

WOOD & WHITE

Investment Advisors, LLC

Market Commentary

January 18, 2010

To our clients and friends:

The persistent rally in the stock market, born in the depths of despair and panic in early March, continued to defy skeptics through the fourth quarter of 2009. The S&P 500 Index rose in nine of the final ten months of the year to post a total return for 2009 of 26.5%, while the Dow Jones Industrial Average finished the year up 18.8%. The more risky sectors of the capital markets - those hit hardest in 2008 – not surprisingly delivered strong performance in 2009, with international markets, junk bonds and commodities all roaring higher.

In retrospect, it is clear that the global deleveraging and forced selling of risk-based assets in late 2008 and early 2009 had produced massive distortions in asset prices. Unprecedented levels of global government intervention and stimulus sowed the seeds for a violent recovery that has proven almost as unrelenting as the previous decline. Through the course of 2009, financial markets moved from pricing-in a complete collapse of the financial system, to pricing-in a severe recession, to pricing-in a reluctant recognition that a muted economic recovery might well be sustained. We have kept our clients positioned to participate in the market recovery, and we are pleased to report that our clients have enjoyed strong returns in 2009. Together with our clients, we have weathered the worst financial crisis of our generation and have lived to fight another day.

In reflecting on recent events, there are several basic tenets of our investment philosophy that have been validated through the recent downturn and subsequent recovery. To highlight a few:

- It is prudent to plan for extreme market events to occur more frequently than an analysis of long-term financial market trends would suggest.
- Modern financial markets have exhibited a greater vulnerability to statistically improbable shocks to the downside, versus extreme shocks to the upside.
- When investing for families and individuals, “risk” is most appropriately measured as the potential for permanent loss of principal, rather than variability of returns from one period to the next (standard deviation).
- Many quantitative asset allocation models used in the investment industry are flawed in their assessment of risk and, in many cases, create a false sense of certainty in evaluating future outcomes.
- Managing risk in client portfolios is more important to ensuring their long-term financial security than seeking alpha (excess return).

- Basic asset allocation through market cycles – striking an appropriate balance of investment in risky assets vs. high-quality bonds and cash - is markedly more important to a client's long-term success than the consideration of a given asset classes' performance relative to an index or benchmark.
- When financial markets are under extreme duress, all risky assets are highly correlated. Careful planning for client liquidity and income needs, combined with a sufficient provision for principal protection, is the key to survival in such an environment.

The stock market has essentially enjoyed an uninterrupted climb since early March, but the economy's recovery potential in the near-term will likely be tempered. This is primarily because the American consumer continues to deleverage. The debt-driven consumption model that has driven economic growth in recent years would appear to be permanently impaired. We believe the "survival trade" may have run its course. Corporate earnings and expectations for economic growth are set to return as the primary determinants of stock performance.

As stated in a recent *Wall Street Journal* headline, "Rebuilt Markets Must [now] Stand Alone". Government intervention has helped the markets find stronger footing, but it is likely only a matter of time before investors begin to worry about the "double edged sword" of these unprecedented government actions. What is their exit strategy? How will markets react when the Federal Reserve begins withdrawing liquidity? If the Fed remains accommodative for longer than expected, shouldn't inflation expectations and fears increase markedly? Precise answers to these questions are unknowable, but we believe that a near-term correction in stock prices would not be surprising.

From a longer-term perspective, the past 10 years of negative returns for stocks may have set the stage for above trend returns over the next 5-10 years. According to a study by Yale University Finance Professor William Goetzmann, the average stock traded on the New York Stock Exchange posted an annualized total return of negative 0.32% from the end of 1999 through the end of 2009, representing the worst calendar decade for U.S. stocks since the 1820's. Comparative rates of return between asset classes have historically run in cycles, and we believe strongly that long-term mean-reversion trends suggest that the worst is behind us. High-quality stocks currently present a far more compelling long-term opportunity than bonds or cash. Therefore, we will remain a net purchaser of equities on any meaningful market pullback.

We welcome your comments and questions at any time.

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