

April 1, 2009

Dear Valued Investor:

The Obama administration and the Federal Reserve (the Fed) have been very busy in the first quarter, moving ahead quickly with policy actions aimed at countering the recession. In addition to accommodative monetary policies, the government's large stimulus spending initiatives will begin to work its way through the economy and at least part of it will be helpful. As with most previous anti-recession spending programs, the recession will likely be over before a large part of the programs has been executed. If so, I expect that at least part of the "stimulus package" will end up being reduced as forward years' budgets are formulated in more normal economic conditions.

For now, the government appears to be entirely committed to a major anti-recession effort. The Treasury has rolled out an ambitious program to ease the credit crunch for banks, and the Fed has begun another very large wave of buying various debts in order to bring stability to credit markets. Some programs and bailouts remain in doubt—the support programs for the automakers may fail and lead to reorganization in bankruptcy, and the bank bailout policy still appears to me to have major challenges. However, while various programs may or may not ultimately be effective, I think that the government will continue to adjust and move to, on balance, helpful policies this year.

At the present time the economy is showing surprisingly mixed results. The general view has been that just about all the statistics would look bleak for some time, but that has not been the case. Employment, usually a lagging indicator, remains very weak, but other statistics have shown turnaround potential. Retail sales appear to have bottomed in December and are up so far this year. Also, new orders for capital goods turned up in February. Personal income is still up 2.2% in real terms through February compared to last February, despite the drop in employment. Housing sales and prices also showed minor signs of a turnaround, but remain deeply depressed. I think, but am not sure, that we are in the process of forming a bottom in the economy in the second quarter.

I believe the Fed is embarked on a major expansion of the money supply to counteract the recession, general deflationary conditions, and the decline in home prices. Given the Fed's essentially unlimited monetary resources, I believe they will be successful. However, with this program, as well as all the others, there will be a price to pay down the road. The Fed will have to start reversing the monetary expansion and credit support programs as the economy recovers, and that change will likely put upward pressure on interest rates later in the recovery period. Growing Federal budget deficits will add to interest rate pressure. And we still must confront the longer-term imbalances in Social Security and Medicare. That said, I would rather have an expanding economy with a return to rising employment, even if part of the cost is higher interest rates.

We may be forming a bottom in financial markets. Over the last three weeks the stock market rallied about 20%, as measured by the S&P 500, but most market measures are still down from the beginning of the year. To me, this is encouraging news, but is by no means a new bull market. With more generally bad economic news ahead, it is way too soon to make the call that the worst is over. As always please call your financial professional with any questions or concerns.

Best Regards,



Lincoln Anderson
Senior Economic Consultant

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