



## ECONOMIC UPDATE: RECOVERY UNDERWAY

3rd Quarter  
2009

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Economic Update

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Update

The second quarter solidified March 9th as the bottom of the recent bear market. By July 31st, the Dow Jones Industrial Average (DJIA) had risen over 2850 points to an intraday high of 9298. This amounted to a phenomenal 44% increase in just 5 months, as investors believed the economy was no longer headed toward the Great Depression II. Realistically, the economy has endured the longest downturn in 80 years, and equity prices have deflated to reflect this reality. The underlying fundamentals of the economy have changed. These changes will be important themes for investor portfolios going forward:

July 31, 2009 DJIA intraday high 9298... "a phenomenal 44% increase in just 5 months"

### Credit is Scarce

Prior to 2008, credit was easily available on a worldwide scale. Due to securitization, creditworthiness had largely been "packaged away" by Wall Street investment banks. This allowed poorly qualified borrowers to access credit markets at historically low-rates, artificially boosting growth rates. Today, despite a 0% Federal Funds rate, and a full-scale nationalization of the conforming mortgage market (Fannie Mae and Freddie Mac), lenders are once again scrutinizing borrowers' balance sheets and repayment ability. This is a fundamental change for investors, a trend that will favor well-financed companies going forward.

### Redefining Risk

Prior to Q3-2008, a generation of investors had never experienced substantial losses. From the 1987 crash through September 2007, the DJIA rose nearly 700%. Even the technology bubble of the early 2000's did not substantially dampen these phenomenal long term returns. Last year, as stocks were crashing investors were forced to analyze companies not only for the capital appreciation their shares could provide, but also for the volatility, quality, and sustainability of their business model. *Cutler believes that a successful investor looks beyond the short-term stock price and looks at these long-term variables to assess a company's prospects, in both good times and bad.*

### Policy Matters

We have witnessed a level of government intrusion in the private sector rarely seen in US history. Beginning with the banking sector, extending to the auto sector, and with talk of the health insurance sector, the government is an important variable for investors to consider. Politics aside, government involvement is now something investors will need to take into account. The role of an independent Federal Reserve has been permanently blurred, supporting Cutler's view of a higher inflation era in the coming years.

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*"When you earn a dollar, it has gained your respect.  
When you invest that dollar, the investment should reflect your respect."*

- Ken Cutler



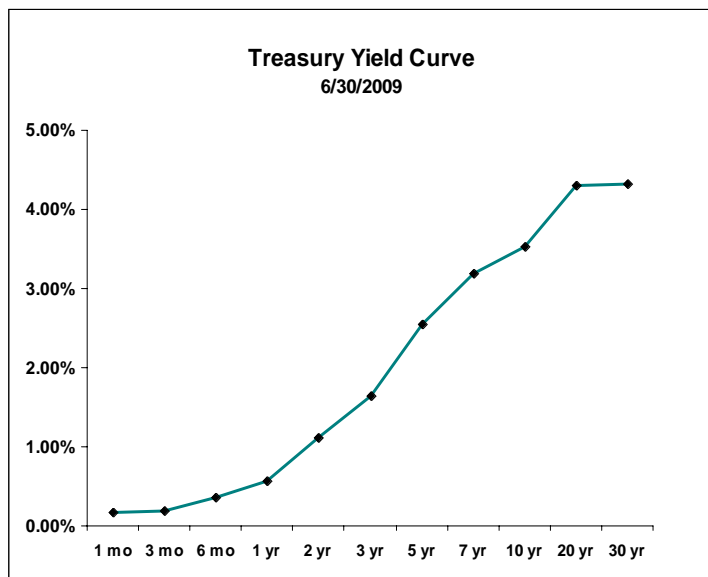
# FIXED INCOME UPDATE

## ECONOMIC UPDATE CONTINUED...

Ultimately, we believe that with these changing fundamentals, equity prices are trading at fair levels today. A return to Dow 14,000 will take years, not a matter of months, and equity investors will need to maintain a long-term viewpoint. The factors above are far reaching changes, impacting real estate values, both sovereign and corporate fixed income, cash values and equity prices. At Cutler, we believe that the ability of equities to weather these various market conditions make stocks the best asset class to own at current valuations. Once again looking back to 1987, even with the recent market crash (the 2nd worst in history), the DJIA is up over 350% from the Black Monday levels. The long-term value in owning stocks remains an axiom as true or truer than at any time in America's recent past.

