

Key Data Points:

- Job losses appear to have ended. Job gains are expected to average 100,000-per-month this year.
- Leading indicators, including the stock market, point to continued growth. Double-dip recession unlikely.
- National debt is soaring. U.S. debt-to-GDP could reach 65%.
- Real GDP growth of 3% expected for 2010, rising to 4% in 2011.
- Homes prices expected to fall another 5% nationally.

Inside this issue:

- Economic forecasts strengthen 1
- Stock market rally continues 1
- Recovery Still at Risk 2
- Small Cap Value Advantage 2
- REIT fundamentals and dividends 3
- Emerging markets leading recovery 3
- Roth Conversions *Back*

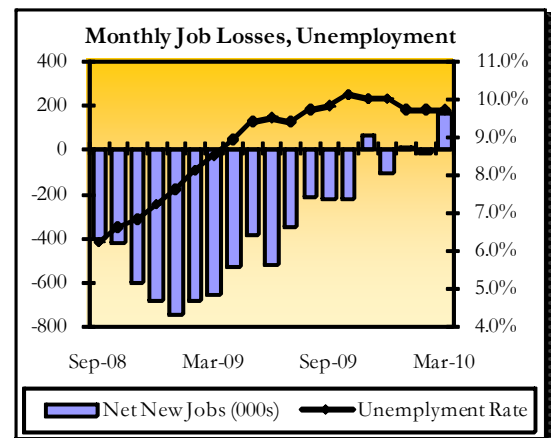
U.S. Economic Recovery Begins to Gain Traction

Most economic statistics have turned positive, but the economy needs to start creating jobs.

Economic recovery in the U.S. is gradually morphing into a self-sustaining expansion. Real GDP has been increasing since the middle of last year and job creation is beginning to gain traction. Over the last few months, expected 2010 GDP growth has been upgraded from just over 2% to closer to 3%. Meanwhile, the Federal Reserve and fiscal policymakers remain committed to supporting the economy through low interest rates and high government spending, making a double-dip recession even more unlikely. By this time next year, economic expansion should be in full swing.

JOB GROWTH AT LAST

Even as GDP growth has turned positive, the missing link between a government-supported recovery and a self-



sustaining expansion has been the lack of hiring. Luckily, February will likely mark the end of job losses for this cycle (chart). Employment increased by 162,000 in March with gains in manufacturing, retail, and lei-

(Continued on page 2, Economy...)

Stocks Push Higher as Economy Recovers

Small company stocks look especially attractive based on valuations.

The first quarter began with the stock market correcting roughly 6%. However, after this initial move lower, the bull market resumed pushing the Dow Jones Industrial Average to nearly 11,000. In March, the broader S&P 500 index enjoyed its best month since last August, rising 5.9%.

In March, the S&P 500 advanced 5.9% — its best gain since August.

Since bottoming more than a year ago, the stock market's steady climb has proved frustrating to those investors waiting for a sizable pullback before investing — once again demonstrating the perils of

trying to time the market.

We remain cautiously optimistic that the recent upward trend can continue. Business conditions continue to improve, stock valuations are reasonable, interest rates are still very low, and as a contrary indicator, investors remain skeptical about both the stock market rally, and the sustainability of the economic recovery. In other words, this market lacks the general investor optimism and complacency that often signal a market top.

In addition, companies are flush with cash — roughly \$2.8 trillion for nonfinancial firms. With the exception of a brief

(Continued on page 2, Stock Market...)

ECONOMY...

(continued from page 1)

sure, as well as governmental hiring related to the census. However, the unemployment rate held steady in March at 9.7%, as more people re-entered the labor force.

Business conditions seem to be in place for additional job creation. Demand for goods and services has stabilized, while corporate profits and cash flows have rebounded strongly. At the same time, unit labor costs are falling at their fastest pace on record, as wage growth has slowed and productivity has risen sharply.

Larger firms that significantly cut payrolls during the downturn seem especially well positioned to resume hiring due to their improved business outlook and relative ease in obtaining credit – something which is still difficult for smaller firms.

RECOVERY STILL AT RISK

The economy is gaining strength, but until job growth is sufficient to meaningfully reduce slack in the labor market, recovery is not certain. In the coming months, the labor force is likely to grow as discouraged job seekers return to the job market as job prospects improve. To accommodate these workers, and lower the unemployment rate, monthly job gains need to be consistently above 150,000 – which could be months away.

Until a significant number of the 15 million unemployed (not to mention the 11 million underemployed) are working again, the recovery will be at risk.

GOVERNMENT BORROWING

With all the government spending designed to support the sagging economy, the federal budget deficit is set to top last year's record \$1.4 trillion shortfall. This additional debt

is expected to push the nation's debt-to-GDP ratio to 65%. To put this in a historical context, the U.S. debt-to-GDP ratio has averaged around 40% since World War II, and hasn't reached its current level since just after that war.

