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February 2010

In this month's market letter we will comment on whether an active approach to investing is favorable in 2010, review the 2009 year ending data, and our outlook for 2010.

Equity investing

Investors are human. We all tend to gravitate toward the easiest method of approaching most difficult tasks we are facing. The riding lawn mower, the automatic dishwasher, even the automobile, these are things we created to make our lives easier. The same can be inferred about the buy and hold approach to investing. For a few decades investors have been sold on the idea that you simply invest money into a mutual fund or an index investment and do not try to time the market by making changes to your position. This approach has been touted by companies that create investment products we are supposed to use for this philosophy, so naturally they are unwavering in their support of this thesis.

However, this approach has fallen apart during the last 10 years as investors neglected to continue their due diligence and maintenance of their investment portfolios. We prefer to approach investing differently. We look for out-of-consensus ideas that incorporate ahead of the curve investing. We would prefer to be early to an investment idea rather than late. It is our view that this approach provides the best opportunity to outperform the broad market.

An example of this was our favoring Consumer Discretionary stocks late in 2008. At that time many investors shied away from taking on stocks that suffer during economic downturns. Our viewpoint was to look at some of the mid to low level retailers and restaurants to find value in their business during an economic downturn as an opportunity to invest early in a sector that could actually be quite stable. More people would shop at TJ Max (symbol TJX) stores, or eat at one of Darden Restaurant's (DRI) dining establishments than they would spend big dollars at a high-end retailer or restaurant. As such, our positions in these two stocks, and others in that sector, were reasonable choices and resulted in successful investments because we invested early in a sector that was oversold, had stability within a difficult economy, and would soon turn very positive as the economy improved.

A key component to this active approach was that we avoided this sector completely in 2008 as the economy fell, and the outlook worsened. We avoided the downturn and began our investment in Q4 2008 closer to the bottom. If we were buy and holders, we never would have created this opportunity.

As we move ahead through 2010 there are several catalysts that we feel will help equities. The fourth-quarter earnings season continues to be strong – 70% of the 222 companies of the S&P 500 that have reported so far have beaten estimates. 4Q09 earnings are now estimated to come in at $16.96 per share, a continued climb from extraordinary low levels.[1] There was no change in the inflation portion of the FOMC statement, with subdued inflation expected to remain for the upcoming year. Overall, the January FOMC statement language appears to be pointing toward improving economic conditions. It is our view that despite the impressive run-up, stocks still look cheap by conventional valuation measures and are still the favored asset class over bonds and cash.

A look at the figures and forecast

In January 2009, we were faced with a record slide occurring in most areas of the economy and the financial markets. The outlook was quite bleak, and the consensus estimates for 2009 were pessimistic. I felt that the economy would bottom well *after* the market had bottomed – recall the leading/lagging indicator discussions - and that the recovery in the stock market would take hold in 2009, while many investors were still downbeat.

When a year with great volatility in the markets is upon us, and bonds, stocks, and economic data are heading in seeming conflicting directions, it is very difficult to hit the mark with twelve-month predictions. However, after the dust settled, my view of where we would end the year was an accurate approximation.

	End 2008	Forecast '09	Actual 2009
Global GDP Growth	2.01%	(1.7%)	(2.0%)
Core CPI (US)	1.8%	1.5%	1.8%
Unemployment	7.2%	8.5%	10%
Fed Funds Rate	0-0.25%	0.25%	0.25%
S&P 500 index	903.25	1075	1115.10
10 yr Treasury Note	3.85%	4.25%	3.84%

The area that should stand out to us is the S&P 500 index level. Considering the environment in early 2009, taking such a bullish stance in the equity markets and anticipating a 20% return in the market, was quite bold. However, considering (1) double digit rallies have often occurred after severe market sell-offs, and (2) the comparison of corporate earnings expectations to the price of stocks was reasonable, it was not an overly aggressive position.

Here is a summary of my view of the economy and the markets in 2010.

Global GDP growth	4.20%
US GDP growth	4.25%
Unemployment rate	8.5%
Core CPI (inflation)	2.2%
Fed Funds Rate	0.50%
S&P 500	1225
10 yr Treas Note yield	4.25%

Overview of the 2010 outlook for equities

In our view, our economy can be expected to continue its recovery in 2010, leading to asset price appreciation in most types of investments. However, a key theme for 2010 will be to accurately identify the outperforming sectors as not all asset classes will show strong performance.

The strong performance of risky asset classes last year will continue this year but at a more muted pace. We favor risk assets over safe assets, but recommend a slightly higher quality risk asset during this phase of the recovery. Typically, once our economy bottoms and stock prices have severely declined, the markets experience "snap back" rallies in many of the stocks that have fallen the most. These rallies occasionally continue for several months. We experienced this in 2009 as investors realized all businesses were not headed into the abyss, and at some point the value of these companies would be fully appreciated by the market. This resulted in higher bids for stock prices in the future. As a few stocks gained momentum, the broad market was impacted as more and more investors accepted this view. The result was the greater than 50% upswing we realized from the market low in March of last year to the end of the year.

This pace of growth in stocks may slow in 2010, and our selectivity favors investors overweighting better quality companies. There will still be some opportunity in low quality/high risk stocks, but we believe the opportunity will be rather narrow and only within favorable sectors, thus an investor must be careful to target specific companies.

Within our Sustainable Dividend Portfolio of individual stocks, we maintain our Value style orientation, and continue to screen the market for companies exceeding our criteria for free cash flow, dividend payout ratios, and earnings growth. We favor an overweight in the Industrial, Health Care and Energy Sectors, while we are less constructive on Utilities, Materials, and Telecommunications.

In our Global Allocation Portfolio for equities, we are overweight Large Companies, and underweight Medium and Small companies. Our overall exposure to Domestic companies in the portfolio is still much greater than International, however we have increased our weighting in the new year among international country specific investments. At this time we prefer the Emerging Market countries over the Developed Market countries.

We have seen reasonable valuations and the likelihood of earnings improvements as catalysts for equity market performance in 2010. There have been plenty of positive earnings reports from previous quarter's activity which suggests the rally of 2009 is sustainable this year. Investors will continue the trend of reallocating money from cash back into the equity markets. This is the fuel that we discussed last year. Impediments to the continued growth of stocks in 2010 may include the acceleration of an increase in interest rates, the return of weaker economic growth, and the possibility of legislation that is unfavorable to equity growth.

However, we expect that an investor who makes a commitment in 2010 to the equity market will be rewarded. Whether their investment is measured at the end of the year, or more reasonably in 5 years, an equity investor should feel comfortable committing capital in 2010. Our belief is that we will realize a slow grind upward, with some hiccups along the way, and an investor would be best served by tactfully selecting their entry points and sectors. In other words, the spread between the best performing sectors and the worst performing sectors will widen in 2010 and we advise an active approach to investment selection and portfolio management.

Considering the content of this month's Market Letter, you may have questions. If you are uncomfortable with your current investment plan, I encourage you to call us to discuss your situation. Please call me at 610-629-0660, or email me at PaulL@centurionassetmgt.com, to discuss your feedback or questions.

Sincerely,

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[1] JPMorgan, January 2010 "Market Insights".

Important Disclosures

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