

Investment Outlook

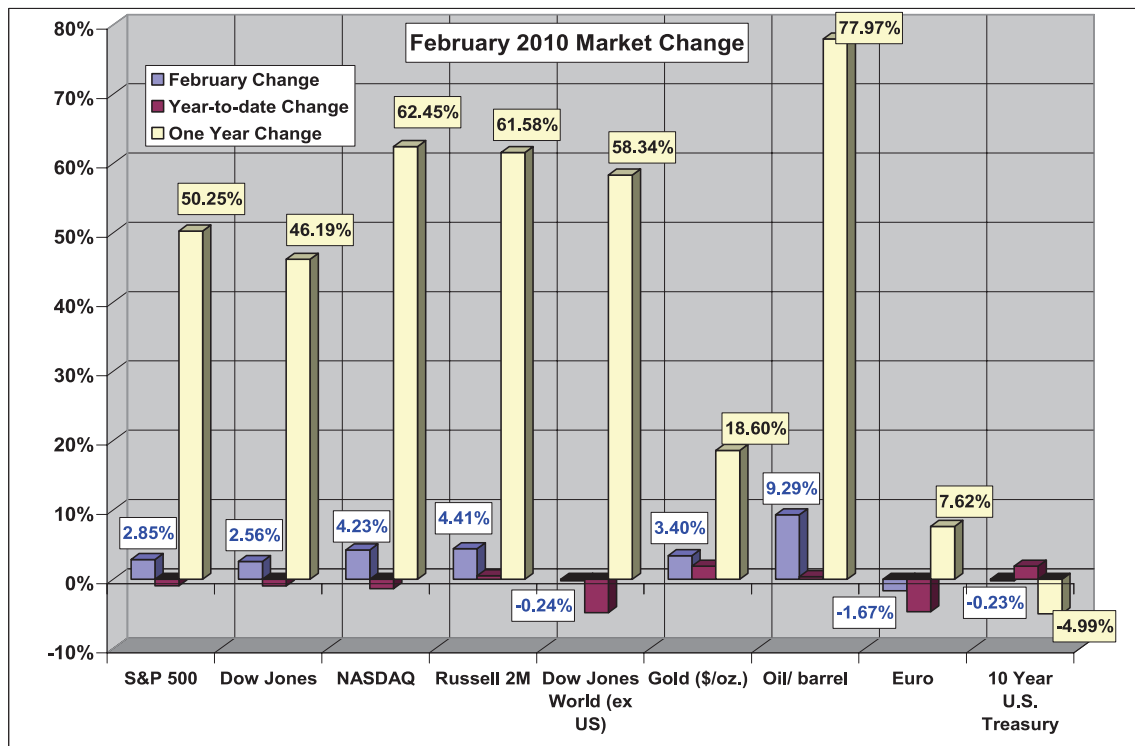
March 2010

Paths to prosperity



February Markets *Beware of Greeks bearing bonds...*

Investors were reminded in early February that all may not yet be right in the world when the extent of the fiscal problems in Greece became better known. As the focus shifted from the extent of the Greek deficit to those of other developed countries,



including the U.S., a familiar flight to safety from stocks to Treasury debt and dollars took place.

Evidence that the Europeans may solve their own problems, coupled with soothing words from Federal Reserve Chairman Bernanke regarding the need for rates to remain low for an "extended period of time", led to a sharp improvement in investor sentiment as the month progressed. As detailed on the chart above, equities rallied in February with the S&P 500 having its best month since last November with a gain of 2.85%. The continued dollar strength is evident in February's decline of the Euro as well as the small monthly loss in international (i.e. non U.S.) equities.

Commodities also enjoyed a positive month with gold's gains in line with equities while oil was the month's best performing asset with a 9.29% advance. Once again, Treasury bonds offered disappointing results with a modest February decline equal to

that of non-U.S. stocks, while also surrendering almost 5.00% over the past year; the worst performance of the assets measured.

The approaching anniversary of last year's market lows, and subsequent recovery, is also evident by the gold lines on the same chart. Having the double-digit numbers on the positive side of the chart is only one sign of the improvements evident from a year ago.

Commentary ***A tale of two theses...***

This year has provided an unusually high amount of opportunities to discuss our economic and financial outlook with clients and other advisors and listen to their points of view. These are always welcome and enjoyable encounters as the honing effect can only be positive and, to quote the wise man that raised me, *"...it's hard to make progress with your mouth open and mind closed"*.

Taken to their extremes the theses we've heard this year fall into two camps. The first fears that the pace of economic recovery will stimulate demand which will spark rampant inflation if the Fed fails to withdraw its robust stimulus quick enough; with most proponents believing they may already be behind the curve. We'll label this the "Inflation Camp".

The other views the trillions of dollars of stimulus provided by central banks and governments as key to preventing a global economic catastrophe. Removing this support too early may result in renewed crisis with falling asset values and lack of liquidity. This camp can be labeled the "Deflation Camp".

Central to both of these themes is outlook for the extraordinary amount of fiscal and monetary "stimuli" infused into the global markets over the past eighteen months. The fact that there is little precedent for these circumstances provides some credence to either argument coupled with the risk of responses that are either premature or extremely prolonged.