## FIXED INCOME: IS THE TREASURY RUN OVER?

The indiscriminate selling witnessed in 2008, in all sectors beyond Treasuries, reversed in the second quarter. The Barclays Capital Aggregate Index produced a total return of 1.78%. This modest unwinding of the previous trend included Treasuries, which sold off -3.02%. Long-term Treasuries were hurt even more, posting a 7% decline in value. The result is a steeper yield curve, but interest rates remain too low for any meaningful yield curve extension strategy (extending maturity of holdings). We continue to think that the best tactical opportunity is to stay neutral to the benchmark's term and await future opportunities.



The Quarter ended with the corporate and CMBS (Collateralized Mortgage Backed Securities) sectors posting strong relative returns. Regardless of market volatility, the investment grade credit sector performed extremely well. Spreads compressed across all sectors and the investment grade index provided a healthy 10.45% return for the quarter. The CMBS sector also provided spectacular returns of 12.4%, on the heels of a -20.5% return for 2008.

The last 12 months have seen volatility of fixed income returns unlike any period in recent memory. Over the last year, the mortgage sector performed the best with a return of 9.4%, followed by the agency and treasury sectors. The CMBS sector, even after two strong quarters, lagged the other sectors by a wide margin, as it remained in negative territory for a return of -10.1%. The corporate sector lagged the government sector as well; however, the differential narrowed significantly as this sector also enjoyed two very strong back-to-back quarters to start of 2009. The net result was a 12-month return of 3.84%.

Interest rates remain volatile and bond prices are expensive, as yields continue to hover around historic lows. Consequently, it is difficult to foresee a meaningful and sustained rally in the Treasury market. As a result, Cutler portfolios will continue to err on the conservative side of the duration spectrum relative to their benchmark.



# PAYING DIVIDENDS

## ENCOURAGING 401K PARTICIPATION - BY CAROL FISCHER

**A**t Cutler, we put a lot of emphasis on an investment's ability to generate income. Dividends are a consistent way to generate shareholder returns. Companies that pay (and increase) dividends are a conservative way to produce long-term value.

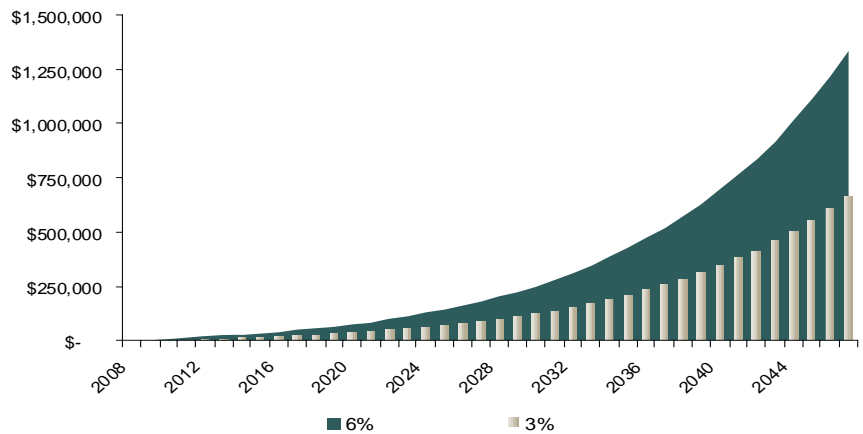
The concept of "compounding" is important to understanding why dividends matter. Simply put, small contributions can add up to a lot. Take Johnson & Johnson for example\*. If you bought a share of JNJ on 12/31/1999, the stock was paying \$0.14 per share. While this doesn't seem like much, if you reinvested the dividend payment, your return would be 59.47% (after two bear markets!). Without reinvestment, your return would have still been an impressive, 31.76%. But, those little \$0.14 contributions nearly doubled your investment! Moreover, those \$0.14 per share dividend checks have grown to a more impressive \$0.49.



