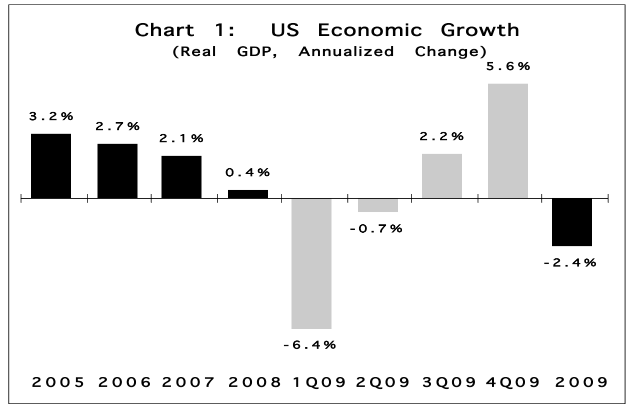
Investment Update
First Quarter 2010

Economy

The domestic economy is growing strongly as evidenced by the fourth quarter GDP gain of 5.6%, and the expectation is that the first quarter of this year will be ahead 3% or more on a year over year basis. Fears of a "double dip" pattern have largely dissipated, and almost all observers expect positive growth over the balance of the year. Corporate profits, in particular, have been robust with first quarter reports likely to be as much as 30% ahead of the previous year. Aggressive governmental actions have been significant and have been a major positive factor in the recovery. Throughout recent periods inflation and interest rates have remained subdued.



Still, major problem areas remain and many will require a combination of time, correct policy decisions, and perhaps a bit of good fortune for ultimate improvement. Unemployment is unacceptably high, capital spending is subdued, and credit markets are still burdened by restrictive conditions. Further, many of the governmental initiatives are about to expire or have done so. Perhaps most troubling, the federal budget deficit has soared as spending has grown at unsustainable rates. This year's deficit is estimated at over $2 trillion and next year's will be roughly the same. Currently, government debt is around 55% of GDP, a ratio last seen at the end of World War II. Based on current estimates of revenue and spending, debt will increase to 100% of GDP by 2020. While one must be extremely cautious regarding such long-range forecasts, this result would negatively impact our secular economic performance and our world standing.

Put simply, our economy is no longer able to self-finance its deficits. Rather, we must convince our bankers, China for example, to extend credit to offset our fiscal shortfall. At some point our creditors will require higher interest rates and might also be in a position to influence our political objectives.

There are two main schools of thought regarding the proper interpretation of these trends. One, referred to as "The New Normal", simply accepts the likelihood of subpar GDP growth in the area of 2-3% as consumers must repay debt to more manageable levels and also deal with higher fees and taxes. Corporate investment spending would also be constrained by uncertainties regarding regulations and taxes. An opposing point of view, "The New Mix", offers a more optimistic outlook. This theory relies on a surge in business investment spending seeking to realize technology induced productivity gains and to capture new markets, particularly exports to the emerging markets. GDP growth under this set of assumptions would probably range from 3 1/2-4% per annum. The difference in economic growth under each theory may seem small, but over time the cumulative effects of each would produce markedly different results.

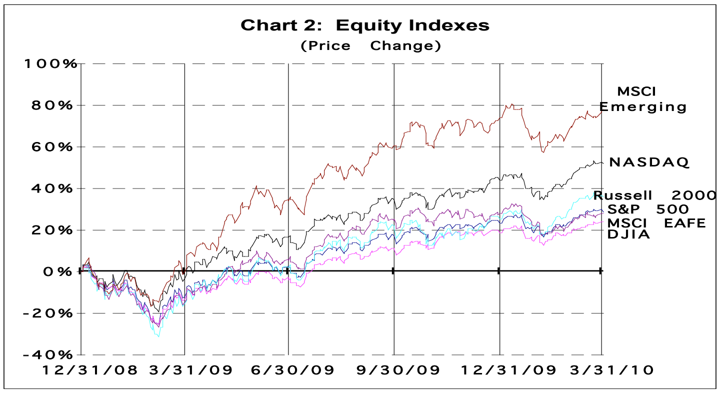
At this point the available evidence is not strong enough to definitively support one theory or the other. Early indications showing a strong recovery seems to favor the more optimistic scenario, but the real test may arrive when various government stimuli have been withdrawn and the Federal Reserve starts to drain liquidity from the banking system by raising interest rates and contracting its balance sheet. By the end of the year it may be possible to form a more definitive point of view.

