

# Investment Commentary

MARCH 23, 2009

Equities rallied through the first part of last week before succumbing to some profit-taking. Nevertheless, stocks managed to post gains for a second consecutive week, with the Dow Jones Industrial Average climbing 0.8% to 7,278, the S&P 500 Index advancing 1.6% to 769 and the Nasdaq Composite rising 1.8% to 1,457. From their lows on March 6 through the peak in the middle of last week, stocks were up nearly 20%.

The main event last week was the Federal Reserve's announcement that it would purchase upwards of \$1 trillion worth of mortgage-backed and Treasury securities in an effort to boost economic growth. The Fed's efforts to purchase massive amounts of mortgage debt are designed to lower mortgage rates to allow many homeowners to refinance, providing them with increased monthly cash flow. Ideally, the lower rates should also prompt some prospective buyers to move off the sidelines and enter the residential real estate marketplace.

While the Fed seems to be doing everything in its power to help the economy and the banking system to recover, the rest of Washington remains mired in discussions over the AIG bonus pool. While the outrage engendered by the bonus payments is certainly understandable, we do not believe the Congressional response has been. Should the proposed bonus tax package be enacted, we believe it would cause many TARP recipients to leave the program as quickly as possible, undermining the entire idea of rebuilding the banking system. The mending of the banking system remains a prerequisite for achieving an economic and financial market recovery. The banks themselves need to stabilize, credit and loan markets have to start operating efficiently, leverage must continue to decrease and the overall erosion of confidence has to wane. With its actions last week, the Fed has done just about all it can in the way of aggressive monetary stimulus, and the spotlight is now squarely on the Obama administration and Congress as they act to design, implement and fund a financial fix, partially spelled out in the details of the just-announced Treasury Department's Public-Private Investment Program.

Regarding the broader economy, some recent signals might suggest we are nearing an inflection point. Improvements in housing starts, the trade deficit and retail sales suggest that at least some parts of the economy may be bottoming. This does not suggest that the economy is about to recover, but it does point to a degree of stabilization and a potential end to the severe rates of decline. At present, we believe there is some probability that we will witness the start of an economic recovery by the end of the year that could lead into sub par, but positive, growth in 2010. For equities, a clear outlook remains difficult to ascertain. The recent rally was important, but it remains to be seen whether it will have legs. We expect some additional back-and-forth action, which will hopefully create a more stable trend. We also believe the rally will continue, although at a slower pace. From a longer-term perspective, equities do appear to be attractively valued, particularly when compared to cash or to a 2.5% Treasury yield.

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