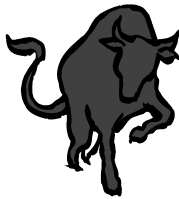


Index	Quarter Return	YTD Return
DJIA	15.7	13.5
S & P 500	15.6	19.3
NASDAQ	15.7	34.6
Russell 2000	19.3	22.4
MSCI EAFE	18.8	25.5
Barclay's Aggregate Bond	3.7	5.7
Consumer Price Index	0.1	2.7



### Third Quarter Investment Commentary

The third quarter has ended in what continues to be a most eventful year for the stock markets and the economy. It's also one year since the weekend that shook the foundations of Wall Street and of the global financial system – when Lehman Brothers collapsed, Merrill Lynch vanished as an independent entity and AIG was taken over by the U.S. government. In light of that, it is important to briefly summarize where we've been and the prospects for the period ahead.

Two years ago, the market was characterized by rampant optimism. The U.S. market had hit a new high in November of 2007 and any concerns were set aside as minor annoyances. By contrast, six months ago, in March, it truly did feel like the world might be coming to an end – talk of a return to a Great Depression-like economy dominated the media. Understandably, fear was rampant – and stocks responded to these nightmarish scenarios by hitting the lowest levels in years, with financials especially hard hit.

Although no one knew it at the time, that turned out to be the bottom. Since then, the economy has moved back from the precipice – there is a growing consensus that we are returning to economic growth or a least a leveling off of the decline. As a result, we've had a strong recovery in markets and a good year-to-date return in all markets.

### Where We Are Today

Today, the market is somewhere between the two extremes seen in the last two years, and most investors can be characterized as extremely nervous. As a general rule, a certain level of healthy anxiety is positive – what gets investors in trouble is an excess of either optimism or pessimism. Being cautious in the current market makes sense... provided that prudent caution doesn't cross the line into panicked inertia or hasty decisions.

The case for optimism is simple: Beyond the issues facing the global economy, there are many underlying positives that give cause for optimism if we look out two or three years or beyond. Powerful forces under the surface will drive economic growth... and that economic growth will drive stock prices. Examples include the positive impact of technology, the recovering U.S. housing market, the revitalization of economies and the incredible energy from the developing world's educated youth and emerging middle class, especially in Asia. Almost half of profits of S&P 500 companies come from overseas, and that fraction is destined to increase.

While we will see more bank failures, as real estate-related loan losses (residential and commercial) continue, we are confident that the government has taken the financial-system meltdown risk off the table. The economy is probably already growing again. But there remains the important question of how strong the recovery will be, and whether it will be sustained or whether there will be another leg down for the economy (which is commonly described as a W-shaped recession).

The pessimistic case begins with declines in household net worth erasing years of gains, debt levels far too high, access to credit more limited than it has been in years and, with labor markets feeble, the consumer is in a weakened state. We continue to believe that households will want and need to rebuild their balance sheets, especially the 78 million baby boomers depending on their net worth to help fund retirement. The end of the home equity ATM, and generally less available credit as financial institutions repair their balance sheets, will reinforce this trend. The consumer is 70% of the economy, so clearly consumption growth is of critical importance to economic growth. Thus, it is the expectation of slow consumer spending growth, coupled with increasing regulation and likely reduced risk taking on the part of businesses and investors (relative to much of the past 20 years), that suggests to us that any near-term burst of economic activity is unlikely to be sustained at a robust level. We are less sanguine than most investors and expect slow economic growth for 2010 and probably beyond.

### **Investment Strategy**

Since November 2008, we have been steadily investing the record (for us) levels of cash, but the markets have gotten stretched and we are now taking risk exposure out of our portfolios. The fact is that the lower quality and highest risk investments have done the best this year, and we have mostly stayed away from these and will continue to do so. We think that any surprises from here will mostly be on the negative side, and we think it is important to continue to give our investors downside protection. We continue to believe that inflation will not be a problem over the next few years, but we all know that the "elephant in the room" is an increase in interest rates that is surely coming. The Federal deficit is running at \$2 Trillion per year, and this is in addition to the high borrowings already on the table. When it will impact the economy, bonds, stocks and interest rates is impossible to know but fixed income, in particular, will be impacted in a significant way. That is why we are staying with higher quality and shorter duration bonds.

Regardless of the economic and investment environment ahead, we will attempt to mitigate volatility and guard against undue losses until things become clearer. We encourage you to re-read our last few *ReViews of the Market*. These will provide further depth into our thinking and investment methodology.