

2010 Economic and Stock Market Outlook

Please refer to Appendix – Important Disclosures and Analyst Certification

The Good, The Bad, and The Implications of a Fragile Recovery

2010 Outlook Summary

Risk on S&P 500 to 950, Reward to 1250.

Elevated risk of first half (likely Q2) correction on breadth breakdowns and unsustainability of recent growth trend. More favorable path for stocks later in the year as the outcome of the 2010 mid-term elections becomes more certain.

GDP growth forecast – H1: 2.5%, H2: 1.5%. Following stimulus and inventory fueled bounce; consumer re-trenchment comes back into focus.

Inflation measures move toward trend, but an inflationary head fake would not diminish the deflationary impact of heavy debt loads and ongoing de-leveraging.

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- **Broad Market Trends – Bullish; Breakdowns Need To Be Watched**
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What a difference a year makes – right? At this point last year, the S&P 500 stock index was well on its way to falling more than 38% for the year. Now, the S&P 500 is 22% above its year-end 2008 level and is more than 60% above its March low. The recession that has held sway since late 2007 has loosened its grip, and economic conditions have become more favorable. The passage of a year's time has allayed some concerns and provided a more hopeful context in which to move forward. However, the perspective that we suggested was necessary in last year's outlook piece remains key. That the markets may now be functioning on a more orderly basis leads some to believe that the crisis has past and the normal that we once counted on will soon re-emerge. We disagree. **The recession from which we are emerging marked the opening act of a long-term process that remains ongoing. There has been a secular change in household behavior towards spending and saving, and there is little evidence that a new equilibrium has been reached.** Moreover, while the actions taken by consumers, government, and the Federal Reserve over the course of the past eighteen months have served to limit the damage to the economy and the financial markets, more challenges lie ahead. What has been seen is not an aberration from the previous trend; it represents a shift that must be acknowledged for investors to be successful in the years ahead. Before moving to a

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review of the financial and economic evidence that guides our view of the path forward in 2010, we consider, with the perspective gained by having survived yet another year, the Good, the Bad, and the Not-Going-Away-Anytime-Soon.

The Good: The return of differentiation in 2009 (and going forward) represents a marked improvement over the state of affairs in 2008. Last year (2008) was unique in many ways, one of which was the degree to which the returns on risk-assets, both domestic and global, was correlated. Seemingly risk-free U.S. Treasuries offered a positive return last year, while virtually all other asset classes were down. This culminated in March 2009 as markets essentially ceased to operate due to a lack of bids. To have a market one must have a buyer as well as a seller, and buyers were hard to find in the first quarter. As the year has progressed, buyers have re-emerged and the markets have acted again as, well, markets. Moreover, returns have varied across asset classes as relative risk preferences have been re-established (in 2008, what mattered was risk or no risk, not degrees of risk). While



this has been framed in contrast to 2008 and has been discussed as not everything going down at the same time, the inverse is likely also true. **We have not seen the emergence of a global secular up-trend and it should be assumed that not all assets will continue to move higher in tandem.** This provides a basis for market activity moving forward, and variation in returns is likely to be pronounced as cyclical trends ebb and flow in the coming quarters.

The Bad: What makes the transitory nature of the emerging economic recovery particularly disconcerting is the degree to which it is not being recognized for what it is. Too many continue to view the recent recession as little more than a cyclical event: a classic inventory cycle sparked by weakness in the housing market. Following this logic, and with inventories drawn down, housing market activity coming back, consumer demand pent-up, and government priming the pump, economic growth is poised to surge higher and the upward trend is likely to resume. Our view remains that **the housing market was not the cause of the downturn, but a symptom.**

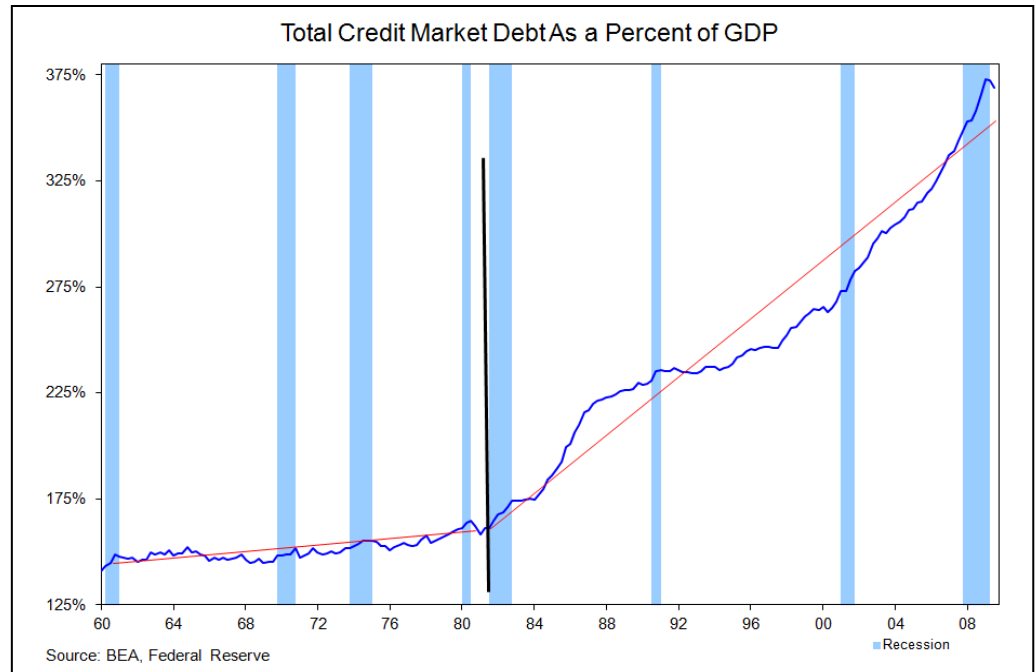


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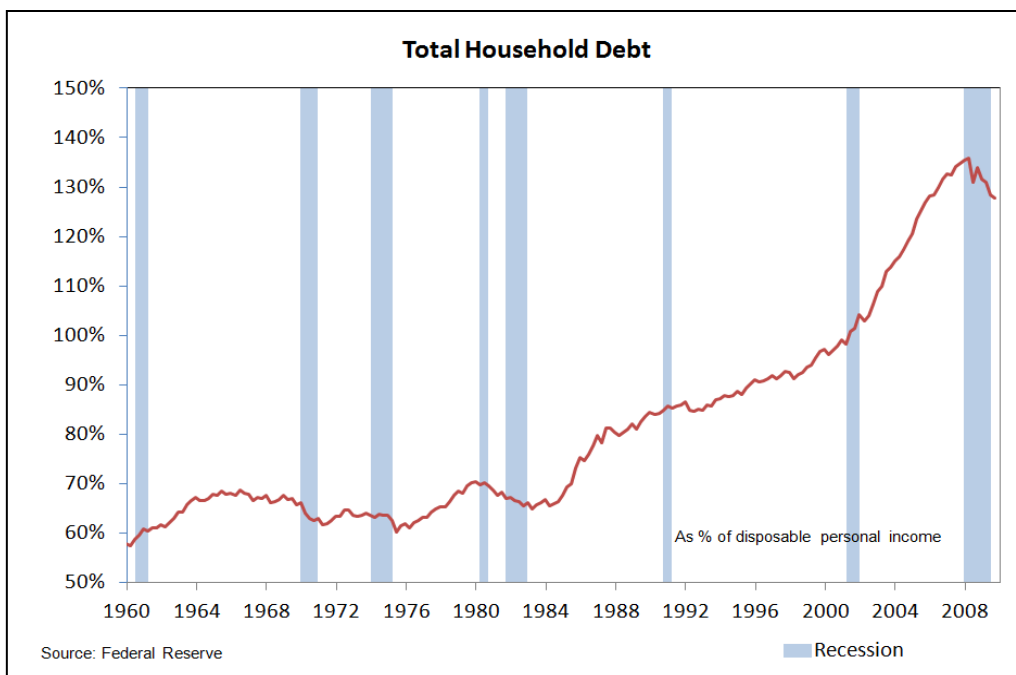
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The underlying cause was the excessive levels of debt that were amassed at virtually every level of the economy. Secular up-trends (in the market or the economy) emerge when the excesses of the previous cycles are relieved. **A new secular up-trend in the economy is unlikely to emerge until debt levels return to more normal levels.** Preferably this will happen in an orderly fashion over time, but even the destruction of debt via bankruptcy helps in this regard. Recent government actions to spur near-term economic growth by amassing additional debt likely delay the beginning of the new long-term expansion. The stimulus

measures, enacted and proposed, have largely shifted future growth into current quarters, with little impact on the underlying trend. Moreover, the policy decisions being discussed appear to put the United States on a path towards a Europeanization of the economy, which could hamper the innovative and entrepreneurial spirit of the private sector. To wit, the December White House jobs forum (held, ironically enough, just a day before the best jobs report in two years) featured union



representatives and academics, not representatives of the National Federation of Independent Businesses or Chambers of Commerce (that is, the small businesses that generate have historically been the source of most of the job growth). With as much money as the government has thrown at the economy, some rebound is almost inevitable. But in the wake of this bounce, and as the growth generated by a modest inventory rebuild fades, the secular retrenchment of the U.S. consumer, marked by a generational shift from spending to saving, will come into clearer view. *A sustained period of strong economic growth remains in the distance.*



Not-Going-Away-Anytime-Soon: Consistent with a protracted basing period for the economy is the view that despite a return to differentiation among assets classes, **global fragility remains a dominant theme.** This fragility may be mitigated somewhat by the lessons learned from the recent past. These include more prudent views towards risk, and recognition by many investors that they are indeed less tolerant of risk than previously assumed. Offsetting these are

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the still fresh memories of late-2008/early-2009 about how quickly markets can move and the tendency of liquidity to evaporate when it is needed most. *In many ways the risks are more elevated now than they were a year ago given the resources of the various governments and central banks that have already been brought to bear.* The expected period of economic volatility and elevated risk is likely to leave markets more fragile than in the past.

