



January 4, 2010

Dear valued client:

At the beginning of the year, if you had asked us the probability of the S&P gaining 26.46% in the same year where unemployment reached 10% and where 140 banks across the country failed and were taken over by the FDIC¹, we would have given you a very low number. However, that is exactly what happened this year as stocks made huge gains off the lows established on March 9th, 2009. For the year, the Dow, S&P, & NASDAQ ended higher by 22.68%, 26.46%, & 43.89%, respectively. Although the magnitude of the 2009 gains impressed even the most bullish of market forecasters, the bullish move once again reinforces the fact that no matter how bad the news, markets generally tend to be forward-looking, not backward. Consequently, the linearity between price and fundamentals isn't always a one-to-one relationship, particularly in the short-term. This is why we continue to advocate the value of a long-term investment approach, which protects us from the natural human tendency we have to react based upon short-term, news driven events that have very little influence over the long-term intrinsic value of a business. Benjamin Graham, author of *The Intelligent Investor*, gave us a timeless piece of advice when he said: "The markets are there to serve you, not instruct you."

2009 was characterized by a rising tide that lifted most stocks higher. For 2010, we believe excess investment returns will likely be realized from shrewd stock selection, not from broad market movements. Given the disproportionate upward movement in stock prices relative to earnings fundamentals, valuation multiples have moved higher, which is to be expected in the early phases of a market recovery, but not likely to be sustained for a prolonged period without a corresponding bounce in earnings, which we hope to see during 2010. Since the recovery is still in its early phases, the variability of outcomes surrounding the shape of economic recovery continues to be elevated.

As we have mentioned in previous investment letters, some forecasters believe the economy will experience a slower than normal recovery due to the expiration of temporary government stimulus programs designed to support the housing market, persistently high un-employment, and the continued negative impact of de-leveraging, both from banks and individuals. Others believe that this recession is not that different than other cyclical-driven post war recessions and that the economy will exceed expectations as inventories are replenished, government stimulus money gets put to work and companies begin utilizing their available cash to make capital investments, which will eventually trickle down into employment and help create a self-sustaining level of end demand. Despite the elevated variability of outcomes, we believe 2010 will likely be a year where the rubber meets the road, as government stimulus programs designed to support the housing market are removed and the economy is gradually forced to stand on its own two feet.

As always, we thank you for your trust and support and look forward serving you in 2010.



1 Federal Deposit Insurance Corporation (FDIC) data on the number of failed banks came from their public website at <http://www.fdic.gov/bank/individual/failed/banklist.html>

The S&P 500 consists of 500 stocks chosen for market size, liquidity and industry group representation. Each stock's weight in the index is proportionate to its market value. The S&P 500 is one of the most widely used benchmarks of US equity performance.

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