MARKET OUTLOOK

APRIL 2010

In the first quarter of 2010, stock prices continued the strong advance which began in March of last year. For the quarter, stocks were up 5.4% which brought the twelve month gain to an unusually strong 49.8%. The rally was a result of the anticipation of an economic recovery fueled by cheap money, rebounding corporate profits, and federal stimulus. As the rally progressed, money flowed into riskier and smaller stocks as investors' appetites for risk increased. Over the last quarter, bond returns were modestly positive. As with stocks, riskier bonds performed better with junk bonds and mainstream corporate bonds returning more than intermediate government bonds. Short-term rates remain low but the yield curve has steepened indicating the anticipation of rising rates across the maturity spectrum.

The markets now expect rising interest rates due to the enormous supply of new Treasury securities needed to fund our ballooning federal deficit of $1.4 trillion this year and at least $1 trillion for each of the next ten years. The end of the Fed's purchases of mortgage back securities and the gradual withdrawal of the large fiscal stimulus of 2008-2009 may also lead to rising rates. Further, the rising need for local and state bond issuance will add to the supply of bonds and push rates higher.

Real Gross Domestic Product (GDP) turned positive in the third quarter of 2009 and has continued to show growth into 2010. Corporate profits turned positive in the last quarter of 2009 after eight consecutive quarterly year-over-year declines. Because of lackluster revenue gains, profit increases have been heavily dependent on cost cutting and the resulting increase in productivity. Consensus estimates call for double digit gains this year and next, but this is dependent on a pick up in sales growth. To date, the recovery has been below average and while we expect growth to continue, it will be slower than past recoveries and with no imminent threat of inflation.

Taxes will rise significantly in 2011 as the Bush tax cuts are set to expire. Consumers still need to rebuild their balance sheets and unemployment will continue to be high, both of which will inhibit consumer spending. The overhang of foreclosed and underwater mortgages will keep a lid on the housing market. Financial institutions, both in the U.S. and abroad, still hold a significant amount of questionable assets which may have to be written down and the financial sector faces significantly increased regulations, the details of which will not be known for months. Businesses face a high level of uncertainty over taxes, increased regulations, and uncertain rules resulting from the new health care law. These factors will all result in lower business spending than would normally occur at this stage of a recovery.

In this environment, we will continue to emphasize balance, diversification, and quality with a modest bias toward income generating securities. These characteristics, in total, will result in lower asset volatility and enhanced asset preservation. We will continue to look for opportunities to purchase securities at attractive levels, especially if we have periodic declines in prices. At the same time, we will monitor events and markets very closely and will not hesitate to take profits if warranted.

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