

April 13, 2010

As 2010 began, investors looked forward to a strengthening economy and a further recovery in stock prices. Soon, global concerns emerged that would threaten that hopeful view. Investors grew concerned over China's decision to cool its economy by reversing some economic stimulus programs. In Europe, fears grew regarding Greece's budget deficit and the country's ability to service its growing debt. Headlines blared about sovereign default and the stability of European currencies. Equity markets soon gave up modest gains and traded lower. By early February, the Dow Jones Industrial Average again fell below the 10,000 mark. Expectations of a continued recovery faded.

Ironically, low expectations can be good for the disciplined, long-term investor. This was the case in the first quarter. In most cases, corporations continued to report earnings above diminished views. While the situation is still uncertain, stronger European countries tentatively signaled support for a restructuring of Greece's debt. As fears subsided, the rally resumed. In the end, the Dow Jones Industrial Average had its best first quarter performance since 1999. The equity and most

| <b><u>% Return as of 3/31/10</u></b> |                     |                    |                    |
|--------------------------------------|---------------------|--------------------|--------------------|
| <b><u>Equity Indexes</u></b>         | <b><u>1st Q</u></b> | <b><u>1 Yr</u></b> | <b><u>3 Yr</u></b> |
| S&P 500                              | 5.4                 | 49.8               | -4.2               |
| Russell 2500                         | 9.2                 | 65.7               | -3.2               |
| MSCI EAFE                            | 0.2                 | 50.0               | -9.6               |
| Emerging Market                      | 2.1                 | 77.3               | 2.8                |
| DJ Wilshire REIT                     | 9.8                 | 113.7              | -12.0              |
| <b><u>Bond Indexes</u></b>           |                     |                    |                    |
| TIPS                                 | 0.6                 | 6.2                | 6.0                |
| Aggregate                            | 1.8                 | 7.7                | 6.1                |
| Governments                          | 1.1                 | -0.1               | 6.0                |
| Mortgages                            | 0.9                 | 8.0                | 6.7                |
| Investment Corporate                 | 2.3                 | 23.8               | 6.0                |
| Long Corporate                       | 1.8                 | 31.1               | 5.6                |
| High Yield                           | 4.6                 | 56.2               | 6.7                |
| Municipals                           | 1.3                 | 9.7                | 4.6                |
| <b><u>Cash Equivalents</u></b>       |                     |                    |                    |
| 3-Month T-Bill                       | 0.0                 | 0.1                | 1.6                |
| <b><u>Consumer Price Index</u></b>   | 0.4                 | 2.0                | 1.8                |

fixed-income markets have now advanced for four consecutive quarters.

**Domestic Equities:** Stocks rose as the credit crisis waned and international concerns faded. The S&P 500 rose 5.4% for the quarter. From one year ago, it vaulted to an almost 50% gain. Smaller stocks, which had been hard hit during the credit crisis, continued to bounce back. The Russell 2500, a measure of smaller domestic stocks, rose 9.2% for the quarter. The trailing one year return was up a powerful 65.7%.

**International Equities:** Returns of international stocks were somewhat muted due to concerns relating to the European Union and the Euro. Despite the turmoil, the MSCI EAFE index, a measure of international developed markets stocks, managed to eke out a 0.2% gain for the first quarter. The trailing year was a different story with a return of 50%. Emerging markets stocks turned in similar results. The MSCI Emerging Markets Index was up a modest 2.1% for the quarter but soared 77.3% for the trailing year.

**Fixed-Income:** Bond returns were positive but subdued. The Barclay's Aggregate, a measure of the total bond market, rose 1.8% for the quarter and 7.7% for the trailing year. As credit fears continued to fade, bonds with greater credit risk continued to lead. Corporate bonds rose 2.3% for the quarter and 23.8% for the trailing 12 months. The Barclay's High Yield index did even better. It rose 4.6% for the quarter and advanced a powerful 56.2% for the trailing year. Some investors believe that bonds are low volatility investment choices. Given current low rates and the improving economy, this may not always be the case.

**Real Estate:** Real estate, both residential and commercial, was at the core of the credit crisis. As valuations weakened, credit became difficult to obtain. Some overly-leveraged owners became forced sellers. This further weakened valuations and a vicious circle ensued. As one might expect, as credit conditions thawed, valuations have greatly improved. Publicly traded REITs, as represented by the Wilshire REIT index, gained 9.8% for the quarter. For the trailing year, the index shot up 113.7%. Despite the strong results, hurdles still remain for publicly traded REITs as refinancing could still be difficult.

Investment sentiment was far different last year. The world was mired in the uncertainties of the credit crisis. Market pundits and many in the media were calling for a return to the Great Depression or worse. Many believed long-held principles had failed and the future was bleak. Some desperately proposed new strategies to deal with the dire new reality. Our investment letter from one year ago made our position very clear.

*"During times of extreme uncertainty it is tempting to listen to those with extreme positions and shrill voices. Our commitment is instead to use prudence and mathematical principles to help build your future. Our response is not to shrink away and hope for the best. Instead, we will confront these challenges with discipline and strength. This, we believe is the only way back."*

We have come back. Strong double-digit and even triple-digit returns were certainly dramatic. It is good to again be rewarded for having a well-grounded approach. Many challenges, however, still remain. The recovery has been partially built on artificially low interest rates and government stimulus programs. These must be gradually withdrawn without damaging the recovery. Governments worldwide will need political will to pay down debt and rebuild balance sheets. Accomplishing these objectives without serious dislocations will not be easy or without setbacks.

Uncertainty is nothing new to us. Whatever the future may bring, we will be here to help. I will be talking with you soon about your portfolio and any adjustments that may be required. In the meantime, let me know if there is any change in your specific situation or if you have any questions or concerns.

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