



WEALTH MANAGEMENT GROUP INVESTMENT PERSPECTIVES

3rd Quarter, 2009

Speed Bumps, Yes - Double Dip, No

The third quarter of 2009 continued to show signs that a synchronized global recovery remained underway, and that the hundreds of stimulative policy actions taken in countries around the world were a major success, at least from a short-term cyclical perspective, and potentially from a longer term perspective as well. While there remain speed bumps in the road to recovery, we believe that the chance of a double-dip recession is highly unlikely given the positive feedback loops that have kicked in between the economy and the capital markets.

While the financial crisis started in the U.S. with the Lehman shock, it was felt around the world. Nearly every country's economy, regardless of how strong their credit and housing markets were, experienced deep declines in GDP. Now, however, virtually every country in the world is showing signs of improvement. Annualized second quarter GDP figures showed that many economies returned to positive growth, including Japan (0.6%), Australia (0.6%), and Singapore (20.4%), while the U.K. (-0.7%) and the Eurozone (-0.1%) had smaller than expected declines. In addition, employment has already started to increase in at least 6 countries outside of the U.S. including Korea (+1.1%), Brazil (+1.0%), Russia (+0.9%), Japan (+0.5%) and Australia (+0.4%). The fact that some of the same forces that are lifting employment abroad are also working domestically gives us some confidence that U.S. payroll employment will start to increase in 2010.

U.S. Economy Continues to Improve

Despite the unemployment rate of 9.7%, the highest level since June 1983, third quarter economic data revealed that the U.S. economy continues to heal. Manufacturing continued to expand, corporate profits continued to beat expectations and earnings

continued to be revised upward. Consumer confidence, as measured by the University of Michigan survey, hit its highest level since January 2008. Retail sales increased 2.7%, and excluding automobile sales and the cash-for-clunkers stimulus, retail sales still increased 1.1%. In the housing sector, prices have begun registering monthly gains, inventory has declined, and new construction activity has picked up. Conversely, durable goods orders were down (-2.4%) as orders for transportation equipment were weak, and the September employment report was weaker than expected.

Tough Jobs Environment

If there is one major roadblock that will impede the recovery, it is the dismal state of the job market. Yes, conditions are getting "less bad" as the green-shoot fans keep reminding us. Companies, for one, are reducing headcount at a slower pace than earlier in the year. During the first quarter, more than 2 million workers were purged from nonfarm payrolls. Since then, the pace of job losses has receded to 1.3 million in the second quarter and to less than 800 thousand in the third. Some other measures of labor force stress are also moving in an encouraging direction. First-time claims for unemployment benefits, for example, have fallen significantly in recent months, another sign that layoffs are ebbing.

But while the firing frenzy may have subsided, the labor market remains extremely inhospitable to job seekers. That was strikingly revealed in a relatively new government report called the "Job Openings and Labor Turnover Survey" (JOLTS), which only covers the time period beginning in 2000.

The most telling aspect of the JOLTS data is that it confirms an ominous trend that job hunters are well aware

of. While more workers are holding on to their positions, fewer and fewer opportunities are opening up for prospective applicants. In August, there were less than 2.4 million new job openings, the lowest for any month since the series began in December 2000; that includes the latest recession, which generated an average of 3.4 million openings over its 21-months. To put this in perspective, the number of unemployed workers, at just under 15 million, was 6.25 times the number of openings, a record high that dwarfs the 2.3 ratio coming out of the 2001 recession – which, in turn, was followed by nearly two years of job losses into the recovery. Given the greater competition for an ever-dwindling number of openings, it is small wonder that finding a job has become extremely difficult and time-consuming.

Potential for Negative Feedback Loop Exists

Needless to say, this is a dispiriting omen for the economic outlook. Consumer confidence and purchasing power are closely linked to income growth, which has slumped badly with the shrinkage of paychecks. Government aid has provided some relief, thanks to unemployment benefits and other transfer payments that have increasingly filled a yawning gap in household budgets. But more than one third of the unemployed have been out of work for at least 6-months, the highest percentage in the postwar period, and this growing



segment of the workforce may soon run out of benefits unless Washington grants an extension, which now seems likely.

The sustained weakness in the job market is a key reason that many economists feel the government should do more to jump-start the recovery. Their fears are not only based on the weak consumer spending prospects that flow from lagging incomes. They also argue that the healing in the financial system will be set back as well. After all, if households aren't receiving paychecks, they can't pay their credit-card bills and mortgages, leading to higher delinquencies and foreclosures. That, in turn, would further erode the capital cushion of banks and other lenders, stifling the availability of credit.

