Quarter Notes

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Market Summary
From the March 9 low, the Dow gained 20% before pulling back slightly in the last days of the quarter. It ended 13% down year to date, posting its sixth straight quarterly loss. The broader S&P 500 losses were 11.7%. Brighter news came from the NASDAQ which bested the larger caps trimming its losses to just 3%. The Russell 2000 dropped 15.4%.

Investors are concerned about the upcoming earnings reports as the first quarter of 2009 is likely to be the nadir for profits. Diversification is once again showing signs that we can expect a return to more normal asset relationships. We are already starting to see differentiation in returns in international and emerging markets.

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Not a Light at the End of The Tunnel, But a Few Flickers

When will this recession end? Divining the right answer would require a better crystal ball than we possess. However, while there is not yet light at the end of the tunnel, we may be witnessing a spark or two. When evaluating the economic news, we see the good, the bad and the ugly.

First the good news: Housing affordability hit an all-time high in February. With 30-year mortgages below 5%, home sales should continue to improve. For qualified borrowers, there is an incentive to refinance at historically low rates. If you have home equity to meet the criteria, even with lower appraised values, reduced mortgage payments can save much-needed cash. On a broader note, there is now anecdotal evidence that the stimulus programs are starting to have a positive effect and the threat of deflation has been reduced. Credit is beginning to loosen for qualified borrowers and the Treasury's plan to deal with toxic assets has been well received by the markets.

In March, the Commerce Department revised fourth quarter 2008 Gross Domestic Product numbers revealing a 6.3% drop. This was the worst contraction since 1982, but less severe than forecast. Current estimates predict another 4-5% GDP loss for first quarter 2009 and as much as 2% in the second quarter. Fast forward to 2010; growth is expected to be feeble, but positive. In 2011 growth should accelerate.

Fourth quarter 2008 consumer spending fell 4.3% and spending on durable goods was down 22.1%. This was the largest drop since 1987. Annual sales of autos are still lagging with sales of nine million cars in 2008, but 12 million vehicles were scrapped. Eventually, these cars have to be replaced and that will boost sales. For other consumer goods, inventory liquidation depressed production at the end of last year. With few firms having excess inventory, production must resume as demand strengthens.

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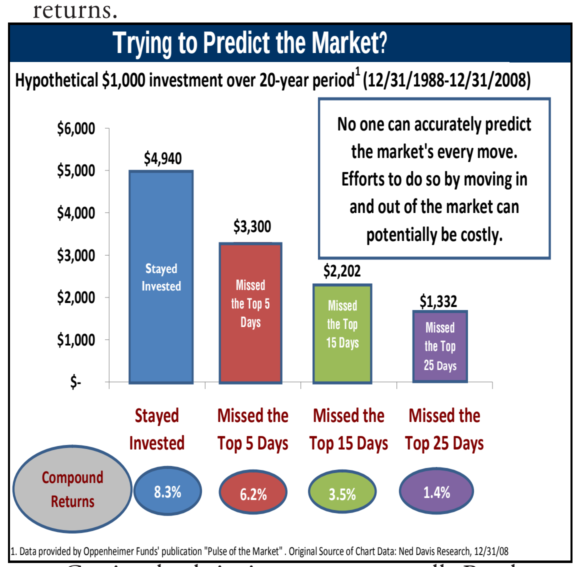
Staying Invested When Markets are Scary

Clients must be as tired of hearing "Stay the course" as we are saying it. It is worth noting, however, that as bad as this cycle has been, economies and markets do recover. If you are not invested, you can miss most of the gains before reaching a level of comfort sufficient to allow you to reinvest.

As seen from the chart below, while missing a market plunge is great, missing a few good days can make a significant difference in your returns.



Getting back in is not an easy call. By the time everything looks rosy again, losses will be locked in and most of the rally may be old news.

The alternative: don't try to time volatile markets. Establish an investment policy that you can live with and then slowly and systematically reinvest based on that policy. It will limit the gain if the market pops up and stays there, but it will limit the "whipsaw" of buying at the top and selling at the bottom while a portfolio is reestablished.

Investors who find they cannot accept the risk of their current policy need to systematically reduce overall exposure to a level they can live with. As difficult as it is to do this, selling investments slowly as markets recover is the way to accomplish this goal in an advantageous way.