Market participants are likely to remain uneasy, selling (or at least attempting to) first and asking questions later. Agile investors should remember that in terms of what matters we have not survived an event, but are working through a process and they may find opportunities to benefit from this fragility and the accompanying volatility. Until a secular bottom has been established, investors should be poised to lean towards and away from various asset classes as the incoming evidence dictates. New investment dollars should be focused on areas of strength in the market, while investors needing to raise cash should reduce exposure

Indicator Review

Fundamental Factors

Federal Reserve Policy	Neutral	0
Underlying Economic Fundamentals	Neutral	0
Valuations	Neutral	0

Technical Factors

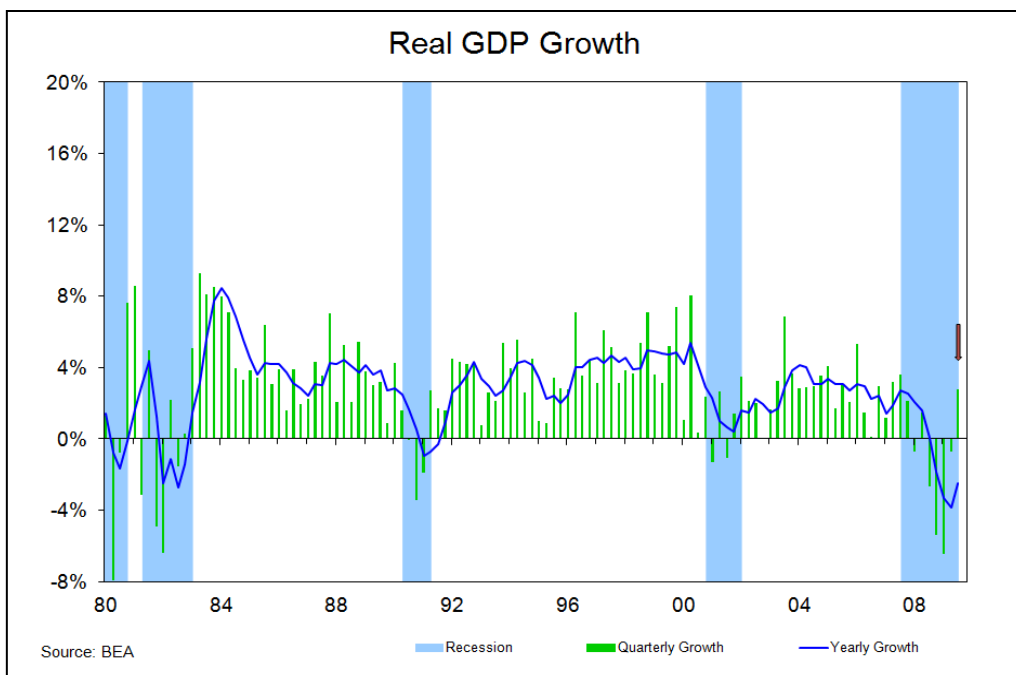
Investor Sentiment	Neutral	0
Trends/Seasonal Tendencies	Bullish	+1
Tape/Breadth	Bullish	+1
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Weight of the Cyclical Evidence	Bullish	+2

to areas showing poor relative trends.

Indicator Review: These secular thoughts guide our views on the markets and help inform the signals flashed by the various models, but our active analysis relies on a combination of fundamental and technical indicators that are at the core of our weight-of-the-evidence approach. These factors each have an individual influence on the markets, and by relying on this tree of indicators we are able to offer hints of what could happen, while not unknowingly deviating from what is happening. **Our goal is to stay in harmony with the primary trends, but also know and highlight when it may pay to be wary.**

Following is our current view on each group of indicators, as well as potential developments that may be seen over the course of the coming year. Rather than view this as a hard and fast forecast, readers are encouraged to see it as a prospective roadmap that will be refined as we move forward.

Economic Fundamentals: We have in recent months upgraded our view of the Economic Fundamentals to

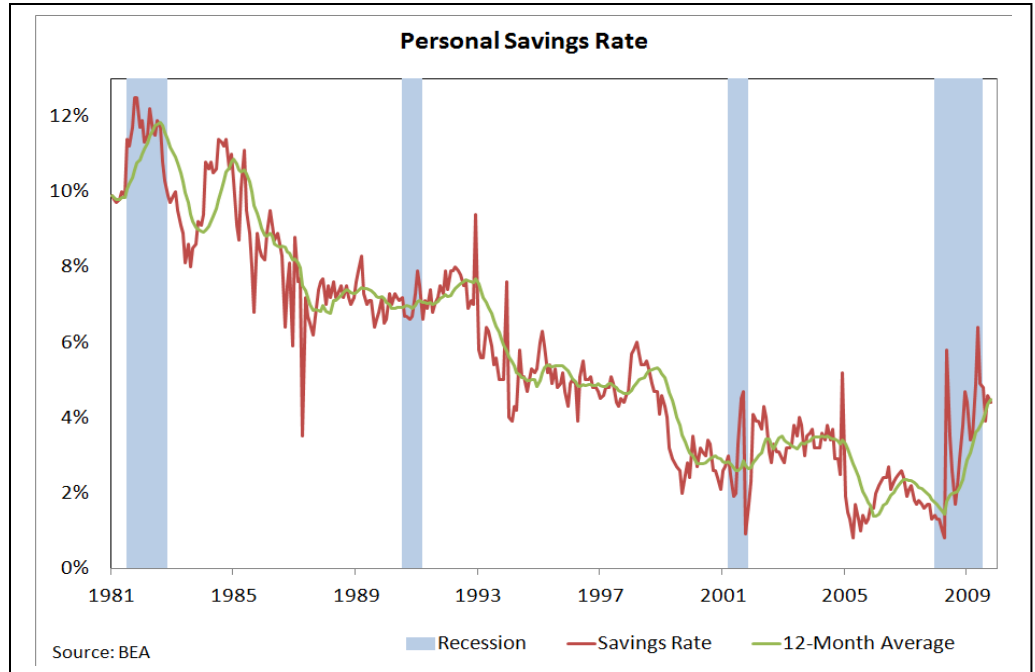


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Neutral as evidence has emerged that economic activity appears to have stabilized and a tentative growth path has been re-established.

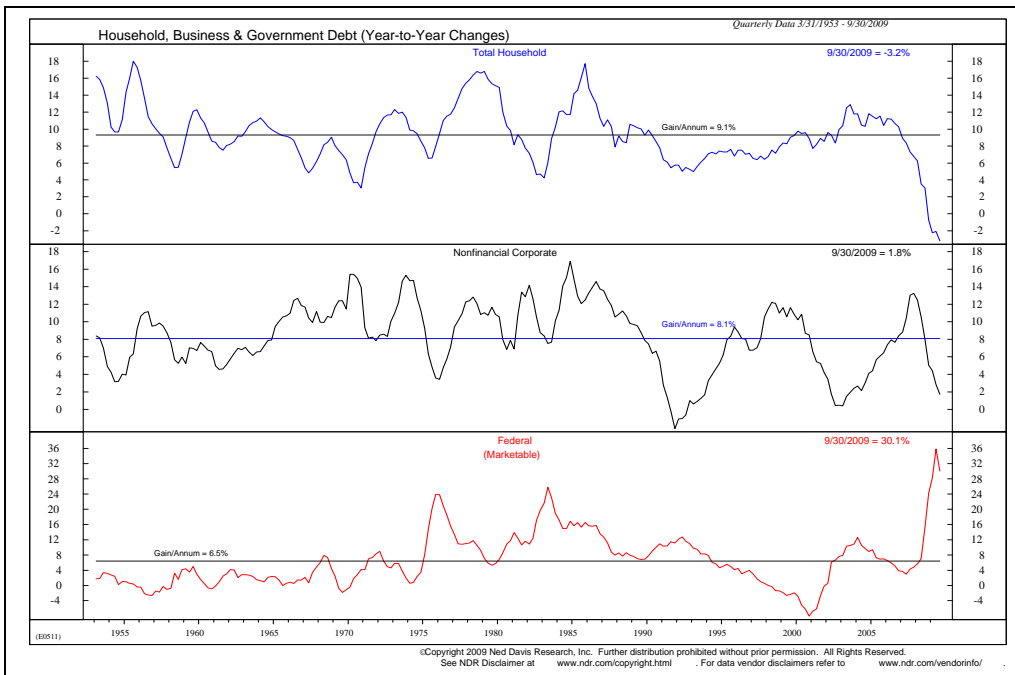
Recent developments have been met with relief, but *significant long-term hurdles remain for the economy in the wake of a 20+ year government policy designed around economic pain avoidance.* This “no pain” policy, which in part continues to be pursued, has distorted incentives and risk taking. Previous recessions ended without the excesses that caused them being fully resolved and the perception that the government would bail out bad decisions came to be viewed as a protective economic put, leading to a mispricing of risk. Among the many developments in 2009 was a marked contrast in private versus public views towards debt. **Households and businesses have begun the process of deleveraging and show an increased aversion to new debt. The government response has been the opposite, with little distinction shown between spending to support the system and spending done**



in the hope of preserving the status quo.

