



March 2, 2009

Dear Clients and Friends,

The financial markets have moved lower once again as corporate earnings reports from the end of 2008 have come in much lower than expectations. While the vast majority of earnings disappointment has been in the form of “non cash” markdowns of asset values, the general outlook for 2009 has declined greatly.

Continued liquidation of hedge funds has been a major force behind the selling. While many, including us, had thought the bulk of hedge-fund redemptions had ended with the fourth quarter of 2008, recent data suggests the industry continues to reel. This adds pressure as those funds sell what they can – often higher quality securities that comprise their “long” positions – to meet redemption requests.

Ongoing uncertainty in the financial sector has also fed the decline. That uncertainty has increased in the past weeks with the Treasury Department’s inconsistent handling of troubled banking institutions. Importantly, the lack of clarity from Washington on a number of issues and potential solutions, including a so-called “bad bank” for removing non-performing assets, modifications to mark-to-market accounting, restrictions on short selling, and incentives to resume lending, has disappointed the markets thus far.

Yet, there are signs of economic life. Notably,

1. The index of Leading Economic Indicators has risen for the past two months;
2. The Baltic Dry Index, a measure of basic global production that captures the cost of shipping key raw materials, has more than doubled from its recent lows;
3. The interbank lending market, as measured by LIBOR and the Federal Funds Rate, no longer reflects the strains on the banking system seen last Fall and may even suggest a healthy improvement in interbank loans despite the recent intensification of worries about a small number of large banks;
4. Commercial paper rates, key to short-term corporate financing, have declined and stabilized;
5. Many industrial corporate bond rates have declined relative to Treasuries in the past three months, suggesting a lower cost of capital for corporations.
6. Corporate bond issuance year-to-date is \$134 billion, about the same as last year, while high yield issuance is running at three times the pace of 2008. The high yield market was the first to freeze when the crisis hit, and appears to be thawing rapidly now.

Despite these positive signals, volatility, fear and uncertainty continue to rule the markets today. While we are reminded of Warren Buffett’s famous adage, **“Be fearful when others are greedy, and greedy when others are fearful,”** we continue to maintain equity levels below what we might consider “normal” allocation levels, and have been buying more fixed-income securities (bonds) where possible and when reasonably attractive. We also have some powder dry to selectively allocate to defensive stocks and sectors when the earnings outlook turns more favorable.

A brief word to our clients with exposure to “preferred stock” securities in their portfolios: In many cases, these securities are supported by underlying bonds. As such, we expect them to continue to pay their dividends as the bond interest “passes through” to the preferred holders. However, in response to the financial crisis, many of these securities have acted more like volatile stocks than bonds. Though we cannot predict when a return to fair value will occur, we do believe that over the long term, yields will again trade at parity with comparable long term bond issues, at which time preferred prices should return to normalized levels. We are also reviewing each holding, as new information becomes available on an issuer-by-issuer basis, to see if more immediate action is required.

As always, thank you for your confidence and support.

Sincerely yours,

Susan Fulton and Mitch Schlesinger