What a difference a year makes…

September 10, 2009

Many investors are experiencing mixed emotions regarding the recent market run. International and U.S. equity markets have been performing very well in the past six months. At the same time, parts of the fixed income markets have also had impressive performance. There are many different viewpoints regarding the recent rise in asset values, some commentators arguing we have come too far too fast, and some arguing the markets are pricing in appropriate expectations for future economic growth.

In light of the recent returns, we believe there is potential for increased volatility in the equity markets, and perhaps even a modest retrenchment as investors continue to assess the prospects for continued economic improvement. Regardless of one's view on the future, the current economic and market conditions are vastly improved from just one year ago.

We have listed a series of news headlines from September 2008, which we found to be interesting reminders of the conditions we were facing just one year ago:

(Sept. 7): *The U.S. government places Fannie Mae and Freddie Mac, companies that together hold more than half of the country's mortgages, under government conservatorship, which is akin to bankruptcy reorganization.*

(Sept. 14): *Merrill Lynch agrees to be acquired by Bank of America for $50 billion, and Lehman Brothers prepares to declare bankruptcy when it fails to find a buyer.*

(Sept. 15)*: The Dow Jones Industrial Average drops more than 500 points, or 4.4%, amid concerns over a financial crisis.*

(Sept. 15)*: Lehman Brothers declares bankruptcy.*

(Sept. 16): *The Federal Reserve agrees to a $85 billion rescue of the American International Group.*

(Sept. 20): *The Bush administration seeks authority from Congress to allow the Treasury Department to buy up to $700 billion in bad mortgage assets from private investment companies.*

(Sept. 22): *Congress begins debating the bailout package, with Democrats insisting that any plan include relief for Americans burdened by mortgages they can't afford.*

(Sept. 26): *Federal regulators seize Washington Mutual, the nation's largest savings and loan.*

(Sept. 28): *Congressional negotiators and Treasury secretary Henry Paulson agree on a $700 billion bailout plan that gives the Treasury unprecedented authority to buy a wide range of troubled financial assets.*
Source: www.infoplease.com/world/events

With hindsight, there are many September 2008 events we can point to and second guess decisions made in investment portfolios. That said, we have made it through the following 12 month period, through August 2009, with meaningful results towards recovery. As perspective, the S&P 500 Index is up over 14.9% for the year to date period, through August 31, 2009. International markets, particularly

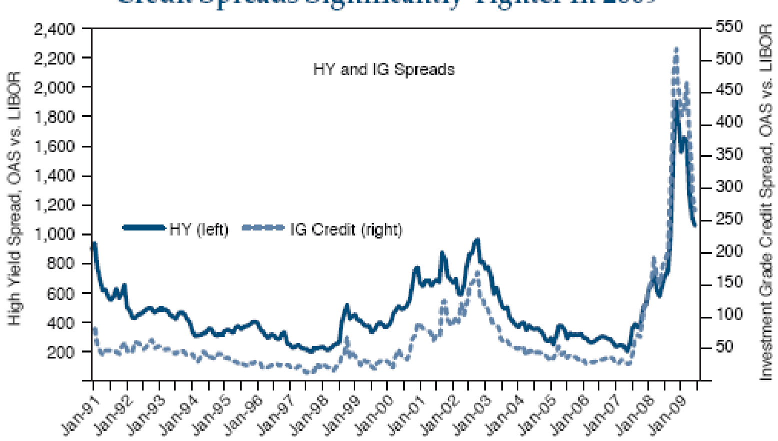
Emerging Markets have performed with even more impressive results, with the MSCI EAFE Index up 24.8% and the MSCI Emerging Markets Index up an astounding 51.1%, year to date. On the heels of the quagmire investors had to wade through last year, these results should be classified as fortunate.

Perhaps more impressive are the shorter-period market returns witnessed from the March 2009 lows. On March 9, 2009, the S&P 500 Index hit the 666 level intraday with the final closing value of 683. Since that intraday low in March, the Index is up 52.3% to a level of 1020, as of August 31, 2009. During this recent run in the markets, economic conditions have been trending towards improvement. Opinions about the sustainability and quality of the improvement remain valid questions in the minds of investors. Economic incentives put in place by the Government have helped to generate economic growth prospects in several major sectors of the economy (financial companies, auto makers, education) but the fundamental questions investors are asking, is whether or not the recently improving conditions can be sustained through private investments. A key component for continuing the recent market performance would be additional economic improvements. We believe investors should continue to focus on the probable economic conditions over the next two to three years and identify with those investments which may be most likely to benefit from the most favorable growth prospects. In addition, we also believe current market conditions favor investments with higher current income (or yield) potential.