Consumers/Households: Households appear to have begun the secular shift from spending to savings. While a portion of this, at least anecdotally, can be ascribed to a sort of willing Puritan repentance, for many there was little choice. Much of the growth in spending in recent years can be traced to the explosion in personal debt obligations. The debt-to-income ratio for households

climbed to 140%, essentially twice its long-term average. Homeowners tapped into the rising value of their homes to finance a multitude of purchases (while at the same time, viewing their homes as a primary means of investment). Not only is new borrowing no longer available for funding consumption, but the debts accumulated in the past now must be paid off. This represents a double blow to spending plans for households (with the third blow being the secular shift in favor of savings). *Spending going forward will be increasingly tied to income, or some percentage thereof.* We expect that the savings rate could be on its way to 10%, which is above its historical

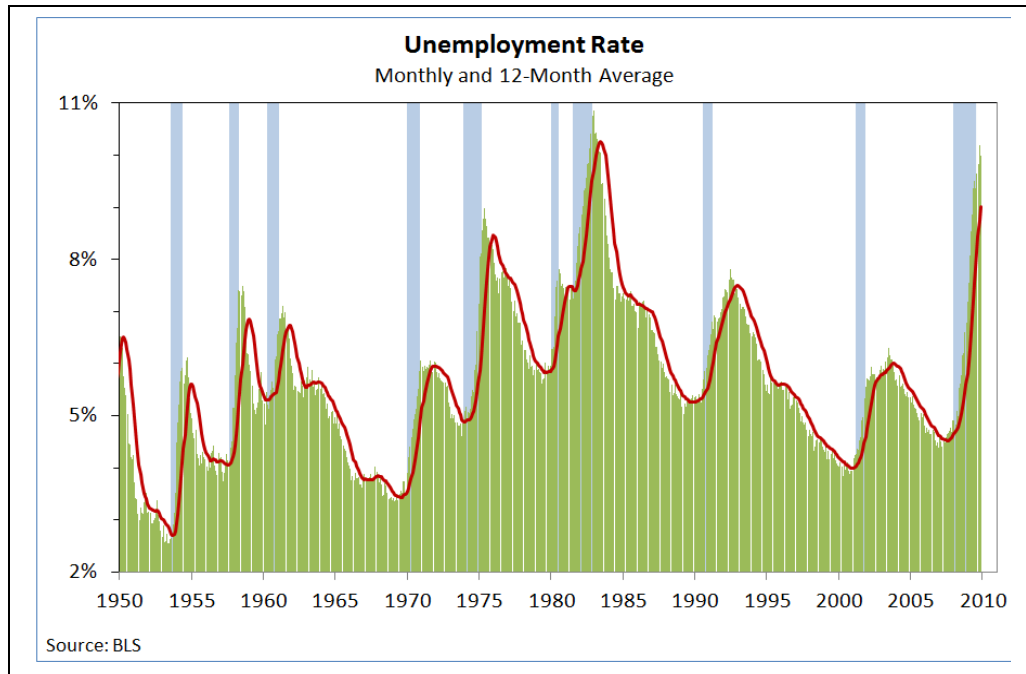


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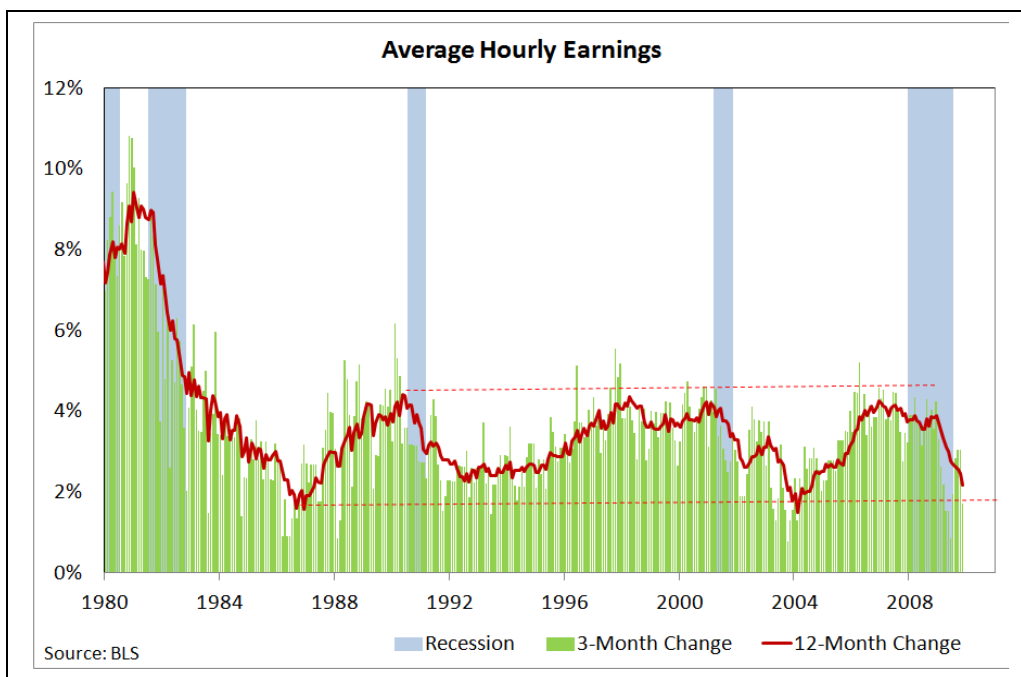
norm, but not by much. In sharp contrast to the recession/recovery at the beginning of this decade, the early stages of this recovery are unlikely to be accompanied by robust consumer activity. Consumers may have been willing to “spend our way out of this” in 2001, but President Obama’s plea is likely to fall on deaf ears in the private sector this time around. **Households will not be in a position to spend until there is substantial improvement in the employment situation, and even then, they are likely to be less pre-disposed to than in the past.**

The November jobs report was encouraging on many fronts: payroll employment posted its smallest decline in nearly two years, the temporary staffing sector added jobs for the fourth month in a row, the hours worked index posted its best gain since 2005, and the official unemployment rate fell from 10.2% to 10.0%. At the same time, however, the yearly growth in hourly earnings has slowed to 2.2%, nearing the lower bound of the range that has persisted for more than 20 years. Even with the pace of firing easing, there



is little evidence that a pick-up in new hiring is imminent. Payroll gains, once they emerge, may be more muted than some are expecting. The cut in hours for workers that kept jobs on the way down (the average workweek is near a record low) could mean slower job growth in a recovery. From the perspective of the unemployment rate, the reported unemployment rate (10.0%) fails to capture those workers who have been forced to work only part-time and those that have become discouraged and stopped looking for work. Adding those workers in

brings the unemployment rate above 17%. The shift of workers back to full-time will not impact the official rate, and so *the unemployment rate may stay higher than the historical pattern would suggest*. We do, however, believe that the unemployment will have peaked by mid-2010 (it is too early to say that the November decline means that it has already peaked) and may be in single-digits by the end of the year. While restrained consumption will be a headwind for growth in 2010, that households have shifted towards a savings mode and have begun to reduce their debt burdens is a positive development for the

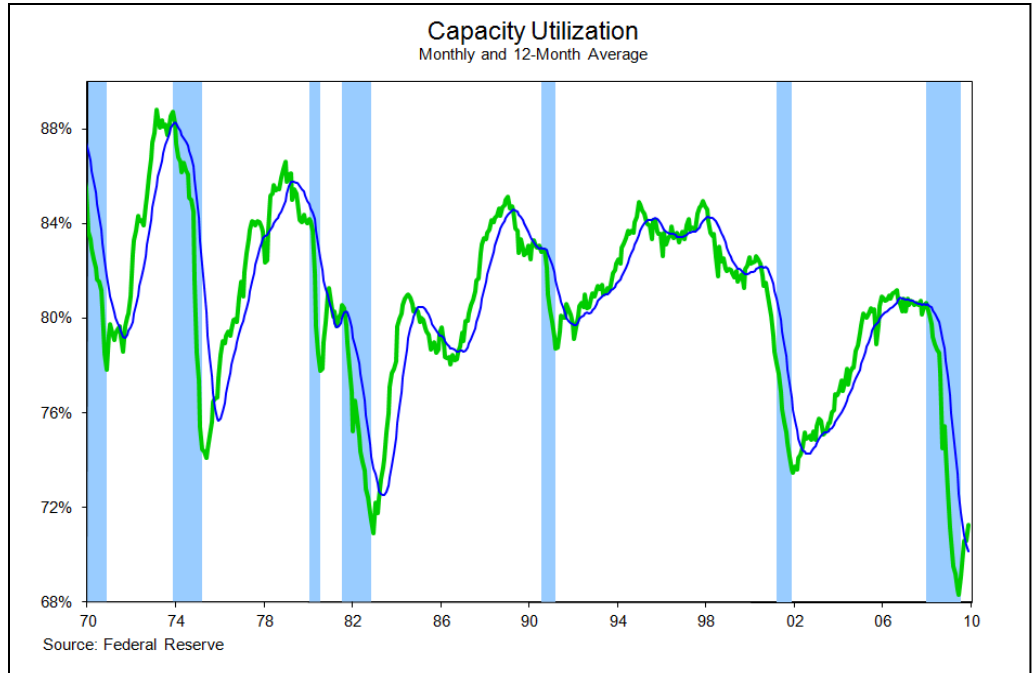


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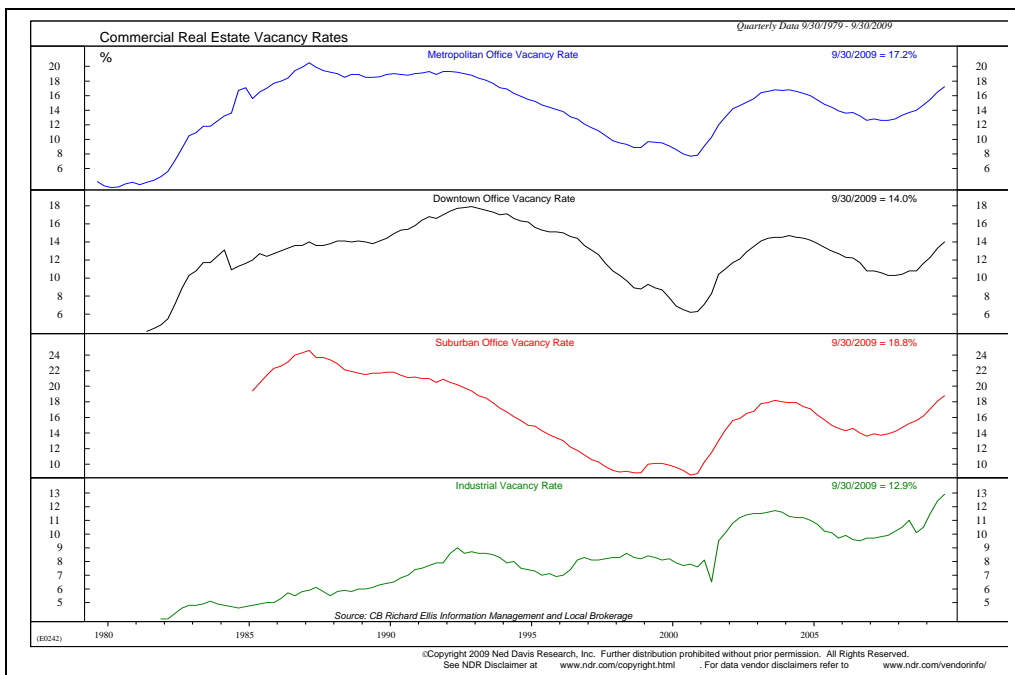
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long-term health of the economy. That work, though, is only just beginning.