Carol Fischer  
Chief Operating Officer

For 401(k) Plan participants, this same concept applies. It is difficult for employees to consistently contribute towards retirement, especially when people are stretched so thin in a recession. However, even small contributions can make a big difference. (see graph below)

An industry study released in July helps to shed some light on this concept. In the study (conducted by the Investment Company Institute), the average 401(k) Plan participant had a 9.5% annual growth rate from 1999-2007 (we also eagerly await the 2008 update). Meanwhile, the median account balance increased 15.2%. This is evidence of how compounded contributions can ultimately increase your account balance, and may even produce a nest egg that grows faster than your investment returns alone!



Hypothetical example shows the growth of retirement contributions with an expected net of fees return of 8.5% (annually). It assumes a starting salary of \$45k with annual increases of 4%. The graph shows the growth of both a 3% and 6% participant contribution.

Cutler's self-directed 401(k) Platform is designed to be participant-friendly, focusing on encouraging contributions through ease-of-use, cost containment, and generating investment returns. If you would like to learn more about encouraging greater employee participation, give me a call today.

***Paying Dividends will occur in Cutler's Quarterly Newsletter and will feature rotating authorship by members of the Cutler team. Look for Matthew Patten's article in our 4th Quarter-2009 newsletter.***

\*JNJ example is provided for illustrative purposes and is not intended to be representative of client accounts.



# GLOBAL MARKET UPDATE

## INVESTORS' APPETITE FOR RISK HAS RETURNED

The trend so far this year has been clear; investors' appetite for risk has returned. Similar to the US equity markets, the best performing international market sectors were materials and information technology. These are early cyclical sectors, trading higher primarily upon improving economic prospects. The health care and telecommunications sectors, traditionally defensive in nature, continued to lag the overall market advances. Furthermore, smaller companies have recently performed significantly better than their larger peers. Most emerging equity market returns exceeded developed markets as investors perceived developing countries, especially those with access to raw materials, as beneficiaries of a global economic recovery.

The resurgence of risk and improving confidence has created a volatile currency market as participants shifted away from safe -haven currencies. Last quarter, some observers believed that the British pound was heading towards parity with the euro because of its exposure to the financial industry, but drastic government and central bank actions to stem the economic decline have been successful. The currency impacts were much more dramatic in



emerging market currencies, especially those with access to raw materials that stand to benefit from an economic recovery. For example, Brazil and South Africa saw their currencies gain 17.5% and 23.1%, respectively, for the quarter. And while not developing, the Australian dollar alone gained 16.4% relative to the U.S. dollar as iron ore and coal are the country's two biggest exports.

Global oil markets showed strength during the quarter, but appear to be fluctuating based on speculative flows rather than supply/demand fundamentals. Higher oil prices also threaten any economic recovery by placing a great tax on consumers and businesses. The inflationary impacts of high oil prices will be important to monitor for the on-going impact on equity portfolios.

For the 2nd quarter and in local currency terms, the best performing developed equity markets were Singapore and Hong Kong, advancing 39.0% and 35.8%, respectively, while the worst performing was Ireland gaining only 0.9%. On a U.S. dollar basis, the MSCI BRIC (Brazil, Russia, India, China) Index was up a phenomenal 41.1%.

In times of market turmoil, diversification can provide investors **peace of mind**. Cutler has experience managing multiple asset classes such as domestic equities, bonds, and global equities. Additionally, we have successfully integrated exchange traded funds into some of our investment strategies. Give us a call today to learn more.