

The Sittenfeld, Stuard & Thornberry Group
Private Wealth Management

27 January 2010

Dear Client:

YEAR IN REVIEW

2009 was a memorable year. From economic collapse, financial market meltdown and stock market plunge to beginning recovery, increasing stability and historic market rebound, it was a year when despair and fear transitioned into renewed hope and cautious optimism. Many lost their jobs; more are earning less than before. Many investors took money out of the markets as they declined and missed the subsequent rally. Everyone knows someone who has encountered the current complexities of selling a home. Some faced the worst case scenario as foreclosure rates reached record levels. The Federal Reserve maintained its commitment to stimulating the economy by keeping short-term interest rates near zero. However, this policy has hurt many Americans who depend on interest earned from fixed income securities.

An encouraging sign has been an improvement in the savings rate from less than zero during the housing boom to nearly 7% in May. That level backtracked to 4.7% as the year ended and consumers, growing weary of being frugal, stimulated a modest increase in last-minute holiday spending. Historically, long-term savings rates are closer to 8% and getting to that level, while healthy overall for individuals, will dampen the strength and speed of an economic recovery. Undoing the excessive leverage of the previous decade will take years. Corporations have more deleveraging ahead, but those that started this downturn in positions of relative strength will emerge from the crisis stronger than before as they trim costs and acquire weaker competitors.

By year end, stocks regained about half of the value lost between the autumn 2007 peak and the low point in March 2009. While everyone is breathing a little easier after this steady market rise, it is not typical to enjoy this level of recovery without corrections along the way. Meanwhile, the price of a barrel of oil has also rebounded to a level over half of its summer 2008 high. The cost of oil has a widespread impact on the profitability of corporations which face higher transportation and raw material expenses. Further increases in oil prices will slow the pace of the recovery.

Market leadership shifted for the year. The four worst performing asset classes for 2008 (small cap, mid cap, large cap growth, and international stocks) were the best performing groups for 2009. Fixed income, the best performing asset class in 2008, was the worst performer for 2009.

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ECONOMY

Government stimulus and stabilization programs of unprecedented levels have shored up the economy in the past year, but not without major costs. The overleveraged condition that led to the recent economic downturn still exists, with a significant amount of the burden having been shifted from the private sector to the government. It remains to be seen how the economy and markets will react as the various stimulus packages expire.

Unemployment is the statistic with the broadest implications for the economy and the markets. The U.S. Bureau of Labor Statistics reports that the chance of a newly unemployed worker finding a job within a month is less than 1 in 5, which compares to 1 in 3 during the 2001 recession and 1 in 2 during the 1950's. The official unemployment rate of 10% is far below the real rate when one includes workers who want full-time work but can only find part-time as well as those who have been out of work so long that they have abandoned the search. Prolonged high unemployment will keep home foreclosure rates at high levels and restrain consumer spending.

Other headwinds challenging the economy are overcapacity in commercial real estate, probable higher income taxes, and a baby boomer generational shift from spending to saving. Further, many small businesses are awaiting the outcome of healthcare reform and other legislation before determining hiring and spending commitments.

MARKETS

The Federal Reserve interest rate policy has proven central to the rise and fall of markets. The housing bubble was, in part, a consequence of the easy credit policy of the Federal Reserve. This is a current Fed concern as it wishes to avoid keeping interest rates low too long and yet does not want to stifle the budding recovery by raising rates too soon. By essentially forcing investors with cash to invest in riskier assets as money market rates near zero, the Fed is artificially interfering with natural market forces. Its track record in knowing when to change direction has been inconsistent.

With interest rates remaining at historic lows, investing in bonds is challenging. Seeing the spike in debt issued by the Treasury, investors are cautious about buying longer maturities knowing neither when nor to what level inflation will return. Consequently, the yield of the 10-year U.S. Treasury has nearly doubled since last December. Meanwhile, short-term interest rates remain at historic lows.

U.S. investors must note that the United States is a diminishing component of a growing global market, and that a portion of a portfolio invested internationally is central to asset allocation. For the first time, the output of the combined economies of emerging markets now exceeds that of the United States. Despite occasional misconduct uncovered within corporate America, our governmental oversight is among the best in the world. We believe that investing in a core of domestically-based companies with substantial, growing revenue overseas is an important way to achieve global diversification. Companies with global sales as well as the financial strength to pay increasing annual dividends afford further basis for confidence.

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During the dark days of the market decline in late 2008 and early 2009, higher quality investments held up better than riskier ones. As the markets bounced back in 2009, lower quality stocks, which had fared worse during the bear market, led the rally. Many analysts believe that in the next phase, higher quality stocks once will assume leadership. With consumers and corporations decreasing debt and spending, strategists expect only modest economic growth. We believe that stocks of companies with strong balance sheets and records of increasing dividends regardless of market dips have better prospects than more cyclical companies.

NEXT STEPS

With stocks having recovered a significant part of what was lost in the dramatic downturn, this is a time to take a comprehensive look at each financial circumstance. Your employment status may be different; you may be helping other family members financially; your risk tolerance may have altered; your goals may have changed.

With the future of the estate tax and capital gains tax rates not clear, gifting plans to family and charities should be reviewed along with estate planning documents. The lifting of income limits on Roth IRA conversions could allow tax-free income in retirement years for those who participate.

The most successful long-term investing strategy is diversification. We will continue to work with you to position and update your investment portfolio and strategy to best meet your financial objectives. We are carefully reviewing the level of prudent risk in your investment allocation and withdrawal rates. Our research suggests that a withdrawal rate in excess of 5% annually significantly increases the possibility an asset base may be depleted. A principal goal is a plan which increases the likelihood of adequate resources throughout one's life.

We look forward to working with you to monitor your specific goals and priorities.

With our thanks and best wishes.

Sincerely,

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