great deal of their content to future decisions by regulators. Uncertainty about future tax rates adds to the worries.

After a fairly typical beginning to the recovery, a vicious circle began emerging: Slower gains in consumer spending reduce the pace of business growth, lessening the need to add workers, which further slows consumer confidence and spending. As a result, unemployment remains much higher than in prior recessions at this point in the recovery.

Are low interest rates good or bad? The Fed has strived to maintain interest rates at extremely low levels in an effort to lubricate the economy. Markets have been helping to achieve this goal. Part of consumer and investor response to the financial crisis has been extreme risk avoidance. Demand surged for government issued bonds and notes and insured bank deposits, increasing the available supply of liquidity, and at the same time borrowing demand fell. More supply and less demand usually means lower prices, and the price of money is no exception.

Low interest rates are helpful to national governments financing deficits and to state and local governments trying to rein in budgets, but they are problematic for people who live on investment income. Watching their spending is a natural response, inhibiting overall consumption growth in the same way as unemployment.

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