

October 7, 2009

Dear Clients:

As I write this letter the third quarter has ended in what continues to be a most eventful year in the capital markets and world economies. It is also the one year anniversary of the weekend that shook the foundations of Wall Street and of the global financial system—when Lehman Brothers collapsed, Merrill Lynch lost its independence by a forced sale to Bank of America, and AIG was taken over by the U.S. government. As the year went on the manufacturing landscape became a soap opera as well, with two thirds of the U.S. auto industry, Chrysler and General Motors succumbing to economic and financial forces to transform from private companies to those with significant government ownership. While these were the headlines for the media, they do not tell the story of the extreme difficulties facing the worker who has lost his job or the business owner that can no longer access sufficient credit to run her business.

In light of these developments, it is worthwhile to briefly summarize where we have been this year, where we are today and the prospects for the period ahead.

***Where we have been...***

As the equity markets bottomed in March some felt as if the world truly may be coming to an end—there was talk of the Great Depression Part 2 at our door step as reported by the media. Fear was wide spread and the equity markets responded in kind as well as most risky assets by dramatically declining in value. Since then there is a general belief that a complete financial collapse has been avoided and that there is a slow healing process that has started in the credit markets. While a muted economic recovery has begun, world equity markets, in particular U.S. stock markets have been on a tear—with the Standard & Poor's index recovering 60% of the lows since the first week in March.

***Where we are...***

My view continues to be that the intrinsic condition of the U.S. economy has not improved, and that the green shoots we've observed are a transient artifact of green dollars poured out by the government. It is my belief that current equity valuations are not accurately reflecting future economic growth. In particular, the continuing significant loss of jobs, the increase in housing inventory, the continuing decline in housing prices, the contraction of personal earnings, and the very anemic consumer spending statistics do not support sustained economic growth. Much of the positive economic growth that will be reported in the coming months will be the direct result of government spending programs, cash for clunkers, first time home buyer tax credits, and the suspension for mark-to-market accounting for banks. It is a fact that organic economic growth does not result from government spending...it must come from the private sector. Current government stimulus responses are actually encouraging the behavior that got us into this mess...to much liquidity, financial leverage, to much debt, and too much spending. What is clearly evident is the high level of volatility of the equity markets this past year. Remember, high volatility is a primary indicator of greater risk.

***Where we are going...***

It is my view that the over zealousness of the equity market will be reconciled with real economic fundamentals in the near future in the form of stocks declining to reflect below trend economic growth going forward. Our thesis is that American's will consume less, will continue to reduce debt, and save more as we slowly move away from the economic abyss, and the heart of the baby boomers move into retirement age. Access to easy credit was the fuel for consumption over the last twenty years and this behavior will revert and result lower long term trend spending patterns in the future. The massive government borrowing that has occurred and will most likely continue will also contribute to slower economic growth by diverting savings/capital that would otherwise flow into funding private sector growth, that will now be used to pay interest on our national debt and fund increasing entitlement programs. Tax increases, whether they are labeled as such or come in the form of "fees" are a certainty....this will also retard future economic growth as incomes are diverted from consumption and saving. The ever expanding deficits (domestic and foreign) will undermine the value of the U.S. dollar. A weaker U.S. dollar is the one government policy tool that is left to stimulate economic growth given interest rates are near zero and budget deficits are out of control. A slowly weaker U.S. dollar is not a bad thing unless it is accompanied by inflation...which at some point will return. The decline in the relative value of the dollar and the fiscal chaos we are in may signal that domestic interest rates may be heading higher in the future as foreign countries spend more of their incomes on domestic programs rather than buying U.S. debt. With developing and emerging countries enjoying smaller domestic and consumer debt as well as trade deficits, we see prospects for a higher level of sustained organic economic growth in the future for these economies. Thus I have been allocating funds to foreign stocks, and international bonds. I have been biased over the last several months toward asset classes in which a majority of their total returns consist of cash flow rather than capital appreciation that being fixed income classes. While we have increased exposure to equities it has been with an inclination towards higher dividend paying classes.

***Our loyalty is to our clients...***

As always, our objective is to be cognizant of the risk/return opportunities presented by all asset classes so that your loss of capital is minimized and your opportunity for growth and income is realized with a fair amount of risk. Sustainable long-term returns require the avoidance of major losses, and the best way to avoid major losses is to: avoid securities where the probable long-term cash flows do not justify the price, and markets where the probable returns from accepting risk are unlikely to be durable. Ultimately our purpose is to help you realize the goals you have expressed to us through your financial plan.

If you have questions or would like to discuss your financial plan or your investment in greater detail I am always delighted to have that conversation. Thank you for the continued opportunity to work together.

Kindest regards,

Glenn