Simply put, the plight of households has negative feedback effects that threaten to derail the still-fragile recovery. The deterioration of credit stemming from rising unemployment makes banks ever more reluctant to extend new loans to consumers and businesses, which impairs their ability to spend and expand operations. Breaking this vicious circle is the most daunting challenge facing policy makers.

Wealth Boost

Clearly, a pickup in job openings would go a long way towards achieving that goal. But the restoration of job growth has historically trailed the recovery, and this time should be no different. At best, the pace of layoffs will continue to recede in coming months, setting the stage for companies to expand the workweek and then payrolls, hopefully early in the new year. Until the labor market starts to generate positive income growth again, consumer spending is likely to restrain the recovery's progress.

That said, there are enough positive forces to sustain the recovery until the job market kicks in. Keep in mind that wages and salaries are not the only influence on spending; despite waning paychecks in the third quarter, personal consumption rebounded sharply during the period. Nor was it just the much-ballyhooed "cash-for-clunkers" program that gave spending its heft. Non-auto sales also rose more than would be expected, given the weakness in personal incomes.

One reason households returned to the malls and shopping centers is that they felt better about their personal balance sheets. Between late 2007 and this year's first quarter, the debilitating losses from plunging stock and home values vaporized \$14 trillion in net worth, which contributed to the steep spending retrenchment last year. In the second quarter, about \$2 trillion of that lost wealth had been restored, thanks mainly to a strong rally in stock prices. The rally continued through late October, which added another \$2 trillion or so to the value of portfolio holdings, and home prices appear to have leveled off.

Stretching Paychecks

What's more, households are making remarkable strides in reducing their debt burdens. Installment debt has been slashed for a record-tying seven consecutive months and total household debt, including mortgages, fell for a full 12-month period through the second quarter for the first time in at least 60-years. By the end of March, debt-servicing payments as a share of disposable incomes had fallen to a 7-year low, freeing up funds for other purchases. That share probably declined further in the third quarter, thanks to persistent low interest rates and further debt reductions.

To be sure, the ongoing quest to reduce debt burdens and rebuild a savings cushion in the wake of the enormous wealth destruction last year means that consumer spending will be influenced more by income growth than debt financing in coming quarters. As already noted, paychecks are still restrained by the tepid state of the labor market; but even here, the situation has a silver lining. Just as debt-servicing payments are taking a smaller bite out of incomes, so too are falling prices boosting the purchasing power of workers. In the third quarter, inflation-adjusted weekly pay gained 3% over the year-earlier quarter, the strongest 12-month increase for a calendar quarter since the late 1960s.

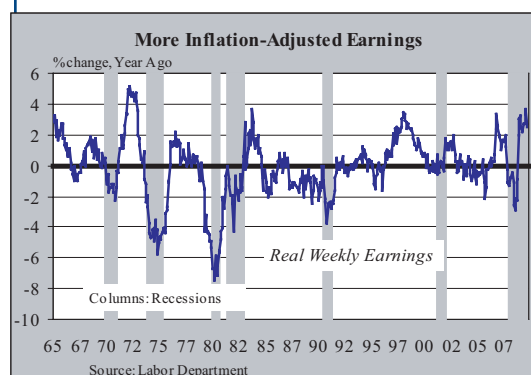
While the now-expired cash-for-clunkers program pushed some auto sales from the fourth quarter into the third, households still have the firepower to sustain spending at a respectable, although slower

pace, in the fourth quarter. Meanwhile, companies used considerably more of their idle capacity in the third quarter and the restocking of depleted inventories is lifting production, all of which portends a pick-up in capital spending. When that occurs, the long-awaited revival in hiring will not be far behind.

Summing Up the Parts

Like in any business cycle, sectors that overshoot fundamentals can rebound sharply once confidence returns. This is no different in the current cycle, as a number of the economic indicators overshot to the downside, or well below their long-run equilibrium. Automobile sales, inventories as a share of GDP and home construction, just to name a few, all fell to unusually low levels and were already showing signs of exhaustion on the downside or stabilization even prior to the stimulus efforts. As these weaknesses begin to reverse, they will all help to boost production and GDP.

While we expect a normal speed of recovery for some of the cyclical components of GDP like business equipment investment, housing and inventories, we expect consumer spending to lag GDP as consumers continue to rebuild savings. Payroll employment should turn positive in the first half of 2010, with unemployment rates peaking shortly after. Overall we expect a slower than normal recovery, but no double dip recession, absent a major shock, as the recovery process that has started will be hard to reverse. In addition, we expect if there are any signs of a retrench, the fiscal and monetary authorities will start a new round of stimulus to counter any secondary crisis. Outside of the U.S. we expect the recovery to be stronger, especially in the emerging markets, which should add to the U.S. recovery as the global trade which came to a screeching halt continues to reverse.



