



HANLON

INVESTMENT MANAGEMENT, INC.

Quarterly Report – September 30, 2009

At this writing we continue to remain invested primarily in high yield corporate bond funds, where available, and continue to believe they are the best risk-reward opportunity in the current market environment. The current yield (rate of interest payment) is approximately 9% per year on many of the high yield mutual funds that our clients own. To review, some bond funds pay monthly, some pay quarterly and in some cases (primarily in variable annuities) the interest payment is imbedded in the actual daily security price. When you combine this current yield with any appreciation in the bond fund price it results in a good total return. Of course there is no guarantee that the bond funds will continue to appreciate in price, but for the past quarter, the returns were outstanding.

Stocks ended the quarter with gains and capped one of their best three month periods in decades. Clearly “growth” oriented indices delivered the best returns during the most recent quarter and so far this year, with the MSCI Emerging Markets iShares and Russell 2000 Small Cap indices delivering the highest returns. They both returned near 20% for the quarter, but these equity returns have come with continued volatility. Recall that total return is what we seek, but we seek it with an attempt at lowering the risk. During this past calendar quarter the Hanlon allocations performed well, with high yield corporate bond funds appreciating an average of approximately 12% for the quarter. But most important, they did it with very little downside price volatility. What we are targeting for our clients is the best possible upside within the context of a reduced, mitigated downside. There are no guarantees that we will always be successful in this pursuit, but the last quarter is about as good as it gets for outstanding risk-adjusted returns.

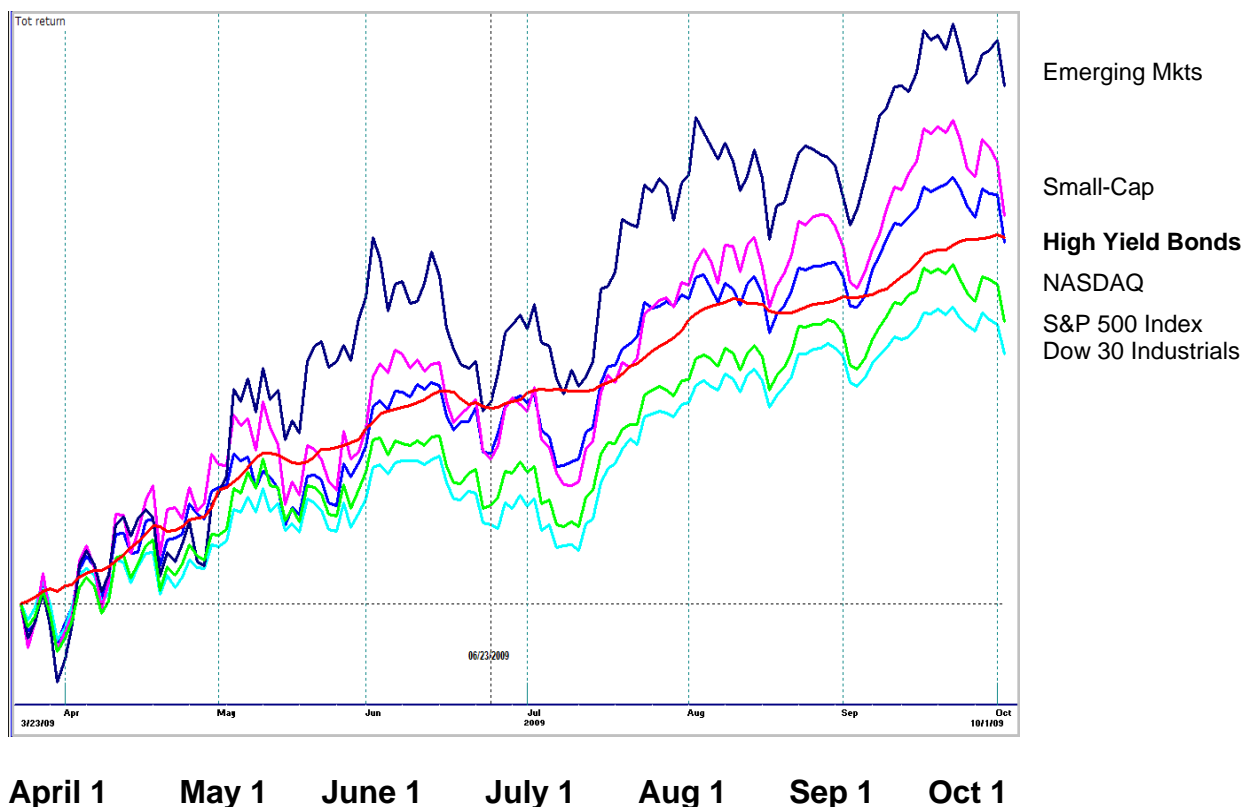
Table 1 – 2009 Performance of the Major Equity and Bond Indices and HIM Allocations

