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Despite a period of brief weakness in late January and early February, the stock market continued to move higher in the first three months of the year. For the quarter, the S&P 500 Index gained 5.4% and the Russell 2000 Index, with its emphasis on smaller stocks, returned 8.9%. Foreign stocks, however, only rose 1.0%, in part due to strength in the U.S. dollar. Bonds, meanwhile, generated modest gains of 1.8% as interest rates remained basically level.

Our portfolios have participated nicely in the recovery of the capital markets over the past year. Among our many successful investments, the greatest contributor to our gains over this period has been our investment in emerging market stocks. These purchases (and recent profit taking) are a fine example of our independent and contrarian investment philosophy. Going back to early 2009, investors had indiscriminately sold emerging market funds down anywhere from 50% to 70% from their prior peaks. At these depressed levels, valuations and the implied reward-risk had become extremely attractive. So in late January of 2009, across appropriate portfolios, we purchased the Schwab Fundamental Emerging Markets Index Fund and the T. Rowe Price New Asia Fund. By the end of 2009, these funds had appreciated 93% and 122% respectively. The move upward extended into the first quarter of this year, but by March emerging markets had once again become relatively expensive and quite popular among the investment "crowd." To many of our long time investors, it should come as no surprise then that just before the end of the quarter we sold these funds and re-invested the proceeds in two foreign stock funds focused on more developed foreign markets. Over the years, Warren Buffet has advised investors to "be fearful when others are greedy and to be greedy only when others a fearful." We have always tried to adhere to this mantra and our successful investment in emerging markets is a fine example of that.

Looking forward to the outlook for the economy and the financial markets over the balance of the year, I am sorry to say that our conviction in the disparate, negative view has increased. While the overall economy appears to have emerged from its deep recession, it is unclear whether this represents core intrinsic strength or a temporary improvement from measures such as the "cash for clunkers" program and the first-time home buyer tax credit. We suspect it is more of the latter. We also continue to believe that the supply-demand imbalance in the residential housing market is such that recent

positive data is suspect and that prices will resume their decline. Finally, we are of the belief that the "Great Recession" of 2008-2009 was not a typical post-WW II recession. It was a seminal event in the economic history of this country that will have lasting effects. As a result, our financial system will not soon return to the same degree of leverage that helped propel the economic growth of the past two decades. The American consumer is now deleveraging as well, having finally learned the risks of excessive borrowing. Furthermore, the Great Recession has left our economy with so much overcapacity that it seems doubtful that the monetary and fiscal stimulus to date will be sufficient to offset the deflationary forces weighing down the economy. Much longer term, we still believe that inflation will emerge as the ultimate enemy of the capital markets, but that such risk is further out than most investors think.

Due to our cautious outlook, we believe that stock market is ripe for a significant correction. As such, we are in the process of moving our portfolios to more defensive postures relative to their respective investment policies. Our sale of our emerging market funds (which would typically suffer in a weak market) is but one example of this shift. Generally speaking, going forward we want to emphasize bonds at the expense of stocks and within these asset classes we want to emphasize quality and safety over risk. This means owning bond funds that invest in Treasuries, investment-grade corporate, and highly rated municipal bonds. As for our reduced stock market exposure, we want to hold funds that invest in large companies with less economically sensitive businesses and strong balance sheets.

On a more positive note, when we look out past the next year we see plenty of potential opportunities for attractive investments. While this decade will continue to be challenging for investors, it will certainly be better than the previous ten years. Our independent, contrarian investment philosophy allowed us to generate respectable returns in the most difficult investment decade since the era of the Great Depression. We are confident that in a somewhat less challenging environment our gains will be even better.

Finally, and on a personal note, please join me in congratulating our client services assistant, Meagan Sells, and her husband, Chris on the birth of their second daughter, Grace Kennedy Sells on February 10th. We are excited for them and look forward to Meagan's gradual return to work over the coming months.

Sincerely,

David B. Ackerman, CFA, CFP