In spite of the ballooning deficit, global investors don't seem to be losing their appetite for U.S. government debt, which has helped to keep 10-year Treasury yields at or below 4%. Fiscal policymakers find themselves in a delicate position. On the one hand, lawmakers want to support their constituents through government stimulus spending. On the other hand, the current high deficits are unsustainable and unless lawmakers can show some spending restraint once the recession is behind us, foreign investors will begin to question the financial soundness of United States, causing long-term interest rates to rise.

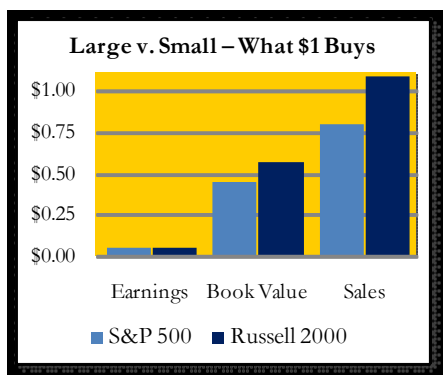
OUTLOOK

The economy's near-term outlook is improving. Real GDP growth is expected to expand by almost 3% in 2010, then accelerate to near 4% in 2011, and 5% in 2012. Employment gains are also expected to accelerate, with monthly job gains averaging about 100,000 this year, 250,000 in 2011, and more than 350,000 in 2012. Still, the unemployment rate will likely tick higher through this year, peaking near 10.25%, as more people enter the labor pool, but it should decline steadily in 2011-2012. However, it likely won't be until 2013 that employment returns to its pre-recession peak.

National house prices are still expected to fall further this year and into next year, but the 5% expected drop in the Fiserv Case-Shiller index is roughly half of decline previously anticipated.

The nascent recovery is still fragile. However, the odds are increasing that a self-sustaining economic expansion will soon take hold. ■

(Stock Market... continued from page 1)



excess cash should help fuel growth as the economy recovers.

Smaller companies are often more vulnerable to economic downturns than larger firms. However, now that the economy appears to be recovering, we estimate the risk

span after the corporate governance scandals of the mid-2000s, firms have a larger percentage of cash on their books than any time in 23 years, and the highest ever if financial companies are included. This

associated with smaller-company stocks has dropped considerably. Much of this assessment is moored in stock valuations that are more attractive than larger-company stocks. In the measures of price-to-earnings, price-to-book, & price-to-sales, small cap stocks show a significant valuation advantage over large cap stocks. (see chart)

Also driving small cap stocks is the rapid rebound of their earnings. Estimates from Standard & Poor's predict that first quarter 2010 earnings for small company stocks will grow 385% over 2009, versus 70% growth large company profits. Second quarter earnings estimates are similarly lopsided, suggesting stock prices could rise further.

In addition, small cap stocks also have a tendency to outperform large cap stocks coming out of recessions. These stocks (as measured by the Russell 2000) have outperformed since the market bottomed in March 2009, but this outperformance may still be in its early stages, as these cycles often last multiple years. ■

Real Estate Investment Trusts (REITs) Could Have Farther to Run

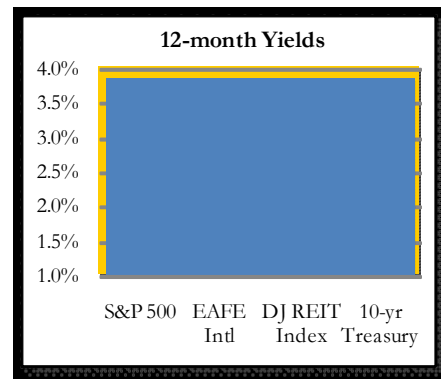
Fundamentals are now stabilizing. An improving economy and rising dividend payouts could help buoy real estate stocks.

After suffering more than a 75% drop in value from their peak in early 2007, REITs have staged a surprisingly strong comeback. Since bottoming in March 2009, the Dow Jones Real Estate Index is up roughly 130%. However, to put this into historical context, the index would still need to rise another 70% or so to reach the all-time highs reached in early 2007.

Fortunately, across most property types, fundamentals appear to have found a bottom; vacancies seem to have peaked and rents have stabilized. The theme now for many larger REITs is external growth through acquisitions. For example, one REIT casualty from the financial meltdown, General Growth Properties, is now in bankruptcy, but two other REITs (Simon Property Group and Brookfield Asset Management) expressed interest in acquiring all or most of the properties owned by General

Growth.

With the economy expected to continue improving, it is also expected that real estate fundamentals will also improve. At present, the Dow Jones REIT index yields roughly 4% – the same as a 10-year Treasury bond. However over the next few years, REIT companies will be able to retreat from the emergency measures taken during the financial crisis, allowing many to grow their dividends at rates projected to be in the low double digits. ■



Emerging Markets Lead Global Recovery

The developing world is still experiencing the fastest growth; however rising inflation is a growing threat.

Emerging economies are leading the global economic recovery. For 2010, the International Monetary Fund (IMF) estimates that real GDP growth (growth minus inflation) in the developing economies will average 6%, led by China (10%), India (7.7%) and Brazil (4.7%). This compares to growth estimates of only 3.9% for the developed world.

