

Investment Outlook

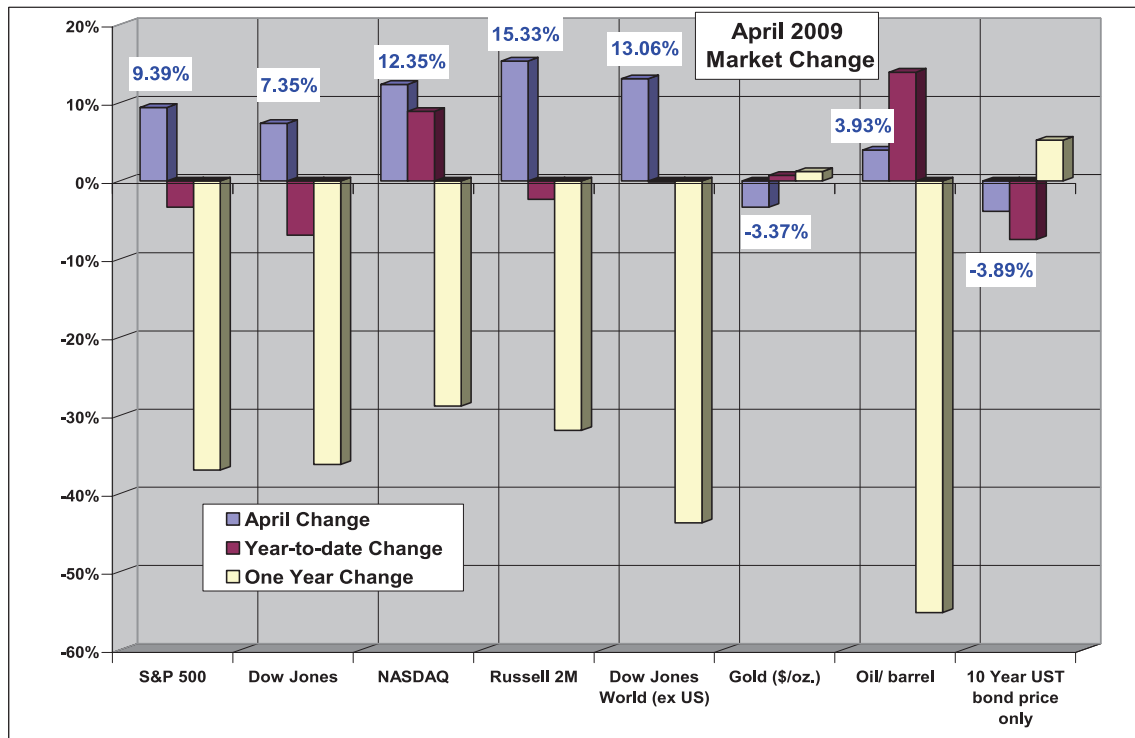
May 2009

Paths to prosperity



April Markets Play ball...!!!

Hope springs eternal every April as gardens sprout, baseball starts and the first quarter's corporate results are announced. 2009 was no exception, but we'll discuss green shoots and muddy cleats some other time. Corporate earnings did capture investor attention however; as the number of companies that exceeded the substantially reduced analyst expectations grew, enticing more cash to move into equities in hopes that this rally might finally be the "real thing".



Regardless, investors' increased appetite for risk in April is evident with the S&P 500 gaining 9.39% for its best month in nine years and the NASDAQ and international markets erasing their year to date losses. The positive results follow the gains in March for two winning months in a row.

Following this risk acceptance trade we note that the 10-year Treasury bond lost value again in April with its year to date 2009 decline now greater than the loss in the Dow Industrials. Gold also lost some of its luster in April as its place as a safe haven over the last year turned to a -3.37% loss in value for the month. While the sustainability of the stock rally may still be in question we'll gladly accept the improvement in market sentiment and portfolio values that accompanied it.

Commentary ***Developing a game plan...***

Sports fans understand that it takes both offense and defense to win a game. Teams that fail to develop their offense can at best hope to hold their opponents to scoreless ties.

A similar discipline exists in wealth management, especially in our current environment. While it has been our defensive abilities that preserved wealth during this downturn, preparing an offensive game plan is necessary to build wealth in the recovery. Much of this plan entails mitigating the risks that will be present while seeking out the opportunities.

Foremost among the risks is the *economic risk* that is now evident in our global recession and the loss of value in virtually all asset classes. The unknown nature and timing of the recovery adds to this risk. Diversification among, and within, asset classes seems the best means of mitigating this risk as it protects a portfolio in the current environment while positioning it to benefit from the next.

This recession is significant due to the magnitude of the decline and its global reach. It also differs markedly from our previous experience as the financial sector collapsed first rendering it incapable of assisting in the recovery. While we have been blessed by the rarity of similar economic events in our history, the recoveries from those we have experienced have been accompanied by significant changes in the previous status quo.

