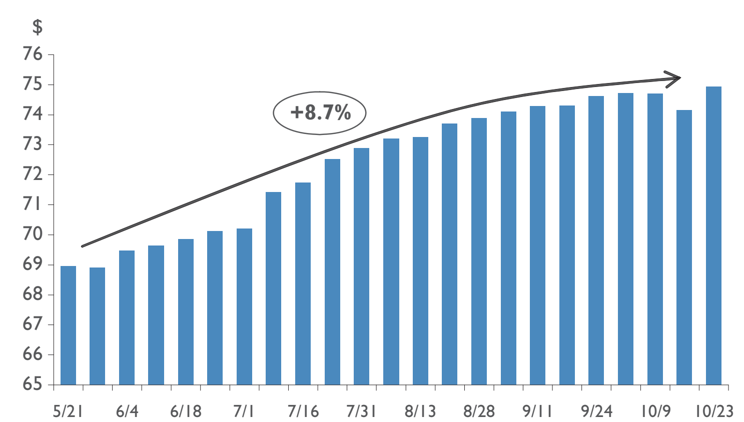
THE MARKET OBSERVER

November 2009

The rally in stock prices from their March 9th lows showed possible signs of fading in October. Prices twice appeared headed to test the 1,000 level of the S&P 500 at the beginning and again at the end of the month. Positive economic news since then, however, pushed prices through their recent high of 1,097, last reached on October 19th as well as the 1,100 level. At its close at 1,109 on November 16th stocks have now advanced 66% from their March lows, and currently stand 29% below their 2007 peak.

2010 Consensus EPS Estimates



Source: The Yield Book, Factset, Bloomberg, Morgan Stanley Research

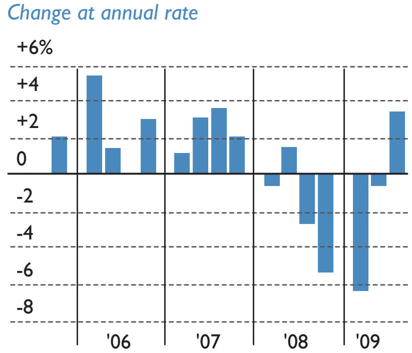
News that the Gross Domestic Product (GDP) advanced at an annual rate of 3.5% in the third quarter, along with corporate earnings reports coming in better than expected, helped buoy the market despite unemployment levels rising to 10.2%. Expectations are for unemployment levels to continue to rise through the first quarter of 2010 before leveling as the monthly rate of new jobless workers is declining. The markets continued strength is apparently based on confidence that this economic uptick is sustainable. Such confidence is surprising to many when recognizing that the preponderance of this improvement was related to government stimulus. The "Cash for Clunkers" program alone contributed 1.7% to overall GDP growth. Obviously, sustainable economic growth cannot be expected to be produced by government subsidized spending, nor can we expect the government to continue to spend money it doesn't have at such a magnified rate. At some point, real economic activity will have to take over. In this cautious environment, it would seem that Corporate America will wait to see such improvement before initiating new hires.

Real Economic Growth

Annual rate of change in the gross domestic product, based on quarterly figures adjusted for inflation and seasonal fluctuations.

3rd Quarter initial +3.5%

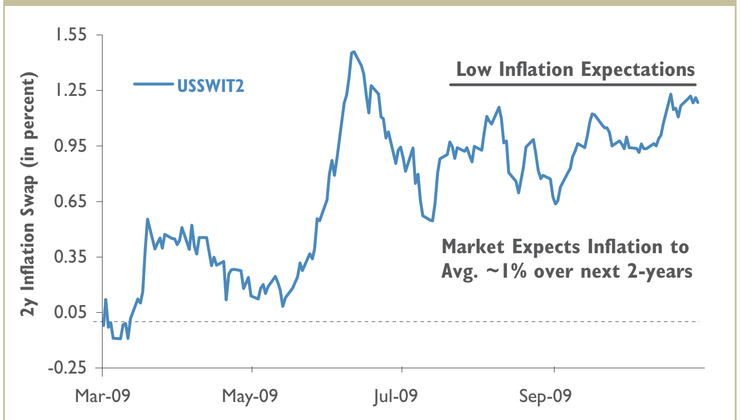
Change at annual rate



Source: Commerce Department

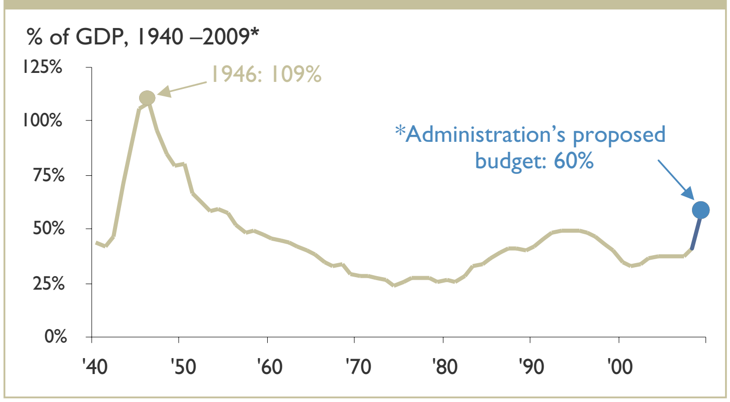
The market appears to be indicating such optimism when reviewing its reaction to recent corporate earnings announcements. Projected earnings for 2010 for the S&P 500 are currently pegged at $75, which

Inflation Expectations Remain Modest



Source: Bloomberg, FID Research, Morgan Stanley Research

Federal Debt (Accumulated Deficits)



Source: Congressional Budget Office, St. Louis Fed, Bureau of Economic Analysis, JPMorgan Asset Management.Data reflects most recently available as of 06/30/09. Note: years shown are fiscal years (Oct. 1 through Sep. 30). Chart displays federal debt in the hands of the public.

means the market is trading at approximately 15 times forward earnings which is in the historical range of what is considered fairly valued. An additional two years of 6% earnings growth would bring profits back to their 2006 pre-decline level of approximately $80. Many technical indicators also point to a positive-turning market, despite the presence of much skepticism. In addition, the vast savings and money market balances that are on the sidelines earning meager interest could be the source of additional buying strength going forward.

Despite a hint that it is ever-watchful of inflation, the Fed is expected to keep rates low to allow this recovery to gain solid footing. Even though the advance in gold prices since the end of October has surpassed that of stocks, inflation appears to be subdued. Despite heightened fears of government printing presses bringing us back to the late 1970s and early 1980s double-digit inflation, the markets recognize that the stimulus is not being compounded through the system through lending and commerce. It appears to date to only have spurred the recovery of financial assets from their lows. The budget deficit for the fiscal year just ended 9/30/09 was the highest percentage of GDP since the end of World War II. Rising gold prices and the declining dollar are cautionary indicators that such levels of deficit spending are viewed as troublesome. In the face of all of this, perhaps the market's continued strength is indicating that it doesn't see Health Care Reform in its current trillion dollar form weaving its way successfully through Congress before the 2010 elections.

So where does this leave us? The economy would seem to have the ability to slowly improve going forward but will continue to be impeded until deficit spending gets back to the 3 - 4% range experienced during the late 1970's. Looking five years out, most investors can make a case to retain their allocation to risk investments. A greater challenge with the fixed portion of their portfolios is to avoid the temptation to reach too much for yield, either by extending maturities or reducing quality. Balance, once again, would seem to be the caution of the day. Liquidity always comes with a cost. Today's money market and savings account yields of less than 1% would appear to be it.

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