

Investment Outlook

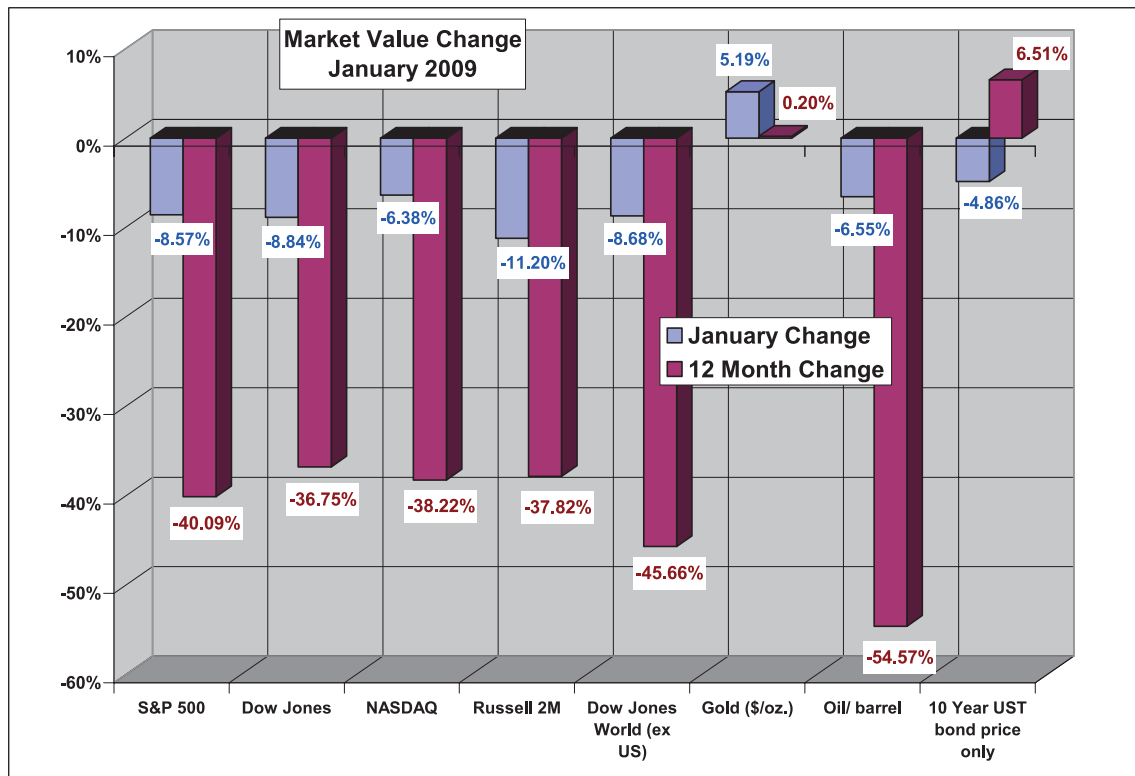
February 2009

Paths to prosperity



January Markets *Bears are nonpartisan...*

Investors expecting a post-inauguration bounce in equity markets were sorely disappointed in January. After continuing the December rally into the initial trading days of the New Year equity markets turned decidedly negative as economic and corporate data confirmed the depth of our current recession.



The revelation that the TARP-infused bank capital proved insufficient to stabilize the biggest banks also startled markets just as the mega-fiscal stimulus plan was being formulated. Equities sold off as investors seemed to adopt a "show me" attitude toward any further government-induced results. January ended with an -8.6% decline for the Dow Industrials, its worst showing in history.

Small cap and international stocks fared worse. Treasury bonds also sold off with notes due in ten years losing almost 5% for the month. The Treasury sell off may be a positive sign however as it indicates that investors are willing to embrace some risk, notably high-quality corporate debt. When this attitude may flow over to benefit equity markets remains to be seen.

Commentary

The consensus view...

Summary

At its mid-January meeting our Wealth Management Investment Committee formed its *Consensus Outlook for 2009*. All six committee members anticipate that the U.S. economy will decline throughout the year. Although some expect it to strengthen during the second half of 2009, none saw the potential recovery as strong enough to offset the earlier weakness.