Index	YTD as of 09/30/09
HIM Allocations Approximately*	+20.00%
Dow Jones Industrials Average	13.41%
S&P 500 Index	19.25%
NASDAQ Composite Index	34.58%
Russell 2000 Index	20.99%
MSCI EAFE iShares	24.45%
MSCI Emerging Markets iShares	57.09%
US T-Bills	0.19%

Source : Investors FastTrack

The chart below contains five of the major equity indices and an index of high yield corporate bond mutual funds that we compose and track daily. The chart begins some months back, near the market bottom in March 2009. It shows that since March 2009 there has been significant appreciation in all these asset classes.

Chart 1 – Various Major Equity Indices Compared to High Yield Corporate Bonds



But the one thing you may notice is that all the equity index lines are rather jagged, jumpy and volatile. Not so for the smooth red line in the middle. The red line is the **high yield corporate bond index**, where most of our client's portfolios are currently invested. That line has exceeded all the other lines in total return since March 2009, with the exception of the Emerging Mkts and the Small-Cap line. And more importantly, it has done so without the associated volatility that the other lines have experienced. For example, just in June alone, the Emerging Mkts line declined 11.66% before recovering and going up further. Another thing you should notice about the above chart is that all of the lines at quarter end, September 30, have pulled back from their highs. But not the red line – it is at its high point for the year. That is good for high yield corporate bond funds and of course for those invested in that asset class.

If your investor profile is such that your Hanlon account is invested only in the **Managed Income Allocation** you can stop reading here if you like, because the remainder of this newsletter will focus mainly on equity investments, as well as a little discussion about inflation again. Much of what follows, however, may still be of interest to our Managed Income Allocation investors. Please know that we place equal importance on both the bond and equity allocations. Always have, always will.

Equity Market – Can It Keep Going Up?

The chart below is 5 years of the S&P 500 Index. Clearly this shows that the “buy and hold” discipline, which is not the investment discipline that Hanlon practices, has had a challenging 5 year period.

Chart 2 – S&P 500 Index Monthly Closes 5 years



We bring your attention to the dark blue bars (they represent down months) that occurred in the fall of 2008 and early 2009. That shows the formidable amount of selling that occurred during that period. This now represents a hurdle area that may continue to keep stocks range bound and near their upper levels of appreciation for the time being. It will be interesting to see if stocks can build on their recovery from here against this challenging road block in the charts.

Inflation Threats – They Still Remain Overblown – We Do Not See Any Inflation!

One of the most often discussed topics these days is inflation, but the economic reports continue to show that there is none! Many in the financial press, as well as those in the investment community, are running around with this “Inflation Armageddon Theory” due to the incredible amounts of government intervention that the world’s central banks have brought. But inflation is not only about monetary policy, it is also about supply and demand. Yes, the government printing presses have issued huge amounts of dollars. These dollars are chasing goods and services and, yes, that “could” be inflationary. But there also needs to be **demand** for those goods and services coupled with a shortage of **supply** of those goods and services in order for the **costs** of those goods and services to inflate. That just is not happening yet.