Business/Investment: While the roots of the recent recession go deeper than in past economic downturns, some aspects of the recovery will be similar. *A secular shift has occurred, but cyclical forces still retain an impact.* Among those cyclical forces in play is the effect of the inventory cycle. An acceleration in inventory drawdowns subtracted nearly 1.5 percentage points of GDP growth per quarter from Q4 2008 through the first half of 2009. This changed in the Q3 2009, when inventory changes boosted overall GDP growth by almost a full percentage point. While a slowing in the pace of inventory drawdown and even a modest inventory rebuild could support economic growth in coming quarters, this alone is not the basis for a lasting and robust recovery. A more sustainable upturn would likely be derived from expanding investment in equipment, but this is constrained by excess capacity and reluctance on the part of banks to lend. The emergence of more favorable lending standards could help support business



investment in 2010. A similar story can be told about non-residential investment in structures, although with a lag. Capacity utilization rates, while still low, have begun to move higher. Office vacancy rates, already at their highest levels since the early 1990's, have yet to show signs of peaking and commercial real estate headwinds remain a drag on the economy. Residential investment (housing) appears to have bottomed, supported by falling prices, low mortgage rates and government incentives. With many homeowners (the term is used here extremely loosely) underwater on their mortgages and given the secular shift away from debt accumulation, a new building boom is unlikely anytime soon. *Given the drag that the housing down-turn has been on the economy over the past couple of years, even stability may be viewed as a net positive.*

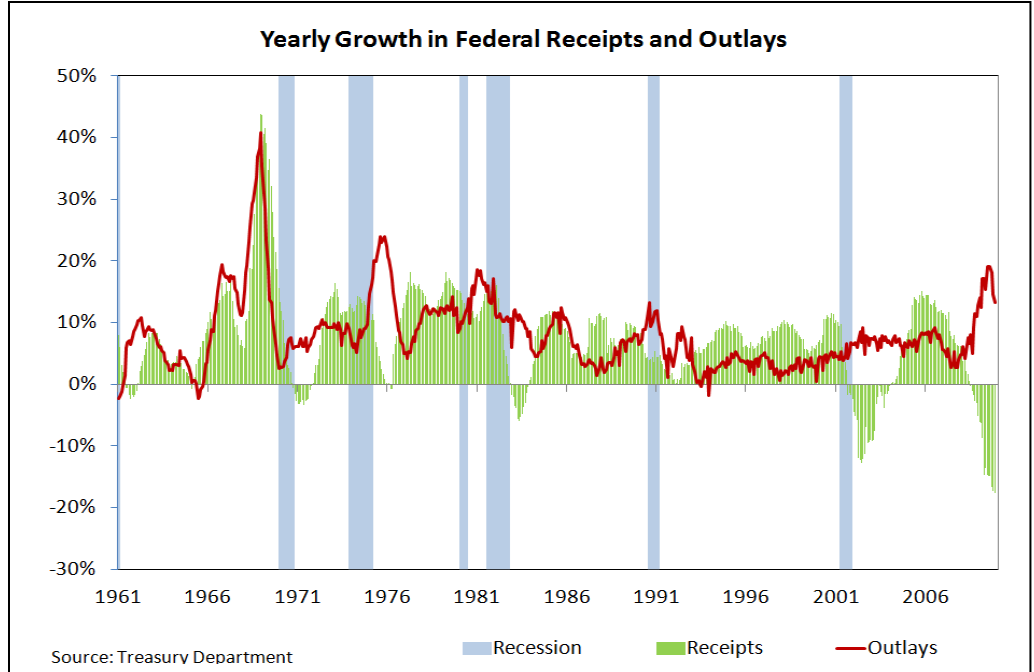


Government: The short-term effects of the fiscal stimulus have been dubious and hardly quantifiable (we put no stock in the "jobs saved or created" metric released by the White House). Most likely government actions overall have provided a modest boost

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to near-term economic activity. The greater impact from these actions likely lies in the future. **The stimulus has done little to create real demand and the near-term boost is mostly a shifting forward of spending.** This could negatively impact demand in coming quarters and, even more importantly, all this spending has yet to be paid for. *While business and households have begun deleveraging their balance sheets, the Federal government (and the Federal Reserve) has done the opposite.* Of every dollar spent by the federal government in fiscal year 2009, less than 60 cents came from tax revenue and the remainder had to be borrowed. This trend appears to have intensified in the first two months of fiscal year 2010. While the ability of the Treasury to print dollar bills is in theory limitless, the willingness of foreigners to continue to buy our debt may not be. The spending binge now underway is not sustainable. The growing disconnect between households and the Federal government may quickly have political ramifications and the calculus ahead of the 2010 mid-term elections could

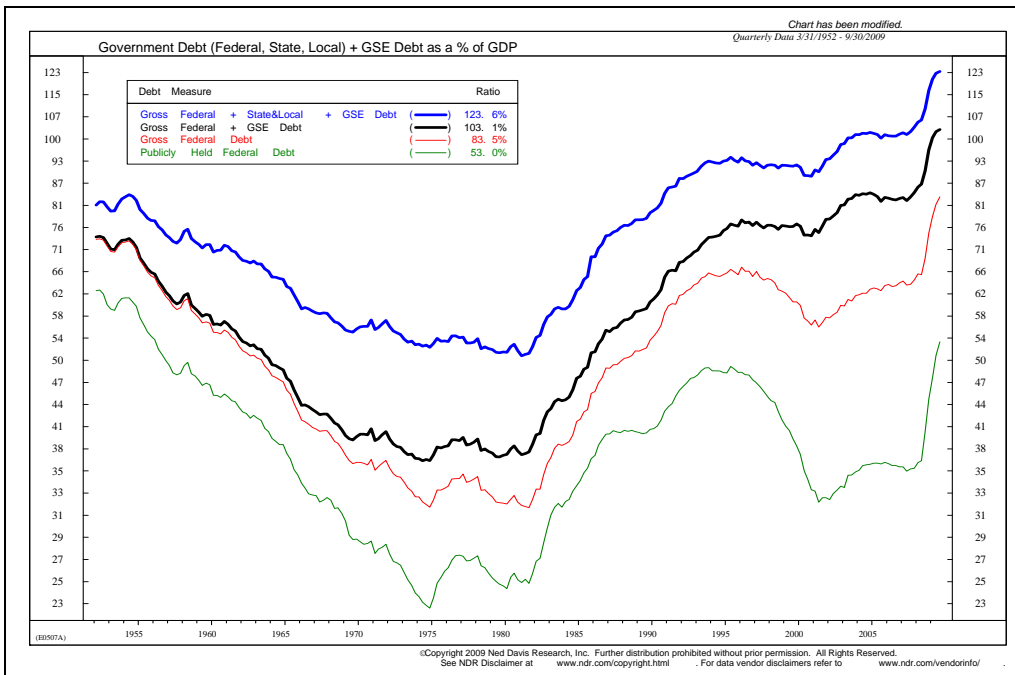


be significant.

The situation for state and local governments appears even more tenuous as their ability to self-finance, through the issuance of debt, is more limited than is Washington's. Governments at all levels need to scale back spending (at the Federal level this may be seen as a slowing in the rate of growth rather than actual reductions). Government jobs that for generations have been viewed as safe may no longer be so. From a

regulatory perspective, further substantive forays in the private sector may hasten the Europeanization of the U.S. economy, limiting the growth potential for years to come. It would also reduce our ability to grow our way out of the debt problem that is mounting for municipalities and the Federal government. With respect to financial market regulation, better organization and enforcement would be preferred to new sweeping additional regulations.

Trade: Weakness in the U.S. dollar could have a positive impact on the U.S. economy by increasing demand for our exports and reducing our demand for imports. Global trade in general was one of