After visiting both of these camps we find ourselves firmly in the middle with the thought that each extreme is equally distasteful and both can be avoided by responsible management. The extraordinary financial responses should be credited with preventing further damage to global markets when they were implemented during the fall of 2008. While further examination of the causes of that crisis may prove instructional in preventing the next one, it serves little value in managing the current recovery. A focus on where we are headed, where we want to go, and how to navigate the course should be the priority.

Presuming that various central bank actions can continue to support liquid markets we believe that the extremes of the Deflation Camp can be avoided. This does require a deft hand by the central bankers in both communicating and executing their moves.

We had a brief encounter with this in mid-February when the Fed actually raised the "discount rate" after announcing its intentions in the minutes of its most recent

meeting. The initial adverse market reaction was excessive and was subsequently calmed when investors were reminded that the move had been well telegraphed, was virtually meaningless to current activities and the Fed had no intention of raising market rates in the near future.

It would appear that a number of these exercises will be necessary before the Fed can comfortably remove the "training wheels". There is already ample opportunity for this as the Fed winds down its various emergency liquidity programs and prepares to cease purchasing of mortgage securities at month end. Similar to the discount-rate adventure the Fed should be in the position to take prompt corrective action in the event that any of these tactics startle markets.

In a similar vein we believe there should be little need to visit the extremes of the Inflation Camp. Unfortunately the pace of the global recovery seems insufficient to absorb the substantial supply of excess capacity that exists in many quarters. Until such time that scarcities start to emerge it is difficult to understand the source of any sustained inflation pressures.

The substantial slowing in sales of both new and existing homes last month served as a sharp reminder of the continued imbalance between supply and demand in residential real estate markets. Concurrently, virtually no progress has been made to reform either Fannie Mae or Freddie Mac as a first step in restoring a functioning mortgage finance apparatus which seems necessary to sustain a recovery in housing. The Administration's announcement that any action related to the mortgage agencies will be postponed until 2011 would indicate recovery and any resulting scarcities in this market will remain slow to develop.

At the same time other structural problems remain within credit markets. Commercial property valuations remain stressed by high vacancies and weak demand. This will continue to pressure bank balance sheets and limit borrower opportunities alike as various credits mature and refinancing options remain limited.

Similarly labor markets remain under pressure. Initial Jobless Claims have increased in each of the last two weeks which indicates conditions remain slow to improve. We also fear that employment may suffer an additional set back later this year when states and municipalities confront the conflict of continued reductions in revenue and their legal obligations for balanced budgets, resulting in further layoffs and wage reductions as the only remaining tactic for compliance.

Not wanting to conclude on a bearish note we continue to believe the depth of the economic contraction has passed and we are in the recovery phase. Unfortunately structural deficiencies, including those noted above, will serve as self-governors to limit the pace of expansion. The good news is that each of these deficiencies has significant indicators that can mark improving conditions or warn of further deterioration. Noting these signals should enable our policy makers to avoid the extremes of either of the two camps noted earlier while also marking the turns in our investment strategy.

Strategy and Outlook ***Waiting for the spring thaw...***

While 2009 may have marked our “economic winter” it is 2010 that will be remembered for its meteorological extremes. During one week last month snow fell in forty six of our fifty states and many locales fully depleted their snow removal budgets before Valentine’s Day.

We don’t believe that this observation is out of place in our investment analysis as we noted a decline in various economic indicators as weather conditions worsened. Adverse weather delays housing starts and construction spending, impedes shoppers and restaurant visits and delays all forms of transportation and delivery. To the extent that these activities were merely delayed for better conditions, not cancelled, the dip in many of February’s economic metrics can be expected to recover in later periods. Investing in anticipation of improving conditions is fundamental to long term success.

In a similar vein we believe we may see a “thaw” in the Euro which has been brutalized by Greece’s fiscal problems and related issues, as noted earlier. To the extent that the recent dollar strength reverses on improvements in Euroland we can expect our international equities to improve as well. Referring to the chart on page one, we note that the *Dow Jones-World Index* meaningfully underperformed its domestic peers in February when the dollar strengthened. We expect a reversal of this with any resurgence of dollar weakness.

Lastly we are witnessing a thaw in corporate purse strings, primarily in the form of using cash to repurchase stock and fund acquisitions. Both activities mark an improved confidence among corporate managers as they are willing to part with the security of record levels of liquidity for longer term investments in their businesses.

Although none of these cause us to depart from our view of a prolonged and labored economic recovery, they all bolster our outlook for improving conditions. Consequently using any lows in the current equity trading range to add to portfolios should prove beneficial for long term investing.

With interest rates destined to remain low for an undetermined time period dividend paying stocks continue to offer a meaningful source of income coupled with an opportunity for growth. As noted above, we continue to evaluate the sustainability of the current rally in the dollar and look to invest in anticipation of a reversal. Current conditions also seem to favor industrial and technology sectors as they will be the beneficiaries of the growth in business spending and investment, have an opportunity to export to faster growing global sectors and have the least exposure to domestic consumers where recovery seems destined to lag.

We’ll be discussing these themes with clients this month, as well as our continued ability to outperform market indices. Others wishing to join the conversation are welcome to call.

<i>S&P 500:</i>	<i>1,118.31</i>	<i>Mark Fingerlin</i>
<i>10 Year U.S. Treasury Yield</i>	<i>3.614%</i>	<i>March 2, 2010</i>

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