The bond markets are also indicating no threat of inflation. We have written recently about the current contradictions developing in the markets. The equity market is forecasting robust growth, which would normally be accompanied by some inflation, but the bond market is forecasting no inflation. What indicator can we reference to prove that the bond market is not forecasting any inflation? The 10-year US Treasury, where interest rates are at 3.20% at this writing. Yes, that is correct - only 3.20%! Investors are willing to lend money to the United States government and accept a federally taxable rate of return of ONLY 3.20% per year for the next 10 years! How can there be a threat of inflation if one of the largest debt markets in the world (the market for US Treasury Debt) is trading at those levels today?

The central banks around the world are doing almost everything that they possibly can to create inflation. We only hope there is inflation near, because our banking system needs a little to make sure that the assets that loans have been made on stay at current levels and do not depreciate further. Inflation is just not happening, at least not in the foreseeable future. The only form of inflation today is the inflating amount of ink that is being used on incorrect written commentary that inflation is very near.

Congratulations to you and your Financial Advisor for instituting a good diversification strategy, by including in your overall portfolio the Hanlon Investment Management intermediate term trend following strategies. Be sure to stay close to your Financial Advisor during these volatile times, reassessing your risk profile, time horizon and investment objectives. As the Chairman, CEO and Chief Investment Officer at Hanlon Investment Management your overall portfolio returns and risks are very important to me and our team at Hanlon.

Thank you,



Sean Hanlon, CFP®
Chairman, CEO and Chief Investment Officer

** Allocation returns in Table 1 are simply an estimated average of all accounts managed by HIM net of HIM's investment management fees. Your exact return is available in the enclosed performance report. Actual investment management fees vary by individual client account, but generally range between 1.20% and 2.20% of the value of the assets under management. The net compounded impact of the deduction of such fees over time will be affected by the amount of the fees, the time period, and the investment performance. The performance presented herein does not reflect the deduction of transactional costs such as brokerage commissions, custodial costs, and other expenses. Estimated performance results have inherent limitations. Unlike an actual performance record, estimated results do not represent actual trading and do not reflect market factors. In addition, estimated returns do not involve financial risk, and no estimated performance can completely account for the impact of financial risk in actual trading. There is no guarantee that the estimates presented herein will come to pass. Past performance is not a guarantee of future results. Investing in the stock market involves gains and losses and may not be suitable for all investors. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. Dow 30 Industrials (DJIA) is an unmanaged index of common stock that tracks changes in stock prices of the 30 most significant and commonly traded U.S. industrial stocks on the New York Stock Exchange. Standard & Poor's 500 (S&P 500) is an unmanaged index of 500 common stocks traded on the New York Stock Exchange that is widely used as an indicator of market trends. NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. Small Cap - Russell 2000 is an unmanaged index comprised of 2000 smaller company stocks and is generally used as a measure of a small cap stock performance. MSCI EAFE iShares seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of the MSCI EAFE index (the underlying index). The underlying index has been developed by MSCI as an equity benchmark for its international stock performance. Emerging Markets - MSCI Emerging Markets is an index created by Morgan Stanley Capital International (MSCI) this is designed to measure equity market performance in global emerging markets. The Emerging Markets Index is a float-adjusted market capitalization index. US T-Bills are short-term debt obligations backed by the U.S. government with a maturity of less than one year. Comparison of the Hanlon Investment Management ("HIM") portfolios to other indices is for illustrative purposes only and the volatility of the indices used for comparison may be materially different from the volatility of the HIM portfolios due to varying degrees of diversification and/or other factors. Indices are unmanaged, reflect reinvestment of income and dividends and do not reflect the impact of advisory fees. Investors cannot invest directly in an index. HIM has prepared this report based on statistics provided by Investors FastTrack. HIM, while deeming such information to be reliable, does not guarantee the accuracy thereof. This data is subject to change without notice and should not be considered as a solicitation to buy or sell any security. This article contains general information that is not suitable for everyone. 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