For instance, the growth of suburbia in the post-Depression/WW II period, emergence of the service economy after the hyper-inflation of the 1970's and globalization of production in the post Y2K experience were born out of the economic crises that preceded them. One significant change already in evidence is the de-leveraging of household and corporate balance sheets. Until a new economic calculus emerges reduced access to credit signals a period of slower growth, less risk taking and more emphasis on equity. Investment in a broadly diversified portfolio of well capitalized companies that can support their growth from within seems the best tactic until new sources of debt financing emerge.

The next risk to be considered is *inflation*. While the current slack in our economy can keep price pressure at bay for some time, it will be the rarest of recoveries that doesn't generate some mismatch between supply and demand with accompanying price pressures. Investing in assets that can gain in value as prices increase will mitigate this risk. While equities as a class can do this; those with a meaningful tie to basic commodities, as well as some real estate rental income, seem to be the most promising candidates for this purpose.

The risk from changing *interest rates* is the cousin of the inflation risk as central bankers increase interest rates to combat inflation. Given the extraordinary involvement of all central bankers in this downturn, and our Federal Reserve in particular, an extremely deft touch will be required to avoid inflation risk without stifling economic recovery. The most likely outcome will be higher rates which will reduce the value of longer term bonds and also pressure the valuation ratios of stocks and other asset classes.

Being unable to call this turn of events it seems that the best mitigation of this risk is to use the current bond rally as an opportunity to shorten the average portfolio maturity. This should still provide ample return compared to the anemic rates on cash while ensuring the opportunity to reinvest at the higher rates we believe will accompany the recovery. A three year "window" seems a good choice here.

How the global economic order emerges may present some *currency risk* as the value of each economy's debt is measured against that of others. Investing in companies, and countries, that can borrow and repay in a currency they control is paramount to mitigating this risk. Investing in assets that are valued in currencies other than ours is also a way to benefit from these changes. We continue to favor moderate exposure to international equities, in selected regions, to diversify potential economic and currency risks.

Market risk is the corollary to the economic risk described earlier. Optimism should reign at the prospects for the creation of new industries and investment opportunities; however the risks associated with being wrong in seeking to ordain the winners at this early phase are quite high. Investing in broad market and industry segments will allow portfolios to participate in the emerging leadership while reducing the risk of "backing the wrong team".

Last but not least is *political risk*. The global reach of this downturn has amplified many of the existing political chasms around the world as unfulfilled expectations among the general populace take hold on political leaders. Demonstrations in Thailand, piracy in the Indian Ocean, and the return of nationalistic tendencies among old adversaries in Asia, Eastern Europe, and some new ones in this hemisphere, are notable examples. Less immediately ominous, but potentially as dangerous, are the near-nationalization of previously private industries, growth of public debt and the burgeoning of federal, state and local budget deficits as program entitlements expand and revenue sources shrink.

Similar to the impact deleveraging will have in discerning the economic risk described earlier, increased governmental involvement seems to be another hallmark of the post-recovery economy. Political risk will accompany this to the extent that decisions are based on political expediencies rather than economic fundamentals.

Government expenditures may provide some investment opportunities if the recipients aren't further constrained in managing their businesses. Concurrently the increased tax burden and debt issuance to fund these will be evident in the inflation, interest rate and market risks already noted. Taxes are generally described as "inevitable"; consequently seeking investments that are either tax-exempt or tax-deferred would seem the best means of postponing them.

Outlook and Strategy ***The transition game...***

The previous discussion notwithstanding, we are at best in a transition phase where playing both defense and offense is important. That the economy is falling at a slower pace in no way signals that the recovery has started. Concurrently, having equity values match the 35% decline in earnings on a year over year basis may not make stocks extraordinarily cheap.

We do believe in an economic recovery that will ultimately result in higher than current stock prices. The question is whether stocks may get cheaper in the meantime. To the extent that emerging second quarter economic data supports the "bottoming" theme and none of the risks noted earlier vigorously present themselves, some dollar cost averaging into equities will be considered. Given the virtually non-existent return on cash, investing in assets with reasonable but secure dividends can provide a source of income that reduces the risk of "being early" if stock prices decline again.

Improving credit conditions and the prospect of rising tax rates have resulted in rallies in both our corporate and municipal bonds. While this rally provides an opportunity to take profits and reposition bond portfolios as noted earlier, we also continue to find attractive investment opportunities for accounts that need an "absolute" return.

Life seems to depart from sport in the inability to call "time out" and the continually changing rules. The similarity we do enjoy however is the desire to achieve a winning score.

Investors with questions and comments, or those with a different play book, are always welcome to call.

<i>S&P 500:</i>	<i>907.24</i>	<i>Mark Fingerlin</i>
<i>10-year U.S. Treasury Bond Yield:</i>	<i>3.157%</i>	<i>May 4, 2009</i>