Equity Markets

The third quarter of 2009 continued where the second quarter left off, by delivering another strong quarter of performance in the global equity markets. Improving economic news increased investors' confidence that the recession is most likely over, which contributed to the market's dramatic ascent. While some end of the quarter economic data caused some reason for concern, it still appears that the synchronized global recovery is intact and well underway, and a double-dip recession scenario is highly improbable.

Increasing investor confidence that the economic recovery will continue does not mean that the recovery will be strong. Quite the opposite, we expect a below average recovery domestically. Normally, coming out of a major recession GDP grows around 6%+ in the forward 12-months, however, this time we expect a much slower recovery with GDP growth of around 3%. With the backdrop of this being a slower than normal recovery, many investors are starting to question whether the equity market's 58% rally off the March bottom may be a little too far too fast. Looking at historical data of past recoveries, it appears that given the magnitude of the recent drop, the market is not overshooting at this time. In a typical recovery, 50% of the prior market peak is recovered in the first 6-months following the market bottom and the remaining 50% occurs over the subsequent 14-months. By this measure, the market rebounding 49% off the bottom to the current levels appears right in line with past recoveries.

All the major indices rose during the quarter, with the broad market indices being led by the NASDAQ composite's 15.9% gain. The Dow Jones Industrial Average increased 15.8%, marking its biggest quarterly gain since 1998. The S&P 500 index gained 15.6%, following a 15.2% gain in the second quarter, creating its strongest two-quarter rally in over 20-years, and putting its year-to-date performance at a positive 19.3%. While all ten of the major sectors posted a gain for the quarter, Financials (+25.5%), Industrials (+22%), and Materials (+21.5%) had the strongest returns. More

stable, defensive sectors like Telecommunication Services (+5.6%) and Utilities (+6.2%) underperformed the more cyclical sectors as investors showed a preference for more risky stocks.

Outside the U.S., international and emerging markets enjoyed another solid quarter. The MSCI EAFE International Index returned 19.5% in the quarter while the MSCI Emerging Markets Index returned 20.9%.

Bond Markets

During the third quarter, interest rates on treasury securities decreased, particularly in the intermediate and longer term maturity (2 to 30-years). The 10-year treasury started the third quarter at 3.53% and ended the quarter at 3.30%, but only after moving to a yield of 3.85% in August. The underlying belief that inflation would not be an issue in the foreseeable future and that central banks would be on hold for an extended period of time resulted in a decline in yields across the maturity curve from August to the end of September. In addition, successful treasury auctions and mixed economic numbers helped substantiate the decline in treasury rates. Credit markets continued to improve during the quarter, and spreads continued to narrow. Improved earnings by corporations and greater liquidity in the credit market were the primary drivers to the spread tightening. Overall, taxable bonds provided significant returns during the quarter led by high yield corporate bonds.

Municipal bond yields also declined during the quarter with AA rated municipals declining approximately 50 basis points (or .50%) on average due to fairly low issuance of tax-exempt bonds during the quarter. In place of issuing tax-exempt debt, municipalities utilized the Build America Bond issue program. This program allows the municipality to tap the taxable bond market, primarily pension funds, which was not available to the municipalities before. With this program, a municipality issues taxable debt and the federal government subsidizes 35% of the interest rate paid by the municipality, leaving the overall cost to the local government equal to the equivalent tax-exempt issue.

Going into the fourth quarter, there is still some advantage to owning quality corporates, but the returns will be driven primarily by the yield rather than spread tightening. The government will continue to issue substantial amounts of debt during the quarter to fund the deficit, but with the Federal Reserve on hold for the near term, the potential for substantial increases in yields is lessened. On a longer-term outlook, economic growth and potential inflation pressures will lead to higher rates and treasuries will become a higher risk investment.

Outlook

Looking ahead into the fourth quarter and 2010, the outlook is for slow and steady growth. Better economic news, stronger corporate earnings, improved credit conditions, and a strong equity rally has most investors feeling more optimistic than they did at the beginning of the year. However, there remain a significant number of risks to the market and the economy including a rising unemployment rate, a burgeoning federal deficit, and the uncertainty surrounding the Federal Reserve's strategy for unwinding both the fiscal and monetary stimulus. That said, we feel that the market can continue to move forward, albeit at a much slower rate than the previous two quarters.