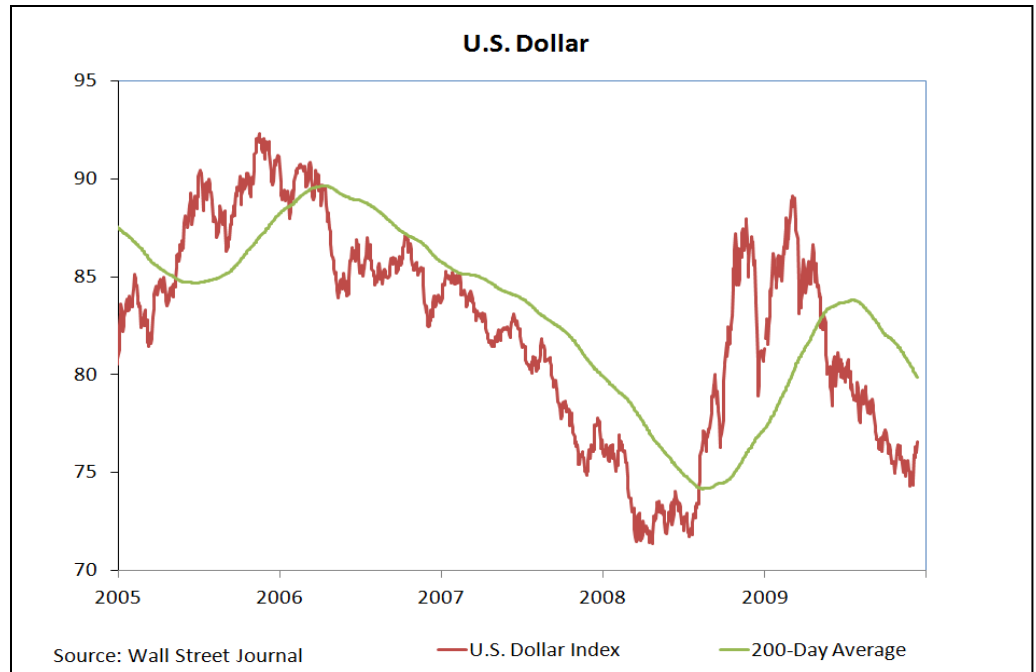


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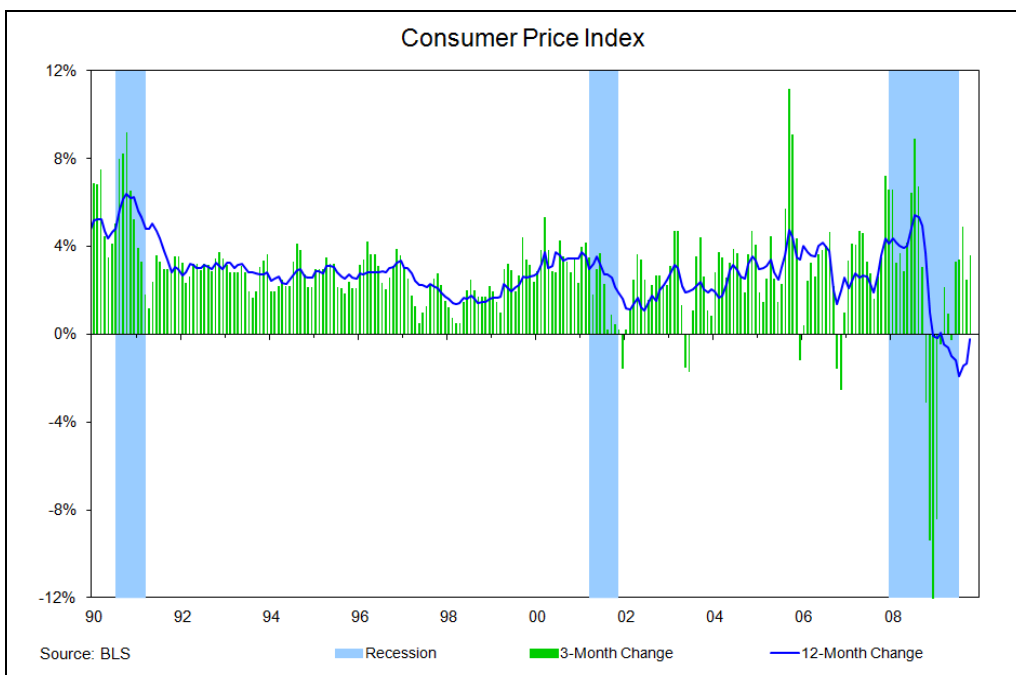
the great casualties of the global recession – in part because aggregate trade is not fully reflected in any one country's output data. In the United States, for example, the trade calculation that enters the GDP data is the change in net exports (exports less imports). Over the past four quarters, exports from the U.S. have fallen 10%, while imports are down 14%, but the trade component has added more than a full percentage point to growth over each of those quarters. Global trade, however, is now rebounding, and while it is still 14% below its April 2008 peak, it has risen 8% since its May 2009 trough. **Moreover, from a global economic growth perspective, lackluster growth in the United States may be offset by robustness in the emerging economies. While still relatively small individually, their total contribution to global output now exceeds that of the United States.**

Inflation/Bond Yields: All the money that the government has thrown at the economy and the financial markets could lead to near-term hints of inflation. Some warning of this could be seen in a rebound in the willingness of



banks to lend, which would be witnessed as an upturn in the velocity of money. *Absent a sustained recovery in wage growth, however, this would not be sustainable.* Deflationary forces in the economy have yet to loosen their grip. Chief among these from an intermediate-term perspective are widespread slack in the economy, measured by low levels of capacity utilization, and high levels of unemployment and office vacancies. Longer-term deflationary forces include the ongoing deleveraging by households and the budgetary constraints of state and local governments. **Given these still-present deflationary headwinds, the recent and ongoing rise in commodity prices is likely more reflective of weakness in the U.S. dollar and real overseas demand than a signal of rising inflation concern.**

Key to the ability for the economy to gain traction in 2010 is continued low Treasury yields. Thus far the expansion in government borrowing has not become a specific headwind because foreigners (and increasingly domestic investors) have continued to buy our debt. A modest rise in yields above

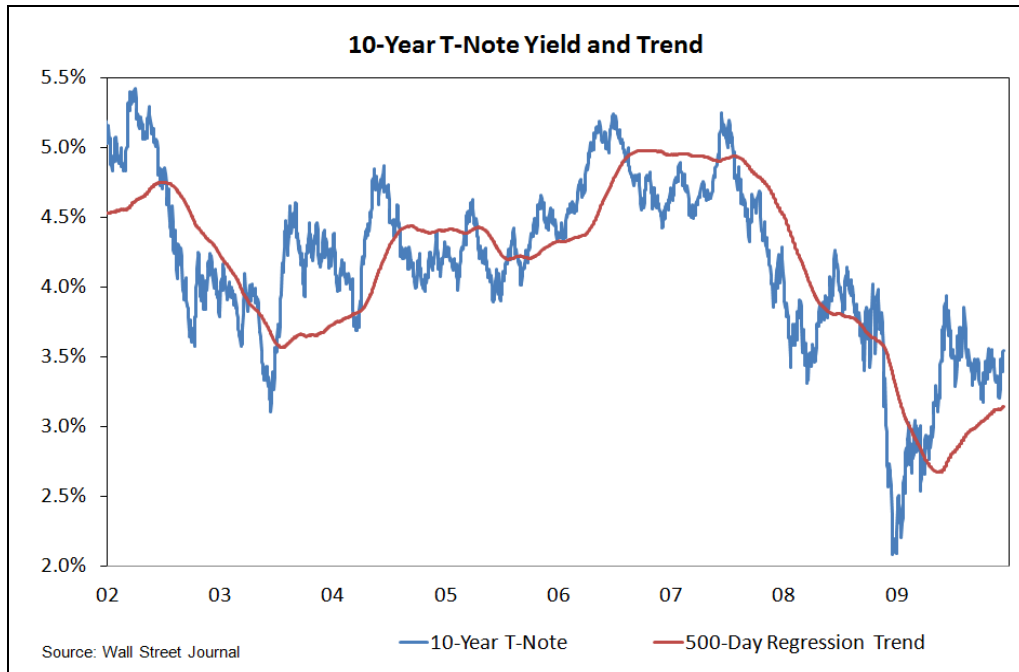


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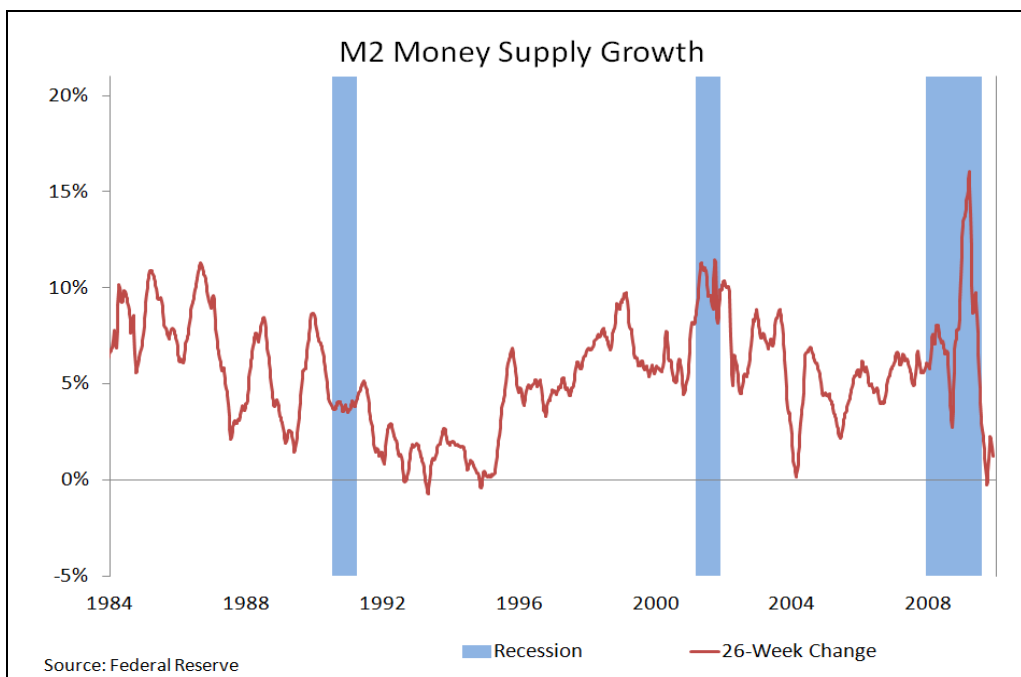
current levels could be borne by the economy, but a 10-year T-Note yield above 4.50% would likely represent a significant headwind. This would affect government borrowing costs, but also negatively impact the housing market due to higher mortgage rates.

Federal Reserve Policy: We rate current Federal Reserve policies as **Neutral**, reflecting an end of the easing cycle (by conventional means or otherwise). *The transition from easing to tightening will be a dominant theme for 2010, both domestically and abroad.* While the global central banks moved in largely coordinated fashion in cutting interest rates, the tightening process is likely to be more varied. The Australian central bank has already raised its interest rates three times (and why not, as that country escaped the global recession largely unscathed). **We do not expect the Federal Reserve to raise interest rates in 2010, but it is likely to continue its efforts to ease away from the active involvement in the financial markets that was necessary in 2008/2009.** Some of the extraordinary actions taken by the Fed have been



designed as only temporary (i.e., the various lending facilities) and these may fade of their own accord. Others, like the purchases of Treasuries and Agencies, would require a more active move to be unwound in the near term. The ability of the Federal Reserve to pay interest on reserves means that when the time comes it will be able to tighten monetary policy even if its balance sheet remains enlarged.