Other Notes

Let's Talk with our Parents: Our parent's financial health may have been affected by the recent market turmoil. This is a good time to open the dialogue to make sure everything is OK with them. Getting over the initial discomfort can be as easy as asking, "How are you doing financially?"

New Gifting Limits: Changes in gift tax laws allow us to gift up to $13,000 for 2009 to any number of individuals. Couples can jointly gift $26,000.

Nervous: Nearly a third of investors surveyed last month said that if they came into new money they would save it rather than invest it in the stock markets. Using the current tax-free money market yield of 0.33% their money will double in just 210 years. (Source Rasmussen Reports)

Optimists, Pessimists and Day Traders: The optimist sees the glass as half full, the pessimist as half empty, and the day trader just adds whiskey.

You Can't Follow the Game without a Scorecard

How do we track what the government is doing to get us out of this mess? The overall efforts to revive the economy are now referred to as the Financial Stability Plan. The government has created a website to help track it. (www.financialstability.gov).

The Plan includes a number of initiatives with the overarching goal to "fix" the economy:

- **Recapitalizing Banks**: With the goal of keeping the banks solvent, TARP (Troubled Asset Relief Program), established during the Bush administration, injected money directly into banks by buying preferred stock that is convertible into common shares.
- **AIG:** Although many of AIG's business lines are healthy, the Financial Products division brought down the world's largest insurer using excessive leverage trading CDS (Credit Default Swaps) and other derivatives without the sufficient collateral. The government now owns 80% of the firm and AIG is attempting sell off the profitable pieces to repay its loans.
- **Autos:** This is all about the jobs. The auto industry worldwide has excess capacity which makes saving the "big three" questionable. To date, the government has infused a combined $17.4B into GM and Chrysler, and both continue to ask for more. Washington continues to review restructuring plans and to elicit concessions. Its latest move forced out GM chairman, Rick Wagoner. Bankruptcy is still on the table. Ford remains the healthiest of the three.
- **Consumer Credit:** TALF (Term asset-backed securities lending facility) allows the Federal Reserve to lend money to investors who want to buy securities backed by consumer loans. The Fed will be "at risk" for losses, but will only finance highly-rated securities. This should loosen consumer credit.
- **Homeowner Bailouts:** In order to stem the number of foreclosures, loan-modifications and refinancing are being made available. Government funds used in partnership with Fannie Mae, Freddie Mac and private mortgage servicers support such efforts for eligible homeowners.
- **Toxic Assets:** PPIP (Public Private Investment Partnership) will use low-interest, federal loans to help pools of private investors buy securities at discounted prices. Future profits are split between the government and the investors, but losses fall disproportionately on the government. The problem is establishing a "fair price" for the assets; too low and the holders won't sell and too high and the investor pools won't buy them.
- **Resolution Authority:** Treasury Secretary Geithner has called for legislation to create an agency that allows nonbank financial institutions to be regulated by the Federal Government. This "Resolution Authority" would allow the government to place financial firms into a conservatorship to systematically unwind obligations and dispose of assets. This is similar to the authority the FDIC has over member banks.

When Will This Be Over?

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Continued weakness in unemployment numbers highlights the ugly side of this recession. Labor Department statistics show that first-time claims for unemployment benefits rose to 652,000 the week of March 16. In February, the number of unemployed increased by 851,000 to 12.5 million and the unemployment rate rose to 8.1 percent. Over the past 12 months, the number of unemployed has increased by 5 million. This number does not recognize the substantial number of those employed at reduced wages and hours or significantly underemployed. In past recessions, unemployment, a lagging economic indicator, continued to rise even after the recession technically ended. We are likely to see layoffs continue and the pain of unemployment depress workers' spending and morale.

The rest of the world can't replace our lost domestic consumption. Worldwide nearly all economies are simultaneously experiencing negative growth. Even China, with a positive expected growth rate, has to contend with a world that can no longer absorb all its output.

Americans are finally saving again. 2008 will be the first year since 1999 that households are net savers rather than borrowers. Historically, consumers supported about 70% of GDP. The government stimulus plans should help in an environment with reduced consumer spending. Investments in infrastructure, healthcare, and green-tech should contribute to accomplishing long-term societal goals.

Inflation is in check for now. However, with the ballooning federal deficit and interest costs,which will consume an ever-growing percentage of national income, inflation is likely to return. Government stimulus is replacing some of the decline in consumer spending so inflation is not yet evident.