



CAPITAL MARKETS OUTLOOK

The Economy ♦ Fixed Income ♦ Equities

OVERVIEW

Gloom and despair continued to grip worldwide equity markets in March. The November lows, which many had hoped would be the bottom in stocks for this recession, were smashed in February and have been replaced by the March 6th intraday lows. Going forward, many will look to see if these lows will hold, but even if they do, the stock market will run into technical headwinds of resistance at points that had been levels of support over the past 18 months.

The Administration has rolled out comprehensive plans for a banking rescue but Wall Street continues to see ad-hoc rescues of financial firms including AIG and Citigroup, and therefore does not believe a comprehensive plan to backstop the banks is yet at hand. The primary issues that remain appear to be twofold in nature. First, what to do with a big financial organization to prevent it from being like one of the Japanese ‘Zombie’ banks of the 1990’s? Federal Reserve Chairman Bernanke has already said that the largest financial institutions will not be allowed to fail, but doesn’t a statement of that nature already put us down the ‘Zombie’ bank path?

PERFORMANCE AS OF: 03/24/2009	March to Date	Year To Date	12-MONTH RETURN
Strategic Growth Portfolio	8.31	-3.00	-30.58
Russell 1000 Growth	9.71	-3.42	-34.82
Strategic Value Portfolio	3.82	-15.17	-34.12
Russell 1000 Value	9.78	-15.83	-43.02
S&P 500 Index	9.86	-10.11	-38.70
MSCI EAFE Index	9.82	-11.12	-42.00
Barclays Cap US Govt/Credit Index	0.82	-0.18	2.31
Dow Jones Industrial Average	8.66	-11.89	-36.98

Comments and Outlook for 2009:

The Economy

- The economy is in a severe recession with activity declining across the consumer and manufacturing sectors.
- GDP for the 4th quarter of 2008 plunged at a (6.2)% annual rate and we expect the economy will remain in a significant recession for the majority of 2009.
- Due to massive government stimulus we believe GDP will improve in the latter half of 2009.
- Personal consumption spending (2/3 of GDP) continues to contract as personal savings increase.
- Home prices are attempting to stabilize as unemployment rises to 8.1%, the highest in 25 years.
- We believe inflation is not a near term issue (.1% for 2008), with deflationary trends continuing mainly due to world wide deleveraging, lower energy and commodity prices, and a firmer dollar.
- Core inflation of 1.8% is within the Federal Reserve’s target range of 1-2%.
- The Fed Funds and Discount Rates are at 0-.25% and .50%, respectively. The Fed will maintain an easing bias due to economic and financial instability and to stimulate lending.

- The Treasury yield curve begins to steepen; 10-year Treasury trading in the 2.10%-3.00% range; Agency and corporate bond spreads at all time highs.

The FED

- Global central bank and Government intervention should alleviate the selling pressure on financial assets. The Fed's process of "quantitative easing" by purchasing Government securities should keep rates low.
- Over the last week the FED announced an expansion of its stimulus plans that highlight its resolve to "employ all available tools to promote economic recovery." Specifically, it will expand its mortgage purchase program to \$1.45 trillion (up from \$600 billion), buy up to \$300 billion of longer-term Treasury securities over the next six months, \$1 trillion for TALF (Term Asset-backed Securities Lending Facility) and up to 1 trillion for the "bad bank fund." The sum total of these programs brings complete FED assets to \$5 trillion dollars or nearly 35% of GDP!

The Bond Market

- We recommend high quality corporate bonds and government-guaranteed securities in the 2 to 5 year maturity range. Emphasize high quality municipal bonds, which are attractively priced.

The Stock Market

- The stock market remains in a bottoming process with a recent short-term bounce. The market's main focus remains on credit and liquidity issues as the global deleveraging process continues.
- We expect widespread deterioration in corporate profits across all sectors.
- Stay with high quality large-caps over small- and mid-cap stocks; favor large-growth over large-value. Continue to diversify using international stocks in portfolios.

Allocation

- Consider alternative investment strategies to reduce volatility and provide absolute return.
- Revisit your overall investment objective to determine if it meets your time horizon, liquidity needs, and risk tolerance.

FIXED INCOME COMMENT

The credit markets are generally healthier now. Interbank Libor rates (short-term rates) have fallen dramatically since they peaked last year, and bond spreads in general have come down. However, bond yields on financial paper have recently gone to new highs suggesting that the markets are still uneasy about bank balance sheets. Indeed some pundits point to this fact to support a "wait and see" attitude on the eventual low.

EQUITY COMMENT

Why the drop in stocks in 2009 when many had thought that the major indices were cheap at the end of 2008? The financial and industrial sectors have by far been the biggest laggards in the S&P 500 year-to-date – industrials because the fundamentals have been poor, and financials because bailout plans from the Obama administration for the financial sector have not been well-received by Wall Street.

The other issue appears to be one of how to remove the toxic assets from bank balance sheets in a way that is equitable to shareholders as well as taxpayers. In the early 1990's, during the last big real estate crisis, this institution was the Resolution Trust Corporation. The FED just announced its "bad bank" plan and the market is digesting the news with pundits on both sides of its probable success.

Even with these woes there are some silver linings to the stock market compared to what was happening to stocks in the fall of 2008. Then, large redemptions by fund clients prompted portfolio managers to sell what they could, not necessarily what they would have preferred to sell. This deleveraging led to a far

worse downdraft in stocks than might have otherwise occurred. Now, selling appears to be based a bit more on fundamentals.

