

HAYES ASSET MANAGEMENT LLC



Index Returns for 2009

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|-----------------------------|---|---------------|
| DOW JONES INDUSTRIALS | ↑ | 18.82% |
| NASDAQ | ↑ | 43.89% |
| STANDARD & POOR 500 | ↑ | 23.45% |
| DJ TOTAL STOCK MARKET INDEX | ↑ | 26.52% |
| BARCLAYS CAPITAL AGGR. BOND | ↑ | 5.93 % |

Treasury Yields

| | |
|----------------|-------|
| 6 Month T-Bill | .19% |
| 2 Year Note | 1.14% |
| 10 Year Bond | 3.84% |
| 30 Year Bond | 4.63% |

Commodities for 2009

| | | |
|-------------|---|---------------|
| Oil | ↑ | 77.76% |
| Natural Gas | ↑ | 3.29% |
| Corn | ↓ | 0.63% |
| Wheat | ↓ | 16.16% |
| Gold | ↑ | 26.48% |

“Successful Investing is Anticipating the Anticipation of Others” - John Maynard Keynes

When we last wrote in November 2009, our government was contemplating a raise in the debt ceiling. On Dec 28th, 2009, President Obama signed into law an increase in the federal government’s borrowing/debt limit to \$12.4 trillion. Barely a month later on Jan 28th, the government raised the ceiling another \$1.9 trillion to a total of 14.3 trillion. That works out to roughly \$45,000 per US citizen.

In the same letter, we also wrote about the US dependence on foreign funding for our deficits, warning that we would need to be wary of China as our biggest creditor. China is now flexing its muscles and beginning to pressure our Treasury Dept. TIPS (Treasury Inflation Protected Securities) auctions this year will increase in size by 40%. China has been gently nudging the US to issue more TIPS securities so it does not get stuck holding a huge amount of low coupon treasuries in an inflationary/rising interest rate environment. This move takes away the advantage of low interest rates for the US government by tying the debt to inflation. Since history has shown the cyclical nature of economic ups and downs, we believe the current recession will inevitably be followed by a period of inflation and when that happens, TIPS securities will cost taxpayers more in the long run.

Nations are no different than companies when it comes to debt. The more debt they carry the harder it is for them to get through the rough patches, i.e. recessions. Granted, governments can issue debt and print money, but at some point they also have to pay back those loans. The United States is carrying some dangerous levels of debt balances. Most of the major credit agencies have reaffirmed the

AAA credit rating of the US but have warned that ballooning debt levels could jeopardize that rating. Japan recently received a warning from S&P about a possible downgrade of their credit rating. The U.S. could be next.

2009 Performance

Looking back, after a dismal start, 2009 turned out to be a stellar year for our investors.

Corporate Bonds

We normally buy fixed income securities and hold them to maturity. But on occasion we purchase corporate bonds with the intent of realizing equity type returns. The following are three examples of the corporate bond investments we made in 2009, which generated the kind of return usually seen only in stocks.

In March 2009 we purchased Commercial Metal bonds 6.5% 7/15/17 at \$74 and sold them in December at \$102. An investment in \$10,000 face amount of the Commercial Metals worked out this way:

| | |
|-----------------------------|------------|
| Original investment amount: | \$7,487.44 |
| Proceeds from sale: | \$10,222 |
| Interest earned: | \$585.00 |
| Profit: | \$3,319.56 |
| 9 mo. % return: | 44% |

The other two purchases also had results well beyond our wildest expectations. We bought Champion International, 7.2% 11/1/26, in April at \$93. It was called away about six months after purchase for 108. The United Dominion story was even more extraordinary. We acquired

United Dominion, 8.5% 9/15/25, in August at 95 on the day before it reported their quarterly earnings. Buried in the earnings release was the information that they were commencing a tender of 110 for the bonds we just bought at 95! We actually held them for only 17 days. In both cases, not only did we get the higher tender/call price, we also collected the coupons for the holding periods. That is what we mean by generating stock returns using corporate bonds. Of course it does not work out this way all the time.

Municipal Bonds

On the other hand, the municipal bond market continues to be held hostage to the BAB Market. BAB, Build America Bonds, which we discussed in our August 2009 newsletter, are fully taxable and continue to be the poison of choice for municipalities. We are again experiencing a market where there are more dollars chasing fewer available securities, ie the traditional municipal bonds, which are completely tax-free. The supply/demand imbalance is keeping municipal bond prices up and yields at very low levels. We will continue to buy bonds with short maturities and be patient. The higher taxes proposed by the current administration will only make municipal bonds more attractive.

Stock Market

Laggards for the year were many of the usual suspects. We bit the bullet and sold several of our Puerto Rico bank holdings mid-2009. Vulcan Materials, tied to the real estate market, is still under severe pressure. Some of the drug/biotech holdings also under performed last year, including Amgen and Biogen.

We saw some merger and acquisition activity with Merck buying Schering Plough. Another of our core holdings, Pfizer, purchased Wyeth. In preparation for that merger Pfizer reduced their dividend by 50% and let it be known that once it began to digest the Wyeth acquisition the dividend would be increased. They followed through with a dividend increase for the 1Q 2010. We also sold our position in StreetTracks Gold Trust. Gold broke \$1,200 per ounce and there have been a flood of commercials and ads on TV, radio, web, and newspapers encouraging the

public to turn in their old gold for cash. Gold parties are the new social phenomenon. Gold has turned into everyone's favorite investment. That kind of market is usually a good time to *sell*. While we still believe that inflation is a threat down the road, it is our feeling that gold has become a commodity for short-term speculation with lots of money flowing into that hard asset. When it is priced more rationally we will look at adding it back to your portfolios.

Other stock investments that had positive returns for 2009 were CB Richard Ellis, Dillard Dept. Stores, McKesson, Intel, Honeywell, Hutchinson Whompoa, American National Insurance, Annaly Capital, Manitowoc and the New York Times. Returns ranged from 23% to 374%.

Let us hear from you regarding any topics covered in this newsletter or the status of your account.

**HAYES
ASSET MANAGEMENT**

Would Like to Invite You to a Night at

LITTLE

On April 8th, we would like to show our appreciation by taking you and a guest to dinner and a movie at The Little on 240 East Ave in Rochester!

“Since 1929, The Little has fulfilled a commitment to excellence in Rochester and is a strong community partner and advocate for growth. As a not-for-profit organization, The Little continues to deliver the finest in film, art and music, while expanding its education and outreach programs, and ensuring its financial integrity through individual and corporate memberships and donations.” (www.TheLittle.org)

Please look to your mail in the coming weeks for an official invitation containing more details! We hope you can join us for this exciting event!

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Hayes Asset Management, LLC
 400 Andrews Street Suite 600 Rochester, NY 14604
 Phone: 585-730-6951 Toll-Free: 866-423-5332 Fax: 585-730-6944
 Website: www.HayesAssetMgt.com Email: LFarmer@HayesAssetMgt.com