American Heritage Securities, Inc.

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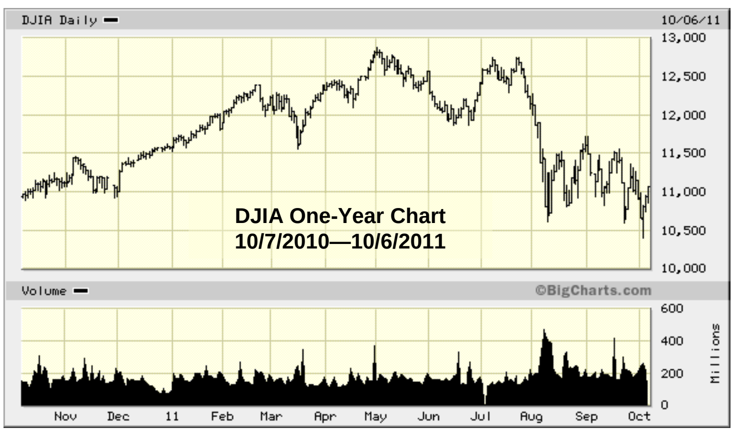
Registered Investment Advisor

Market Update
October 7, 2011

Perception Becomes Reality: Pessimism, uncertainty and gloom reign in the financial markets—and in our world in general. After stocks exhibited mind-numbing volatility in August, the market made September imitate The Cruelest Month by declining another disheartening 7.2%. As of the end of September, the S&P 500 index was down over 17% from the highs of late April. This market decline occurred against a backdrop of weakening economic indicators as well as frustration with political leaders and government action—and/or inaction—all around the globe. Europe's long saga of debt woes seems to finally be reaching a climax while economic data show the impact of mushrooming uncertainty and concerns which have infected business and consumer sentiment.



Clear deterioration in economic conditions during August actually generated reason for optimism in early September with news that the President would announce an "innovative and comprehensive" program to get the economy back on track while the Fed scheduled a special two-day meeting to reassess the economy. The President's back was against the wall and there was hope he would propose effective solutions to relieve the malaise that Washington has inflicted in recent months. Fed chairman Bernanke has a history of aggressive action and a special meeting would surely be followed by an effective plan. Unfortunately, the President's Jobs and Recovery Act turned out to be a huge collection of income transfer ideas that would do little to create real jobs and nothing to improve the economy. Then, the Fed's late September plan turned out to be a subtle program to lower long-term interest rates—nothing that will significantly impact the current economy. Also, Bernanke voiced a new glum assessment of deteriorating economic conditions and increased risks—subduing even further any positive impact the fed's new plan might have had. By the end of September investors didn't know if they should be more frustrated by evaporating stock prices, our government's ineffectiveness or the mounting crisis in Europe.

Within this environment of excessive disillusionment, early October has actually provided a few glimmers of hope. First of all, stocks are tremendously oversold and investor sentiment is at negative extremes typical at major market bottoms. In fact some confidence and sentiment indicators are at levels reached at the market low of March 2009. Second, economic and earnings reports continue to be surprisingly good in spite of all the economic concerns. Important sectors of the economy are still strong and other sectors are showing solid resilience. For example, consumer sales are extremely susceptible to the ills of the economy, yet preliminary reports on retail sales for September show an increase of 5.3% compared to growth of 2.7% in the month last year. More importantly, after a dizzying show of disunity and confusion, European leaders actually agreed on some constructive ideas to address the Greek debt tragedy. While verbal proposals are a far cry from achieving concrete action, markets are encouraged by any kind of unity coming from the battered European Union.

Index	Sept 2011	3rd QTR	2011 Y-T-D
Dow Jones	– 6.0%	–12.1%	– 5.7%
S&P 500	– 7.2%	–14.3%	–10.0%
NASDAQ	– 6.4%	–12.9%	– 9.0%

Looking deeper into the September decline indicates investors are betting the economy will slow dramatically, if not enter recession, in the near future. This is best illustrated by dramatic declines in those stocks most exposed to weakness in the economy—what we call "cyclically sensitive" stocks. The worst performing sector of these cyclical stocks was "materials" (energy, mining and commodity companies)—the sector declined by 16.6% in September while the prototypical non-cyclical sector, utilities, declined only 0.1% last month.

Many investment managers have recently adjusted recommended strategies to reduce exposure to economically sensitive sectors and increase holdings in lower risk sectors and assets. We are not yet convinced the economy is entering a recession and believe the selling has gone too far—especially for the highest quality stocks. We agree that allocations should be carefully reviewed for excessive exposure to economically sensitive sectors and risk but wholesale adjustments to investment strategies are not appropriate in the current crisis environment. Many quality stocks are too cheap considering their long-term potential. Dividend yields for most blue chip companies are secure and such stocks are attractive no matter how aggressive or conservative an investor may be. On the other hand, there is no reason to hold shaky companies or those with a questionable future. Long-term investors should focus on quality and yield as they ride out this environment where perceptions are likely much worse than reality.

Best regards,

Ted Ingraham

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