Important clues will include signs that capital spending by corporations is picking up. To date this area has been notably weak in the face of idle facilities, and uncertainty about government policies.

The case for "The New Mix" theory would be bolstered, if corporate managements began to display more of Lord Keynes' "animal spirits".

Equity Markets

Despite a modest stock market decline in January, equity prices continue to gain as confidence grows in the strength and durability of the recovery. Stocks have been helped by the fact that the competitive appeal of more conservative fixed income securities has been minimal, as money market and short-term rates remain at historic lows. Further, stock valuations are modest at around 15 times forward earnings versus historical multiples of 18 times.



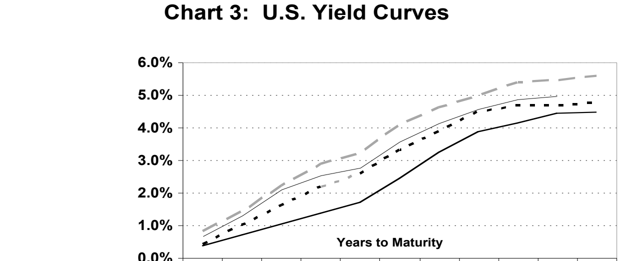
There are several areas that deserve our attention. The emerging markets were relatively unaffected by the recent recession, and the growth outlook for these markets still compares favorably to the more developed markets. The emerging markets have been and will continue to be the engine that drives world economic growth at a rate of 4% or more in 2011. We think some of the best investment opportunities lie in these overseas areas. This can be accomplished by direct investment or by owning shares of large multinational firms. A second area for emphasis is in what can be termed the economic infrastructure. This includes roadways, bridges and various facilities benefitting from governmental stimuli initiatives. Industries expected to benefit include technology, energy and materials. Finally, risk control must remain a major portfolio objective. Asset allocations, arguably the most important portfolio decision, should include as broad a range as possible consistent with individual client needs and objectives. Proper diversification also requires periodic rebalancing.

The market outlook for stocks is favorable in our view based on conservative valuations, a positive interest and inflation rate forecast, and strong prospective earnings growth. Volatility can be expected, however, in light of uncertain governmental policies and the outcome of the secular growth debate regarding our economy. We still believe that common stock ownership is one of the best ways to outperform inflation over the long term.

Fixed Income Markets

The huge federal budget deficit is a major consideration along with similar fiscal problems for many of our trading partners. Higher taxes and inflation seem to be an historical inevitability given this condition. Yet the current circumstances of excess capacity and high unemployment are holding inflation in check. This constraint is expected to continue for at least another year or

Chart 3: U.S. Yield Curves



	1	2	3	4	5	7	10	15	20	25	30
AA Industrial	0.8%	1.4%	2.2%	2.9%	3.2%	4.1%	4.6%	5.0%	5.4%	5.5%	5.6%
US Gov't Agency	0.7%	1.3%	2.1%	2.5%	2.8%	3.6%	4.1%	4.6%	4.9%	5.0%	
US Treasury	0.4%	1.0%	1.6%	2.2%	2.6%	3.3%	3.9%	4.5%	4.7%	4.7%	4.8%
Muni-AAA GO	0.4%	0.7%	1.0%	1.4%	1.7%	2.4%	3.2%	3.9%	4.1%	4.4%	4.5%

perhaps longer if Federal Reserve policy is successful in draining excess liquidity. The latter may be too much to expect since the record in this regard is somewhat uneven. The best course, therefore, may be to emphasize short-term maturities in order to protect principal even though current yields are not particularly attractive.

Ideally, a "ladder" of increasing maturities should be constructed in portfolios, so that the opportunity to reinvest in a rising interest rate environment will be available. A further diversification strategy would be in the area of overseas fixed income securities where prospective higher rates may not be as great a challenge. International bonds would also offer a hedge against fluctuations in foreign exchange values. Finally and where appropriate, tax-exempt securities should be considered based on the likelihood of higher taxes.

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