



Economic & Investment Outlook *1st Qtr 2010*

Economy – A Tale of Two Cities

The recession may have technically ended in Q4 2009 but it still feels bad out there. Main Street is concerned about healthcare reform, potentially higher taxes and energy costs, tighter credit, job losses, declining home values, and leveraged balance sheets. Wall Street is focused on budget deficits, uncertain government policies and regulations, a double dip recession, and geopolitical risks.

We expect sub-par 2010 GDP growth of 2.5-3.5%. This growth will be export and inventory rebuild driven.

The unemployment rate continues to increase (currently 10%) and will peak around 11% in 2010. Almost eight million jobs have been lost since the recession began in December '07. The U-6 rate (unemployed and underemployed) is 17%+ and will trend higher.

Inflation remains dormant and of no concern in the immediate future. The output gap as represented by high unemployment and underutilization of resources has created a non-inflationary environment. We expect core CPI of 3% over the next twelve months. The weak housing subset will help offset potentially higher food and energy prices. Our longer-term concern remains monetary debasement inflation.

We expect the Fed will orchestrate an orderly decline in the value of the U.S. dollar, interrupted by moments of temporary strength during short-lived global economic disruptions. Emerging market currencies will continue to strengthen against the dollar.

We anticipate home prices nationally to weaken marginally from current levels. The expiration of the home buyers tax credit in combination with the completion of the Fed's purchase of \$1.25T MBS will further pressure home prices in 2010. A housing recovery is not expected until the 2nd half of 2010.

Fixed Income & Interest Rates

Long term interest rates will ultimately drift higher as the supply of treasuries continues to increase dramatically as the U.S. deficit remains at unsustainable levels due to the stimulus package, the multitude of financial rescue programs, and declining tax revenues.

Bond returns over the next twelve months will be constrained by rising intermediate to long-term interest rates. U.S. Treasuries continue to be unattractive investments as yields remain near historical lows.

Federal Reserve's Zero Interest Rate Policy (ZIRP) expected to be in place well into 2010. The Federal Reserve can not raise interest rates until the unemployment level peaks. Fed's balance sheet exceeds \$2 trillion. We have concern over the Fed's ability to successfully remove the \$1T of excess liquidity from the markets without dampening the sub-par economic recovery.

Equities

Equity markets will be supported by and benefit from strong corporate balance sheets (\$2.9T in cash), increased M&A activity, and improving corporate profitability.

Equity valuations are at reasonable levels with the S & P 500 trading at 15 times 2010 estimated operating earnings of \$75. We need a sustainable economic recovery and corporate top line growth to propel equities higher from these levels.

Portfolio construction should include high quality domestic large cap dividend paying stocks with significant international exposure. International and emerging market stocks coupled with commodities such as gold, energy, agriculture, and industrial metals and mining should enhance performance and further diversify the portfolio.