New hiring, which has only just begun in much of the developed world, has bounced back sharply in emerging economies. The rebound in both employment and investment has been impressive in Latin America, and even more so in emerging Asia.

Supported by fiscal and monetary stimulus, strong intra-regional trade, and a rising middle-class, Asia-Pacific countries are entering a new phase of self-sustaining growth that is mainly driven by domestic demand.

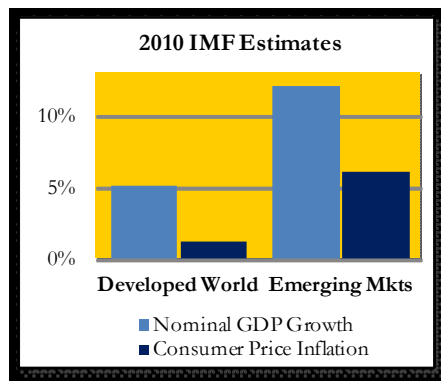
In broad strokes, the emerging economies of the world have two distinct advantages over the developed world. For one, most have large, hard-working, young, and inexpensive labor forces ready to accommodate the strong growth expected from these emerging economies. Secondly, on individual and national levels, the developed world is saddled with large and growing debt (much of it owned directly or indirectly by the emerging world), while the developing world is characterized by high savings rates and trade surpluses.

However, the fly-in-the-ointment for many emerging economies may be accelerating inflation, which is difficult to control when an economy grows rapidly. The IMF estimates that consumer price increases in the emerging and developing world will average 6.2% in 2010, up from

5.2% in 2009. The climb in year-on-year headline rates of inflation in emerging markets is likely to persist into the middle of the year. Already, a faster than anticipated rise in inflation in places like China and Brazil has raised the question of whether these economies might be overheating, forcing a strong policy response such as higher interest rates and/or tighter lending standards.

In China, the combination of continued strong growth and higher inflation should pave the way for modest rate hikes and currency appreciation before midyear. Broadly speaking, now that the economic environment has improved, very accommodative monetary policy is at odds with improving fundamentals. In other words, emerging market central banks will likely move to raise rates over the next couple of quarters in an effort to curb inflation.

We remain bullish on emerging market stocks. However, we are also keenly aware that the growth story of emerging markets is not a closely-held secret. In fact, it is so well known that net new cash flows into emerging markets mutual funds has led fund flows into U.S. equity funds since 2008. With investor optimism running high, and emerging central banks looking to cool growth, the potential for disappointments is rising. ■





Client Focused, Results Driven

COLORADO CAPITAL MANAGEMENT, INC.

4430 Arapahoe Avenue
Suite 120
Boulder, Colorado 80303

Phone: 303.444.9300
Fax: 303.444.2027
Email: MAIL@COLORADOCAP.COM

WWW.COLORADOCAP.COM

Roth Conversions Favor the Wealthy

Recent tax law changes that allow anyone, regardless of income, to convert traditional IRA accounts to Roth IRAs has set in motion a wave of questions from investors about whether or not a Roth conversion is right for them.

There is one rule of thumb: convert to Roth if you think your tax rates will be higher in the future, and you have money outside of the IRA to pay the taxes owed. Pretty straightforward, however few know exactly what tax rates will be in the future.

There is one segment of taxpayers, however, that are pretty much assured of paying higher taxes in the future – the wealthy. For anyone who is in the highest tax bracket, and expects to stay there, doing a Roth conversion is almost invariably a good idea.

At Colorado Capital Management, the Roth conversion is much more of a process than an event. First, we need to make sure that it makes sense given individual circumstances. Secondly, we need to consider whether a full, or partial, conversion is best, and over what period of time (sometimes multiple years). Finally, we monitor the progress of the converted Roths to make sure the strategy is working as planned. After all, the best kept secret about Roth conversions is that you have up until your tax filing deadline next year to “undo” the conversion. This “free look” is quite valuable, and provides you with the opportunity to change your mind in the future at no cost. ■



Hank Nicholson writes the Quarterly Market Update. He is a principal and portfolio manager for Colorado Capital Management and is a CERTIFIED FINANCIAL PLANNER®.

Colorado Capital Management Welcomes Lee Strongwater

Lee Strongwater, formerly managing partner at the financial advisory firm Stongwater Schott, has joined Colorado Capital Management as a vice president. We welcome Lee, his wealth of talent and experience, and his clientele, to our firm.



Lee has worked as a financial advisor for the past eight years. Before that he was an entrepreneur and helped start and manage several small firms, including a children’s product company that went public in 2007. Lee has an in-depth understanding of the unique needs of business owners and helps them navigate the financial decisions that affect both their personal and business lives.

Lee is also a very active volunteer for organizations serving children and helping solve hunger issues in the community. Current and past board affiliations include Carriage House Community Table, the WOW Children’s Museum, Foothills United Way, Trebol Soccer League, and Higher Ground. Lee has two daughters, and in addition to parenting, enjoys skiing, sailing, and reading.

INTEGRITY



QUALITY



RESULTS