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~ OUR CHIEF INVESTMENT OFFICER'S COMMENTARY ~

We often think that the end of one year and the beginning of a new year should be the catalyst for change. Thus along with resolutions we see an abundance of New Year's forecasts. While there may be short term tax strategies which have a temporary calendar effect on stock prices, **in general economic and market cycles are of longer duration**. This is especially true this year.

Indeed, if we were to label the current economic and market environment, we would need to consider it a work in progress or unfinished business. **Much of the market rebound, and the optimism for an eventual economic recovery, are based on the massive amounts of fiscal and monetary stimulus provided globally by governments on a coordinated basis**. The banking system has been reinforced by government intervention and public works and infrastructure projects have been funded to provide jobs.

The stock market, which a year ago was discounting the collapse of civilization, has recovered to reflect a more realistic equilibrium between risk and return. **The economy, too, is beginning to recover, probably having emerged from recession sometime during the second half of last year**. Even residential housing, which led us into this mess, has begun to stabilize, buoyed by government incentives.

As we analyze the macro economic factors, which impact the companies in our portfolios, we are generally optimistic about the coming year. **There are however reasons to balance our optimism with a degree of caution**. For the most part, they are interlinked and arise from the policies that are driving the recovery.

Governments, on a global basis, have become more indebted during the recent crisis. The Dubai World default was cautionary. While highly leveraged countries such as Greece, Ireland and Spain are bringing pressure on European unity, the U.K. whose fiscal position is the worst in the industrialized world, has no implicit guarantee for its debt.

This means, **at some point, central banks need to remove the emergency liquidity supplied during the crisis.** In doing so, they need to avoid damaging the market expectation that global growth will be strong enough to bail out over indebted Western economies.

If the timing is wrong, or the tightening too draconian, there is a significant risk the economy will slip back into recession, forcing unemployment to rise higher still. Under this scenario, the banking system will come under renewed pressure from bad debts as well as higher funding costs.

Given the amount of liquidity already in the system, we think it is more likely that we will continue to grow our way out of the current situation. In the year ahead, both stock market returns and economic growth will be influenced by these policy decisions. **We also think that both the stock market and the economy, in the years ahead, will not be as volatile as the recent past**.

Fixed Income Market

The yield curve has steepened in recent months with the difference between short term 2-year notes and the 10-year note at 2.73 percentage points. This steepening of yields is largely due to the increasing yields on longer maturity instruments in anticipation of a broader economic recovery. For example, the yield on the 10-year note has jumped more than 60 basis points, or 0.6 percentage point, since the end of November. Yet short term rates have remained relatively unchanged as signs point to the Fed keeping its borrowing rates at record lows for the near future.

This steepening of the yield curve does provide some opportunities for longer maturity

bonds, but does not preclude the need for detailed review and evaluation of individual bonds and bond sectors. **One area we continue to favor is in high quality corporate bonds in the near term.** Between reducing costs, raising capital and conservative investing, many companies are sitting on large cash balances, which is good for bondholders.

We also continue to monitor municipal opportunities for our high tax-bracket clients. But with municipal issuers estimated to sell $450.5 billion in debt in 2010 and many states and counties facing reduced revenue and increasing costs, each municipal bond needs to be reviewed for risk.

We have not limited our choices to any particular type of fixed income instruments and have even purchased some reasonable corporate CD offerings backed by the FDIC. We have also examined individual TIPS to combat future inflation, but because of demand for these offerings the yield spread has become less attractive. Additionally, **although Treasuries are the safest fixed income investments, the government continues to pump the system with new offerings to fund the stimulus and government spending initiatives, putting pressure on prices**. We have seen better yields and equally safe offerings from slightly longer term government agency issues.

Ultimately, with a recovering economy and inflation in the future, **we continue to build a high quality, diversified and laddered maturity of relatively short duration bonds focused on capital preservation and portfolio diversification**.

International Market

Time flies. Last year, at this time, investors around the world panicked and sold off stocks as though the world was coming to an end. Last year we wrote, "we see countries around the world providing aggressive fiscal and monetary stimulus to shore up their economies. As these economies begin to stabilize, we think there will be significant investment opportunity in international stocks." **Twelve months have passed and international markets have turned in a great performance**. The MSCI Emerging Markets Index returned more than 73 percent, almost triple the developed market performance. Among the emerging markets, BRIC countries led the way, with the MSCI BRIC Index up by more than 87 percent.

Brazil, Russia, India, and China make up the BRIC nations. Excluding Russia, where we feel the potential for returns does not compensate investors for the country's political risks, we have exposures in the other three nations. **Looking into 2010, we are still positive on these countries; it just is not reasonable to expect a performance encore of the magnitude we experienced in 2009**. Last Quarter, in the International Market Update section of our newsletter, we addressed issues and opportunities in China. This time, we would like to take the opportunity to focus on the other two BRIC nations, Brazil and India.

Investments in Brazilian companies benefited from both the stock market returns and currency appreciation. The country's benchmark Bovespa Stock Index rallied 83 percent this year and put the measure within only 7 percent of its historical high reached in May of 2008. In part this performance was aided by currency translation; the real appreciated 33 percent against the U.S. dollar. We think the Brazilian economy will derive additional benefit from infrastructure spending as it prepares to host the 2014 World Cup and the 2016 Olympics. Demand from China, Brazil's largest trading partner, will also contribute. **However, it is worth noting that the Bovespa is rich, trading at the highest level in 6 years at 21 times reported earnings**.

India was the third best performing market in the world in 2009 after Russia and Brazil. Its benchmark, BSE Sensex Index, returned 81 percent. This superb performance can be attributed to three major reasons; one, India has witnessed a huge inflow from foreign investment funds; second, **Indian companies have delivered strong earnings growth; and maybe the most important reason was the huge victory by the Congress-led UPA Party which gave them a clear majority in the government**. Going forward, we expect India's economic expansion to continue as there remains plenty of room for growth. For example, India has only 7% penetration in broadband, versus 18% in Asia. Only 17% of households have computers, compared to 65% in China. One potential concern is India's dependence on imported oil. If oil prices continue to rise, its balance of trade will deteriorate with a negative impact on economic growth.

In closing, we can not emphasize enough that excess return is a function of assuming additional risk. It is advisable to invest only a portion of investable assets in international markets based on a careful assessment of an investor's tolerance for risk. One only needs to look at Dubai, Ireland, Greece, and Spain to realize that sovereign risk is an essential consideration when investing in international securities.