FOURTH QUARTER 2009 MARKET COMMENTS

The economic recovery that began last quarter has continued and broadened during the current period, with both business and consumer spending picking up steam. The final elements of the recovery, small business confidence and employment gains, should fall into place during the first quarter of 2010, thereby ensuring a sustainable expansion both here and abroad.

Next year will be a transition year for policymakers, who will begin the normalization of fiscal and monetary policy as soon as the economy is strong enough to absorb the impact. At the same time, profit growth should be extraordinary, with most estimates running in excess of 25% gain for the S&P 500. Needless to say, this profit growth will help to offset less-accommodating government policy.

Having been successful in reviving the economy, Mr. Bernanke will turn his attention to keeping inflation expectations under control as business activity expands. At this point, the timing of such a move is uncertain, as any nod towards tighter policy will depend on employment gains and other yet-to-be-realized economic goals. The first steps will be to curtail "quantitative easing" by reducing Federal Reserve asset purchases and draining free reserves from the system. This will send a signal to the financial markets that the period of abnormal ease is drawing to a close, and will help dampen inflation expectations and stock prices without having to raise interest rates. At the moment, the Fed is indicating that it has no intention of raising rates in the foreseeable future, and such could remain the case if the recovery is sluggish and inflation expectations are subdued. Conversely, if the slingshot effect comes into play and the steep decline is followed by a rapid recovery, then policy will have to be reevaluated.

None of these outcomes is likely to create a new bear market in stock prices, and, in fact, the normalization process is an essential part of creating a long-term environment that is favorable for financial assets. While there may be a few bumps in the road, the long-term goal of full employment growth with moderate inflation is indeed attainable, on both a domestic and an international basis.

During the past year, stock prices were driven by massive infusions of liquidity into the system more than by company fundamentals. This should change going forward, with revenue and profit gains providing the impetus for price appreciation. Overseas growth will be especially important as the less-developed countries should be able to grow more rapidly than mature countries like the U.S. At the same time, our economy is renowned for its innovative capabilities, and this significant strength increasingly will come into play as the decade advances.

As 2009 draws to a close, we are optimistic about our economic future and our portfolios. We wish you a happy and prosperous new year.

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