Valuations: Valuations have expanded over the course of the year and while not yet at excessive levels, they appear to have priced in a robust recovery. We continue to rate Valuations as **Neutral**. A review of the valuation indicators brings to light two points. The first, mentioned above, is that current valuation levels seem to have priced in a strong and lasting recovery. While the corporate outlook is improving, much of the recovery in earnings so far has been driven by cost-cutting. **Top-line growth in sales needs to be seen to have increased confidence that earnings growth is sustainable.** This is not unusual as markets emerge from downturns, and the productivity gains seen as the

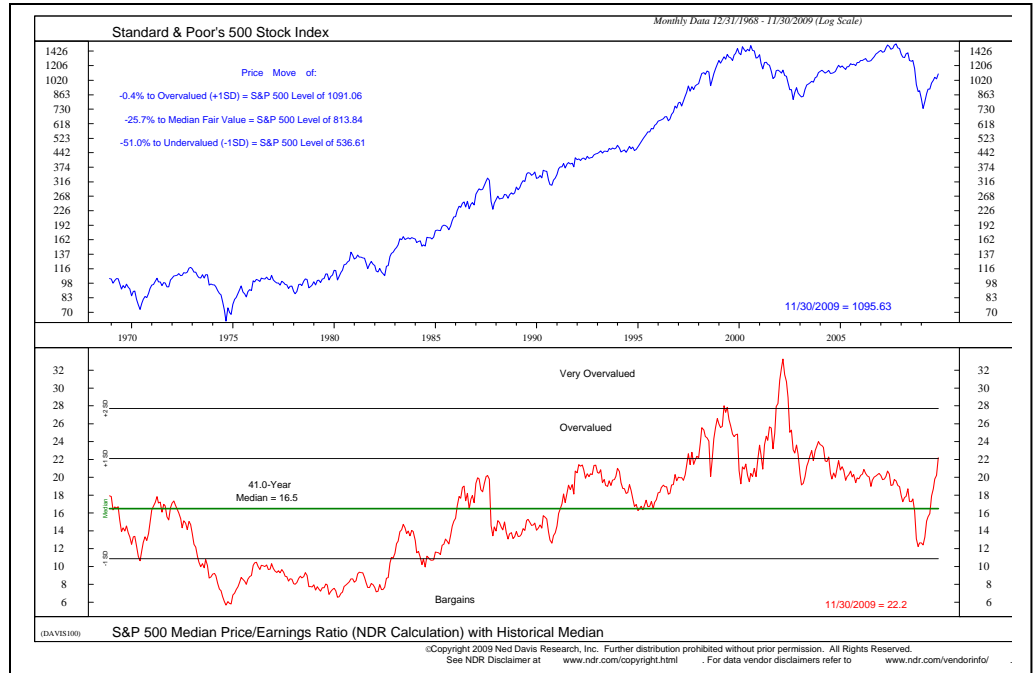


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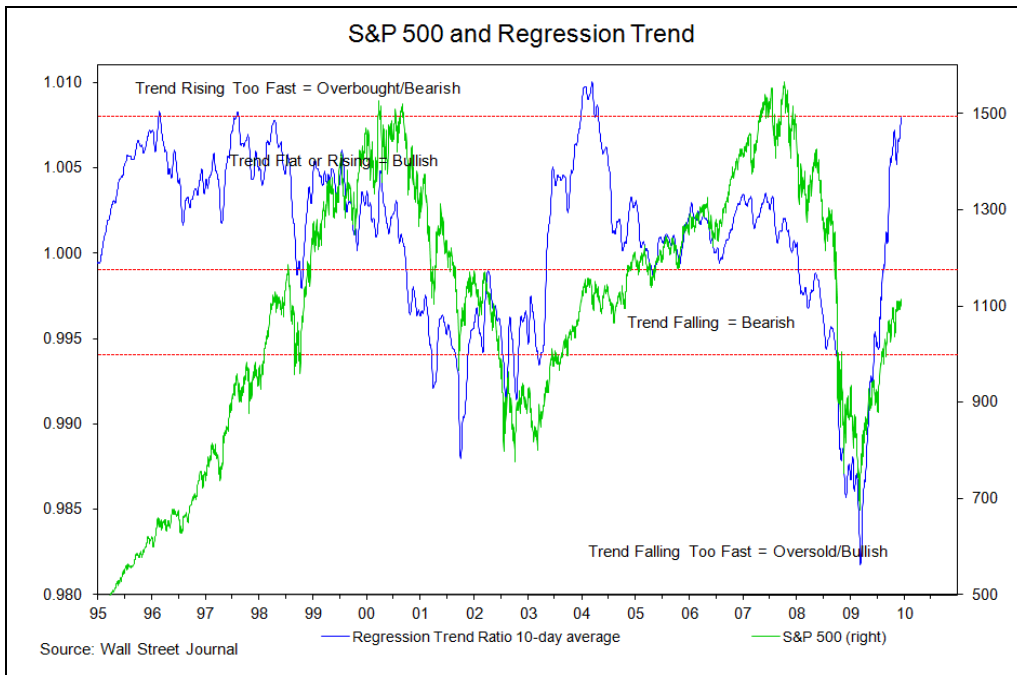
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economy has turned have been noteworthy. Non-farm business productivity posted its largest two-quarter increase in nearly 50 years over the second and third quarters. This fuels bottom line gains but does little for the top line. If the historical pattern holds, sales growth should soon pick up. If not, valuation measures may start to look too excessive.

The second point on valuation is that **while stocks were relatively inexpensive at the March bottom, they were not as inexpensive as is typically seen at secular lows.** The median trailing P/E ratio for the S&P 500 bottomed near 12x earlier this year, failing to get into the single-digit area that typically precedes the onset of secular bull markets. It has since risen through its long-term median level of 16.5x and is now above 22x. This puts it on the threshold of signaling an overvalued level. Further gains in the stock market, absent continued improvement in earnings, could push valuation levels into overvalued territory and prompt a downgrade in our view of this indicator.



Seasonal Tendencies/Trends: Evidence to the contrary lacking, we assume that the cyclical up-trend is intact and with seasonal influence favorable into early 2010 we rate these indicators as **Bullish**. Within secular trends are a series of cyclical moves, such as has been seen this year. *While the cyclical up-trend that emerged earlier this year has lost momentum as we have moved through the fourth quarter, it remains intact and the trend indicators are still favorable.* Our regression-based trend



indicators are rising for the primary indexes. For all thirty of the primary and secondary indexes we track, the 200-day averages are rising and for each the 50-day average is above the 200-day average. Given the lack of evidence that a new secular up-trend has emerged, cyclical peaks can be anticipated by deviations from the trend as the rally becomes overbought. In this regard, the consolidation seen in the S&P 500 in recent weeks is encouraging if it allows the rising trends and averages to catch up to the market. *The risk is that the lost momentum may be unrecoverable at current levels.*

Seasonal patterns remain

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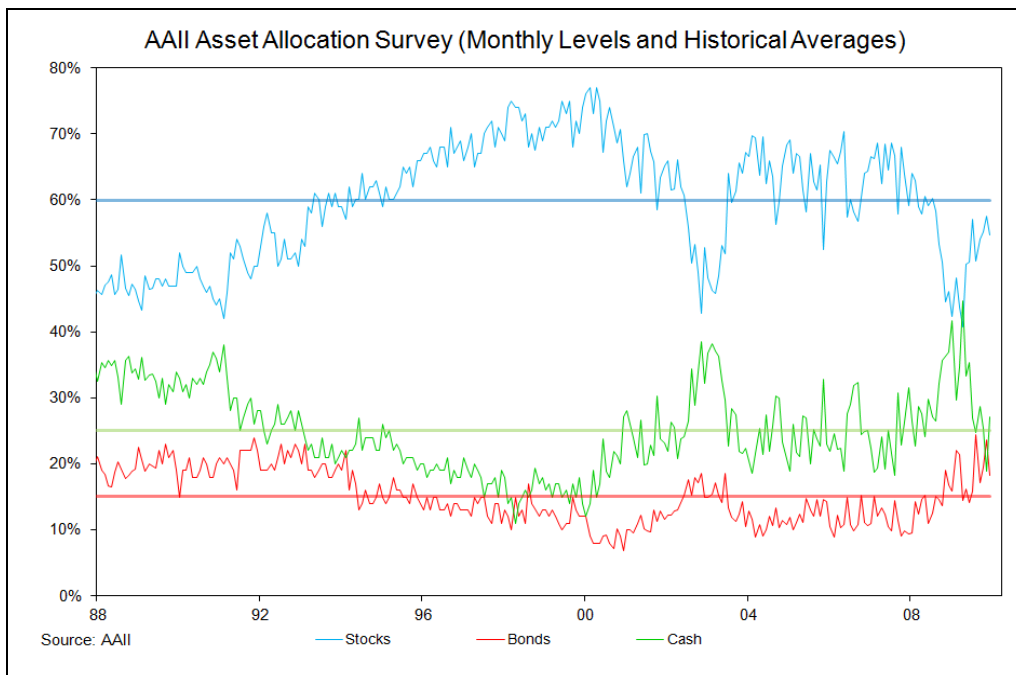
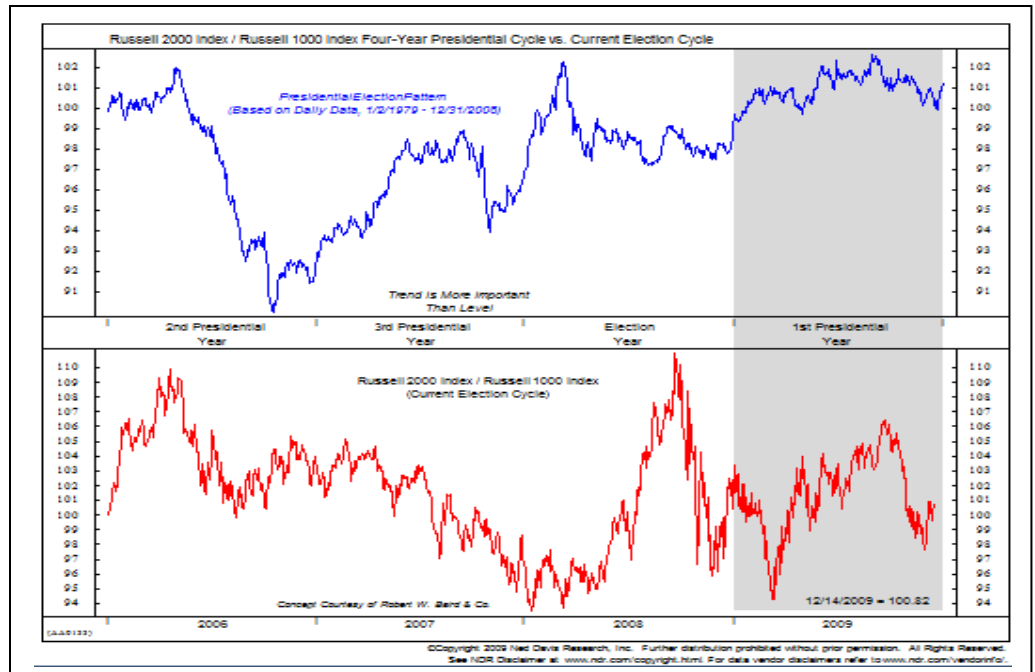
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favorable for the remainder of 2009 and likely into early 2010. The increasingly popular view that stocks could be vulnerable to a pullback in the first quarter of 2010 could delay the risk of correction until the second quarter. Following that, seasonal influences could become more favorable later in the year as uncertainty over the outcome of the mid-term elections ebbs. Mid-year weakness could be particularly acute in small-caps relative to large-caps. **The awareness of the lack of a secular domestic up-trend raises the imperative for defensive actions as the risk of a cyclical peak increases.** Moreover, given that the long-term down-trends have not been decisively broken, oversold indicators may be of reduced value.