After the recent run-up in the equities market, it would not be too surprising to see a pullback or a pause in the near future. Mixed economic data combined with a less than rosy long-term economic outlook will continue to create crosscurrents about the rally's sustainability and most likely create a choppy market. However, we continue to feel that the equity markets remain attractive for long-term investors and will remain fully invested, at least for the near-term.



William Lanzon, Vice President
Betsy Pierson, First Vice President
Steve Maraffio, Senior Vice President
Chief Investment Officer

WEALTH MANAGEMENT GROUP

KEY ECONOMIC AND FINANCIAL INDICATORS

FINANCIAL INDICATORS*

	September	August	July	June	May	April	2009 March	12-Month Range	
								High	Low
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
3-Month CD Rate	0.25	0.30	0.35	0.39	0.57	0.89	1.07	1.07	0.25
3-Month Treasury Bill Rate	0.12	0.17	0.18	0.18	0.18	0.16	0.21	0.21	0.12
5-Year Treasury Note Rate	2.37	2.57	2.46	2.71	2.13	1.86	1.82	2.71	1.82
10-Year Treasury Note Rate	3.40	3.59	3.56	3.72	3.29	2.93	2.82	3.72	2.82
20-Year Treasury Bond Rate	4.14	4.33	4.38	4.51	4.22	3.84	3.78	4.51	3.78
Tax-Exempt Bond Yield	4.24	4.60	4.72	4.81	4.56	4.78	4.99	4.99	4.24
Corporate Bond Yield (AAA)	5.06	5.26	5.41	5.61	5.54	5.39	5.50	5.61	5.06
Dow Jones Industrial Average	9635	9376	8680	8593	8398	7992	7235	9635	7235
S&P 500 Index	1045	1010	936	926	902	848	757	1045	757
Dividend Yield (S&P)	2.05	2.10	2.18	2.35	2.47	2.63	3.03	3.03	2.05
P/E Ratio (S&P)	19.9	18.8	17.0	15.7	14.9	14.1	12.8	19.9	12.8
Dollar Exchange Rate (vs. Major Currencies)	74.6	75.2	76.4	77.0	78.9	82.3	83.8	83.8	74.6

*Monthly Averages

ECONOMIC INDICATORS

	September	August	July	June	May	April	2009 March	12-Month Range	
								High	Low
Housing Starts (in Thousands)	590	587	593	590	551	479	521	593	479
New Home Sales (Thousands of Units)		429	426	400	371	345	332	429	332
New Home Prices (Thousands of Dollars)		195	216	213	222	219	205	222	195
Retail Sales (% Change Year Ago)	-6.0	-5.7	-8.5	-8.8	-9.8	-10.0	-9.5	-5.7	-10.0
Industrial Production (% Change Year Ago)	-6.1	-10.4	-12.5	-13.3	-13.1	-12.4	-12.5	-6.1	-13.3
Operating Rate (% of Capacity)	70.5	69.9	69.0	68.3	68.2	69.2	69.5	70.5	68.2
Inventory Sales Ratio (Months)		1.33	1.36	1.38	1.41	1.43	1.44	1.44	1.33
Real Gross Domestic Product (Annual % Change)				-0.7			-6.4	-0.7	-6.4
Unemployment Rate (Percent)	9.8	9.7	9.4	9.5	9.4	8.9	8.5	9.8	8.5
Payroll Employment (Change in Thousands)	263	-201	-304	-463	-303	-519	-652	-201	-652
Personal Income (% Change Year Ago)		-2.6	-2.5	-3.4	-2.4	-2.1	-2.2	-2.1	-3.4
Savings Rate (3-month moving Average)		3.0	4.0	4.2	5.9	4.5	3.5	5.9	3.0
Hourly Earnings (% Change Year Ago)	2.5	2.6	2.7	2.8	3.0	3.1	3.4	3.4	2.5
Consumer Credit (Change in Mil. of Dollars)		-11980	-18983	-15482	-8805	-17346	-16083	-8805	-18983
Consumer Prices (% Change Year Ago)	-1.3	-1.5	-2.1	-1.4	-1.3	-0.7	-0.4	-0.4	-2.1
CPI Less Food & Energy (% Change Year Ago)	1.5	1.4	1.5	1.7	1.8	1.9	1.8	1.9	1.4
Wholesale Prices (% Change Year Ago)	-4.8	-4.3	-6.8	-4.6	-5.0	-3.7	-3.5	-3.5	-6.8

If you have any questions or for more information, please contact:

William Lanzon, Vice President
(847) 403-8190

Betsy Pierson, 1st Vice President
(847) 403-8074

Steve Maraffio, Senior Vice President
Chief Investment Officer
(630) 547-8870