Indicators

Readings on housing inventory and prices, consumer outlook and credit conditions were the most noted “signposts” members will look for to continue to validate their position. Changes in labor market conditions and money supply were the next favorite indicators.

Interest Rates

All members believe that Treasury rates have bottomed, with the majority expecting rates to continue to rise from current levels. All expect the Treasury yield curve to steepen throughout the year. The committee is also unanimous in expecting non-Treasury rates to fall and bond prices to rally during 2009 as the global credit-crisis moderates.

Inflation

Committee members are also in agreement that inflation will not be a risk during 2009. The consensus is that there is sufficient slack in various segments of our economy to keep any price pressures well in check. Some members note the risk of modest deflation during the year although it is not seen as a sustained threat.

Equities

The committee is generally bearish on stocks with equity markets expected to be “range bound” through most of the year. Markets are expected to retest previous lows while failing to be able to sustain subsequent rallies. Price volatility is expected to remain high during 2009 with “bear market” conditions prevailing.

Economic Drivers

Failure of the housing market to meaningfully stabilize is the most noted “driver” of the members’ outlooks. Consumer behavior is second, followed by the impact of the anticipated stimulus package.

Risks

Given the generally bearish outlook committee members note that the risks to their outlook are to the upside. The most frequently noted risk is a faster than expected economic response to the fiscal stimulus package which could accelerate recoveries in both equity markets and the economy. Downside risks from the impact of expanded Treasury borrowing, accelerating unemployment and the potential for significant dollar weakness are also cited.

Asset Allocation

Committee members continue to remain defensive in asset allocation choosing to retain the large cash positions built up during 2008 until market conditions appear to be markedly improved. The consensus is that while equity markets may improve during 2009, the catalysts to support additional investment are not yet evident.

Opportunities

Large, domestic, growth companies are seen as the most promising sector to add to portfolios, with some interest continuing in selected emerging countries. The committee agreed that Europe is presently an unattractive area for committing additional capital. Although some improvement in non-Treasury rates has already occurred, there is consensus that high quality corporate bonds continue to offer value while waiting for the equity markets to recover.

About the Committee: The WM Investment Committee is comprised of the bank's portfolio managers and research staff. The six members share more than a century of active investment management experience. In addition to their undergraduate degrees, their credentials include MBA, MS Finance, three CFA's, one CTFA as well as multiple securities licenses and designations.

About the process: The WM Investment Committee meets monthly. Prior to the January meeting the committee members completed a questionnaire regarding their outlook for the U.S. economy in 2009 and prevailing market conditions. Their responses were discussed at the January meeting. This consensus summary is the compilation of the responses and discussion.

Outlook and Strategy *...but did the bear see his shadow?*

Apparently the groundhog in Pennsylvania saw his shadow as a harbinger of an extended winter. We've yet to find such animal spirits for Wall Street that can help us navigate the recession that has entered its fourteenth month.

As noted earlier, equity markets were decidedly negative for January as well as the past year. The -40.09% twelve month decline in the S&P 500 becomes understandable when measured against the -35.2% decline in corporate earnings for the last quarter of 2008 and the subdued outlook for growth in 2009.

Having already established decidedly defensive portfolio allocations our current emphasis is on improving yields on cash without risking principal. Although both high quality corporate and municipal bonds have enjoyed significant price recoveries since we started touting them last fall as attractive investments, they still provide a significant income premium over short-term cash.

We also continue to reposition our remaining equity holdings to capitalize on interim market rallies and the ultimate recovery, as detailed in the "opportunities" comments of our consensus. The recent rally in NASDAQ reinforces our view that the recovery will be led by growth oriented companies, although it still seems too early to commit new capital.

We tend to discount much of the prevailing analysis that seeks to tie either the economic or market recoveries to the length of our recession, or the fact that last year was so negative, as much of our present situation is beyond that of any prior experience. Instead a more fundamental approach of seeking to detect positive changes in the indicators we noted earlier seems a more promising strategy to avoid investing too "early".

As we look for these indicators, and the related investment opportunities, investor questions and comments are welcome.

*Dow Jones Industrial 30:
10 Year U.S. Treasury Yield:*

*8,078.36
2.842%*

*Mark Fingerlin
February 3, 2009*