As we have moved through 2009, we have been adding assets to client portfolios which incorporate higher levels of yield, through preferred securities and high income bonds. Our focus was to add the yield in a manner which we believe should be less volatile than equity markets have historically been (especially in the past 15 months) but also in a way for clients to benefit from potential capital appreciation. These income producing assets, preferreds and high income bonds, have performed as well as, and in some cases better than the equity indices, year to date. We continue to believe these types of investments remain attractive for client portfolios.

The high income bond investments have been predicated by what we believe to be attractive spreads between the higher yielding corporate bonds and investment grade bonds. These yield spreads reached levels not seen in the past 20 years and the investments we have been making was intended to benefit from both the yield levels as well as the narrowing of the yield spreads.

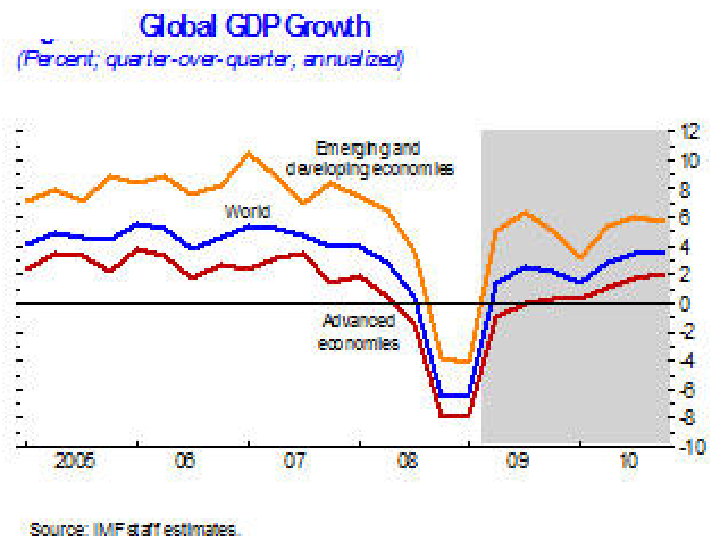
Credit Spreads Significantly Tighter In 2009



Source: Merrill Lynch (U.S. High Yield Cash Pay Index) and Barclay's (investment grade credit index).

The spreads have certainly narrowed to this point in 2009, however, they remain at levels which we believe warrant the continued investment as part of our client bond portfolios. As we continue through the current cycle, default rates may continue to rise. We have been investing with portfolio managers who focus on the types of companies which may have been experiencing financial strains, but at the same time have a higher probability of making it through the recent conditions. Additionally, diversification across companies is critical, as well as limiting the amount of exposure to these investments as part of the overall portfolio.

In addition to the higher yielding assets, we have also incorporated investments within the emerging markets economies during the past year. Historically, investment capital has flowed towards market economies which are projected to have higher growth potential. As seen in the chart below, economic growth prospects for emerging/developing economies are more favorable than the growth potential for developed economies.



Due to the risks associated with investing in developing markets, we are not subscribing high levels of exposure to emerging economies. However, we do believe these markets warrant an allocation within portfolios.

As we move through this market cycle, we continue to seek investment opportunities which we believe may offer potential returns through both yield and capital appreciation. We are also focusing on areas we believe may provide opportunities for capital appreciation in ways which are often overlooked. For example, one area we are closely investigating is the potential for increased mergers and acquisitions. This area seems appealing due to the likelihood that some small and mid size companies may require restructuring in one form or another in the short to intermediate term. Many times these types of companies may be put up for sale or may work to be integrated within a larger organization. These types of companies may also seek to merge, acquire, or be acquired through shareholder friendly transactions.

We believe the economic conditions have improved in dramatic fashion since one year ago. At the same time, we do not believe economic conditions warrant an "all clear" signal for investors. We may see higher levels of volatility, particularly within equity markets and wish to point out that a brief pause in the recent equity market advance may be likely – some level of pullback is possible as well. Therefore, we believe it remains prudent to rely on a portfolio diversified across and among asset classes and to invest in opportunities when they present themselves, which may often run counter to emotions.