Sentiment: Our investor sentiment indicators continue to offer mixed signals, and despite a modest seasonal upswing in optimism, we continue to view Sentiment as **Neutral**. Looking ahead, the secular shift in consumer behavior is manifesting itself in investment decisions. **Investors are becoming less inclined to buy stocks**

and more willing to buy bonds. This leads to some discrepancies between surveys that gauge overall investor sentiment and those focused more specifically on just the stock market. The Investors Intelligence survey of advisory services shows nearly 50% bulls and less than 17% bears. While bulls have been hovering near 50% since August, the drop in bears has been pronounced in recent weeks, and bears are now below the level seen at the October 2007 stock market peak.

The AAIL survey of individual investors shows only a modest tilt toward bulls (43% to 35%), but with fewer funds allocated to the stock market, a lower level of optimism is not surprising. In fact, as we move forward and investors permanently shift from stocks to bonds, the level of optimism necessary to denote excess may be lower than what has been seen in the past. **Even with this lower threshold for optimism, however, it is difficult to say that an extreme has been reached.** Mutual fund flows show that investors continue to shift from equity funds (at the same time that equity fund managers are increasing their funds' exposure to stocks) and toward bond funds.

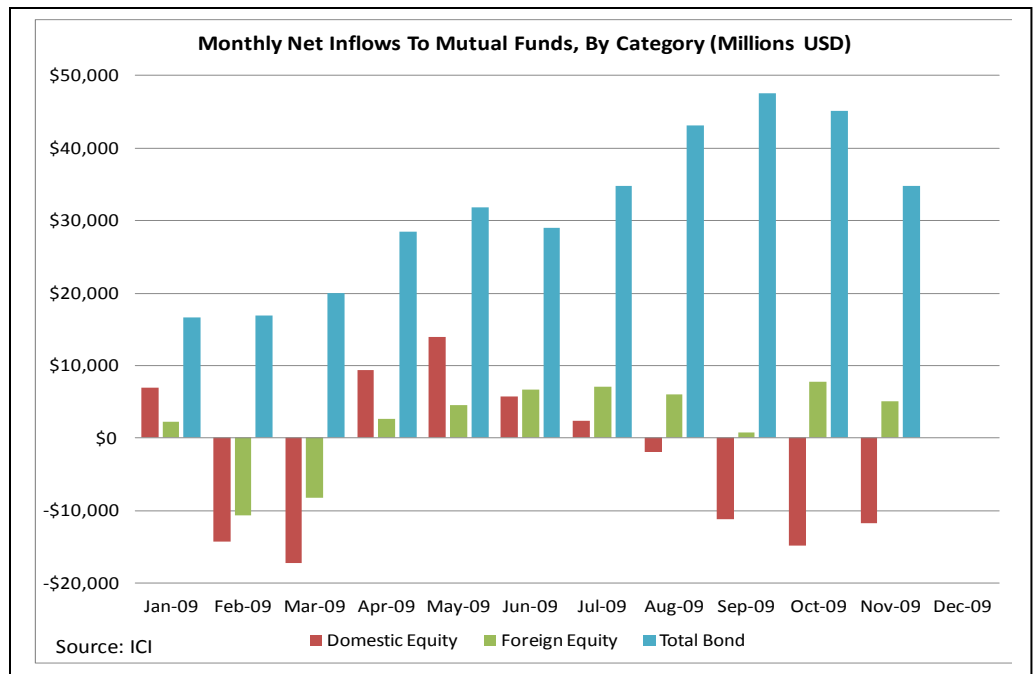
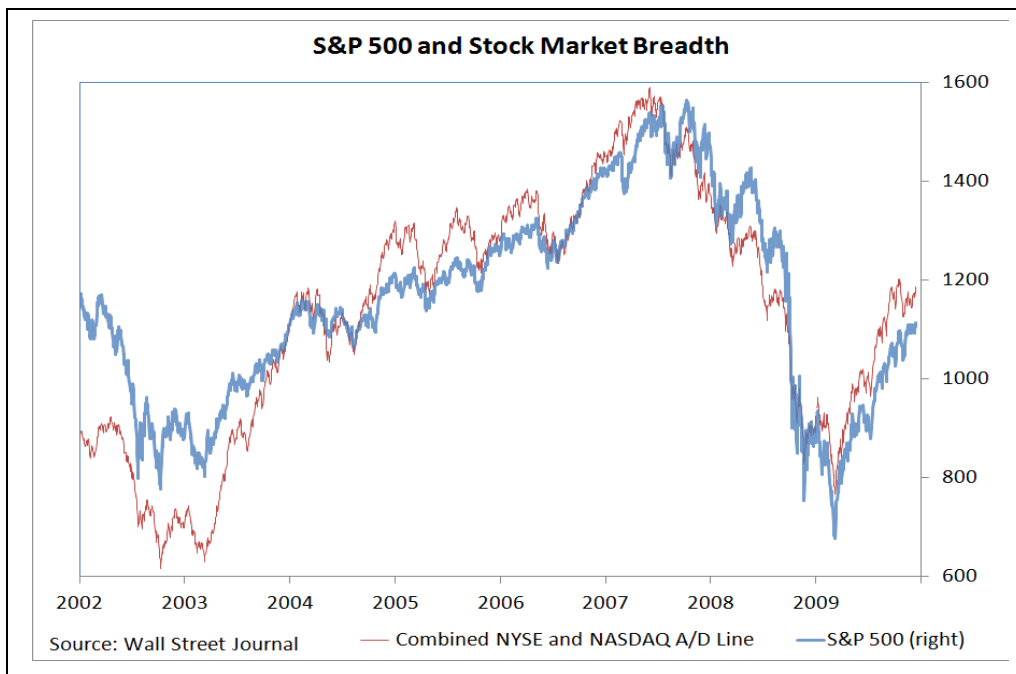


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Those funds that do flow towards equities are almost all going toward foreign funds. Domestic equity funds have seen a steady outflow since August and have seen more outflows than inflows since the March lows. **Seeing individual investors shifting from stocks to bonds is not indicative of a cyclical peak in the stock market, and some reversal in this behavior could suggest the rising risk of an imminent peak in stocks.** Volatility remains near its low for the year and a further decline in the VIX could signal excessive complacency. On a short-term basis, we continue to monitor the put/call ratios, particularly the total market equity put/call ratio, for signs of skepticism and complacency.

Broad Market Trends: While divergences have emerged in recent weeks, breadth remains sufficiently strong to remain a **Bullish** influence on stocks. The persistence and/or exaggeration of the divergences that have already emerged could cast doubt on the ability of the cyclical up-trend to post more than marginally higher highs. **Broad market strength, both domestically and**



internationally, has been a hallmark of the rally that emerged off of the March lows. The percentage of global indexes in uptrends moved from zero in late 2008 to nearly 100% this fall, while domestically virtually all industry groups have participated in the rally. In the fourth quarter, however, some divergences have emerged. While they have not yet risen to the level of significance that argues for action, they should continue to be monitored. Some have been classic signals:

- The Dow Transports are struggling at a resistance level that emerged this summer, while the Industrials continued to post higher highs.
- The Russell 2000 has failed to echo the higher highs posted by the S&P 500, and in October posted a lower low.
- The new highs on the S&P 500 are also unconfirmed by the NYSE + NASDAQ advance/decline line.