Additionally, the volatility in the market has gone down substantially since the fall. In fact, a case can be made that November was the most volatile month ever seen in stocks. The VIX ratio has fallen fairly dramatically since then, and the number of stocks making 52-week lows has dropped as well.

Since we elected not to rebalance accounts at the end of October, the S&P 500 has fallen from 980 to 667 and rebounded to 810. We believe that in the near-term stocks will face significant resistance on any upward movement from ceilings that were floors on the way down.

In addition, we favor the lower-risk areas of the stock market – we would tend to lean toward large-cap growth stocks and would underweight the small-cap value area.

Large Cap Growth Strategy- The portfolio continues to perform well relative to the benchmark due to its defensive nature. The sector overweight in health care along with the underweight in utilities and industrials accounted for the majority of the year-to-date allocation outperformance through the middle of March. Stock selection has been much more of a variable than in prior periods. Our more defensive additions from 2008, including TJX Companies and Gamestop, added greatly to returns. Goldman Sachs and Corning, which had suffered in the last quarter, bounced back and also added to performance. Conversely, FedEx, ConocoPhillips and Aflac detracted from returns. Stock selection within health care was poor as merger targets Genentech and Schering Plough were not in our holdings. Portfolio turnover dropped to 30% for 2008 and only a limited number of swaps, such as Coke for Pepsi, were done in the first quarter.

The Federal government continues to intervene in the economy in an effort to stimulate spending and restore liquidity to the credit markets. Their efforts, while largely ineffective so far, underscore the weakness of the current economy but bolster the inflationary potential somewhere in the future. The portfolio will remain structured in its current defensive position, but is poised to realign for a more aggressive posture when the reflationary effects of Fed policy take effect. Reductions in consumer staples and health care would flow into additions in the industrial, technology, and material sectors.

SECTOR COMMENTS

Finance – We believe the deleveraging process will continue throughout 2009 due to the Government's stress testing of banks and the plan to sell troubled assets from financial institutions. While the eventual outcome of the bank stress testing will be positive; the near-term effects of government influenced asset sales will continue to put downward pressure on asset prices. In addition, the banking industry is fighting the headwinds of more credit deterioration in a contracting economy; which will result in further dividend cuts and the need to raise capital; all dilutive to shareholder equity.

Although, we continue to underweight financials, the worst for the sector may be over. The larger banks, especially Bank of America and Wells Fargo, face integration and management execution issues as they work through their recent mergers. We believe there is more upside potential in the regional banks that have little or no exposure to sub prime loans. Also, the regional banks will benefit from a positively-sloping yield curve. Investment management firms and large custody banks (Goldman Sachs, Bank of New York Mellon) should benefit from increased revenue as the Government plan to sell the troubled assets is implemented. Longer-term, the investment firms participating in the purchase of troubled assets have the ability to earn double-digit returns on these investments. Finally, a sure sign of rejuvenating health in the banking system will be the return of private equity capital.

Energy - The Energy Sector has had good relative performance of late, much of which can be attributed to an increase in oil prices from below \$40 three months ago, to the low \$50's per barrel at the end of March. The worldwide recession has temporarily crushed product demand, but supply has been declining due to OPEC production cuts as they try to stabilize prices. Natural gas prices have not yet begun to recover which is drastically hurting those companies with major exposure to North America drilling and production.

Industrials - The Industrial Sector has continued to be an under-performer relative to most other sectors. The sector was down 24.6% in 2008's last quarter alone. This was partially due to the downward spiral of General Electric, a major component of the index.

We are anticipating better performance due to growth in capital spending on global infrastructure projects. Also, in the past, the sector has been an out-performer following "bear market bottoms." However, profit margins and earnings are still declining and will continue to be a headwind for some time. Therefore, we will stay at a market weight for now. The Construction/Farm Machinery sub sector should rebound and we look for improved performance from companies such as Deere, Caterpillar, Jacobs Engineering, and Fastenal.

Materials and Utilities - We are underweight utilities due to over-bought conditions reflecting the defensive position of most equity investors. A worldwide recession has led to a decrease in demand for raw materials. Also, the materials sector is facing headwinds from a stronger dollar, which erodes the value of foreign sales. One positive trend is that the world's population growth increases demand for food. As a result, the agricultural industry is striving to increase crop production with special fertilizers and genetically engineered disease resistant seeds. We still favor the fertilizer and specialized seed companies and are looking for infrastructure opportunities based on the Government's stimulus spending plan. Crown Holdings, Inc. is an example of a packaging defensive growth play, since the consumer is eating more meals at home.

Consumer Staples - Until we see more evidence of a "bear market bottom" or improving leading economic indicators, we remain defensive and continue to overweight Consumer Staples. When the bear market ends, staples will be negatively impacted by rotation to higher beta, oversold sectors. In the near-term, lower commodity costs are easing the pressure on profit margins. However, we remain concerned about increased international exposure and relative valuations. We favor hypermarket retailer Wal-Mart to benefit from the economic headwinds taking a toll on the consumer's budget.

Consumer Discretionary - The discretionary sector is one of the first sectors to bottom in a recession and has historically been an early cycle group performing relatively well after a "bear market bottom." Most recently, the consumer has experienced relief from the lower energy and stabilizing food prices. However, rising unemployment, falling home prices and net worth, tight credit, and higher consumer loan and mortgage delinquency rates keep us cautious on the consumer sector. The household sector will need to build savings in view of the massive destruction of wealth over the past year. We remain slightly underweight, but will upgrade as the market shows signs of bottoming. We have favored education services provider ITT Education as enrollments have expanded because of the slowing economy.