The percentage of industry groups in up-trends has faltered (but remains elevated), and on the NYSE, the number of issues making new highs has contracted while the number of issues making new lows has expanded. *At this point,*

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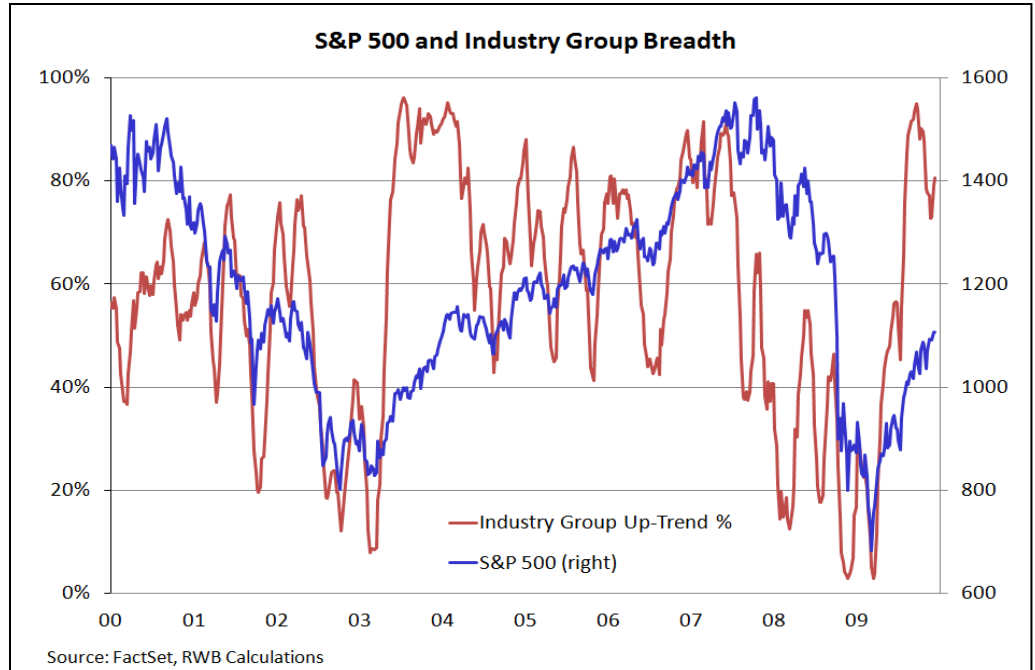
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breadth divergences largely argue for shifts in allocations within stocks rather than from stocks. Large-caps have moved increasingly into a leadership position as upside participation has narrowed. At a sector level, strong breadth trends have emerged in Utilities, Health Care and Consumer Staples – suggesting a shift in leadership from cyclicals to defensive areas. A sustainable break-out in the indexes should be accompanied by the resolution of at least some of these divergences.

Contrarian (Or Unexpected) Outcomes

T-Note Yields Could Fall From Current Levels – while many expect bond yields to creep higher over 2010, we view a break below 3.00% on the 10-year T-Note yield as more likely than a rise above 4.50%. A re-test of the yield lows near 2.0% could be seen, particularly if an emphasis on risk aversion re-emerges.

Housing Stabilizes But Does Not Recover – with households focused on debt reduction and homes for

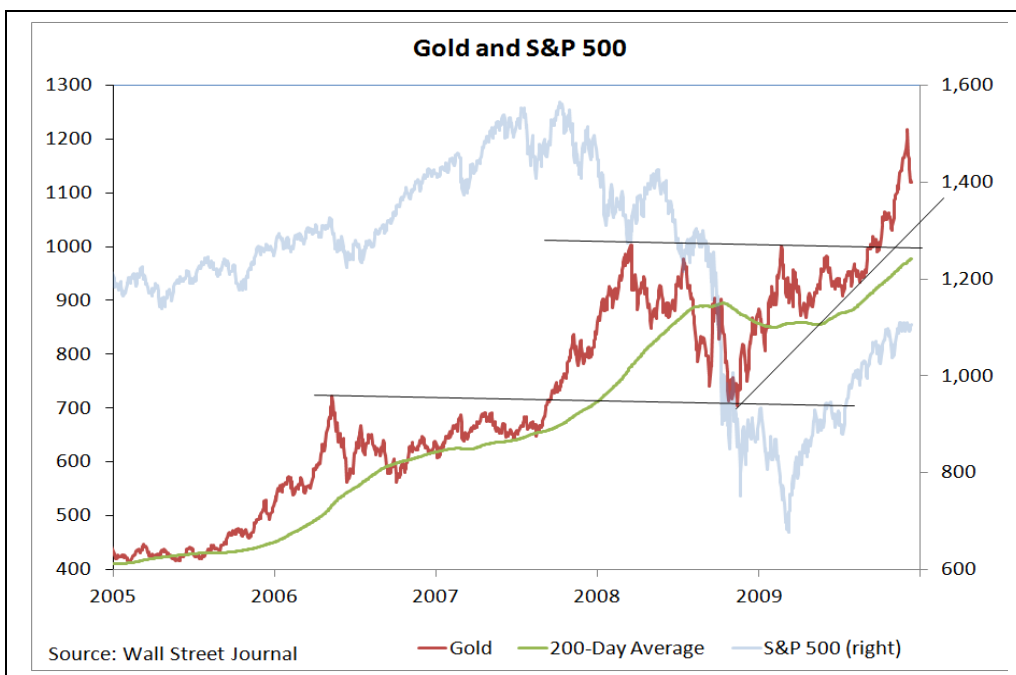


sale still at elevated levels, another home building boom does not appear likely. Residential investment no longer being a drag on output may be all that should be hoped for.

The Dollar Rallies – While the long-term fundamentals for the dollar (not just the current operating budget deficits, but the long-term structural deficits that suggest not shortage of supply of dollars for a generation) are bearish, pessimism on the Greenback appears excessive, and other paper currencies face issues of their own. This suggests that a counter-trend rally in the dollar could appear. Rather than increasing dollar exposure on the rally, it may be more prudent to look to add exposure to Gold if that metal weakens.

The Current Iranian Regime Is Overthrown From Within

– While not geo-political experts, it seems apparent that the current regime in Iran is increasingly tenuous, and the middle class in that country is upset with high inflation, high unemployment, and an administration that is more interested in thwarting the West rather than fixing the



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domestic issues. The impact of such a regime change could have a profound impact on global political and economic realities, with a drop in the price of oil being perhaps the least impressive.

Asset Allocation Themes

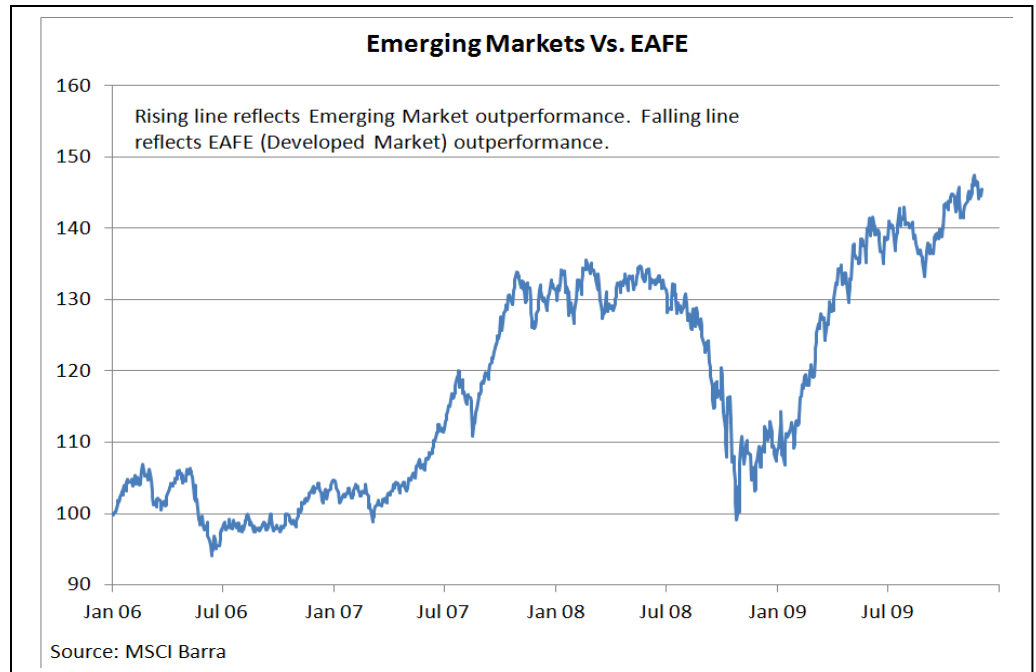
- An active approach to asset allocation is necessary in the current environment. The buy-and-hold strategies that worked so well in the 1982 to 2000 secular upswing have not worked for the past ten years, and there is little evidence that this will change in the near term. The secular bear market that is intact offers cyclical rallies

and retreats, and while the market aggregates may remain range-bound, active allocation strategies may not be so confined. Moreover, a tactical approach to the cyclical trends can keep investors in harmony with the market.

- While cash is currently yielding little more than zero, it needs to be considered within an asset allocation framework, particularly within a tactical asset allocation that is likely to benefit investors in coming quarters.

- The aging and perhaps, expiration of the cyclical trend in 2010 is likely to see increased leadership from high-quality stocks. Investors should tilt toward large-and-mid-cap stocks. From a sector perspective, defensive leadership from Health Care, Consumer Staples, and Utilities has emerged and could persist over the course of 2010. We are more skeptical on the prospects of Financials and Consumer Discretionary.

- Emerging markets remain a source of global economic and financial market strength. The risk is that they may be over believed and vulnerable to a pullback. The absolute and relative (to the developed markets) up trends are strong, and for the most part secular. While investors should tilt in this direction, allocations should be tempered by the cautious reminder that in



periods of strain, the supposed diversification benefits may vanish.

- China remains an important global actor, but investors may choose to focus on derivative effects of China's strength, rather than a direct allocation. Other Asian markets, like Korea or Singapore, may offer a better risk/reward than China. Latin America has seen an improvement in relative strength of late, with Brazil and Mexico being the most accessible to U.S. investors. Europe, both developed and emerging remains beset by headwinds.

- Fixed income investors should pause before chasing yield and remember that not all municipalities are created equal. If the 10-year T-Note Yield rises to 4.50%, Treasury investors should lengthen the maturity of their holdings. High-quality corporates and preferreds remain our recommended exposure for fixed income.

- Finally, investors should remember to respond to what is, not what should (in their mind) be happening. This allows for the flexibility to respond to changing circumstances, keeping portfolios in tune with the primary trends. Flexibility and humility may be the keys to successful investing as the foundation for a secular up-trend continues to be laid.

Appendix – Important Disclosures and Analyst Certification

Disclaimers

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST

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