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Second Quarter 2009 Summary and Commentary

What a difference a quarter can make! As we finished Q1 2009, the markets closed at extremely oversold pricing levels. On March 9, the Dow Jones Industrial Average closed at 6,547, a decline of 54% from its high of 14,146 on October 9, 2007. Similarly, the S&P 500 finished March 9 at 676, booking a 57% decline over the same time period.

We have since seen the markets rally dramatically off of these doomsday levels as the economy has shown signs of the start of a possible recovery. The question: is this rally sustainable and how long will it take for the economy to recover from what has been the most severe recession since the Depression?

As we look at this rally, we have concerns as to its quality and durability. From March 6th to May 6th, the S&P 500 rose 38%. During this time, the lowest quality stocks rose 145%, while the highest quality stocks moved up only 22%. Sustainable market rallies are seldom built on lower quality stocks. While we believe that the March 9th market levels were overly pessimistic, we are only cautiously optimistic for the mid-to-longer term. It would not surprise us to see the market retreat from its current levels during the next few months.

Economic Overview

A new term has entered the investment lexicon. Federal Reserve Chairman Ben Bernanke used "Green Shoots" to describe every possible statistic that might point to recovery in the economy. It has been said many times that the four most dangerous words in investing are "This time is different." While we are seeing improvements in the economy, we believe that this recovery will be different (and slower) from previous recessions. Let's take a look at some of the issues facing the recovery and the economy.

The primary issue is that our economic landscape has changed so much that any comparison to post-World War II recoveries is misleading. We have come to the end of a long cycle of increasing debt that has left us with an overleveraged society. The process of unwinding this leverage and reducing this debt is going to take a long time and have a significant impact on the rate of growth in the United States and international economies. PIMCO's CEO and Co-CIO, Mohammed El Erian, has referred to this as "moving to a new normal."

In our opinion, the new normal will be characterized by a new and lower level of consumer spending and reduced leverage. At this new level, the need for stores and malls will be less. We have already seen what less consumer demand can do to the airline and auto industries. Our economy will grow, but it will be a slower, more sustainable growth than we have seen in economic recoveries. We are already seeing consumer savings increase. If the consumer increases his savings rate to 7%, consumer spending decreases by 7%. The consumer accounts for almost 70% of our GDP. If our savings rate increases, we will see a reduction in the amount the consumer contributes to GDP and economic growth. This reduced level of consumer spending and consumption becomes the new normal.

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While unemployment numbers are “less worse” in May and June, in the new normal world we will produce less to respond to lower consumer demand. This could cause unemployment to remain at higher than normal levels. A consumer who saves more (and spends less) and an economy that de-leverages will have an effect on the growth of corporate profits and stock prices. These issues are not isolated to the United States; these are global issues. The emerging economies will have to adjust to lower U.S. and European consumer spending. The U.S. economy is further complicated by the fact that we are still not sure what level government spending and increased taxation will take in the future.

We believe that the U.S. economy will get back to 3% GDP growth and 5% unemployment at some point. It is just going to take some time and this recovery may be slower and “different” than others we have seen since WW II. Our economy will innovate and create new technologies. These new technologies will create jobs and industries we have yet to imagine. This will assist in the growth of the economy, much as we did coming out of the late 1970’s. The economy is at a point in the cycle where we will need to work through our excessive debt and de-leverage our finances. We have started a recovery from this recession, and we believe the worst is behind us, but we also believe this recovery will be longer and growth slower than in previous recoveries. We need to adjust our expectations.

Critical Factors

We see indicators that point to recovery for the economy and the markets. In the bond markets, we are beginning to see credit markets function more normally. Credit spreads are starting to tighten and, while still higher than normal, have improved substantially over the last few months. This has increased the risk appetite of investors and has improved corporate ability to raise debt capital. We have also seen the yield curve turn to a positive slope, suggesting a recovery. The Federal Reserve and Treasury Department have pumped massive amounts of liquidity into financial markets and have provided backstops to improve the functioning of the credit markets. The risk we see is the timing of the Federal Reserve’s exit. Too early and we may face an additional economic downturn. Too late and we could see rapid inflation.

The unprecedented amount of stimulus applied to the global economy will continue to support recovery and global growth. Global interest rates are currently low and should lead a recovery. Consumer confidence shows signs of improvement, but the situation is fluid. We see a consumer who is reducing debt, de-leveraging and saving more. These issues support our theme of a slower, longer recovery.

The stability of the housing market and residential real estate prices continue to be questionable. While we are seeing “less worse” housing numbers, we face the prospect of increasing foreclosures, decreasing home values, and a significant supply/demand imbalance. We recently ended the foreclosure moratorium period and are starting to see an increase in new foreclosure filings. We are also starting to see an increase in the number of “prime” mortgages going into foreclosure as unemployment and decreasing home values have begun to impact the more affluent sector of the housing market.

There is still a massive amount of liquidity on the investment sidelines. Money market accounts are estimated to hold approximately \$4 trillion. This is equal to almost 40% of the market value of the Wilshire 5000. As we begin to see the risk appetite of investors increase, this money could move off of the sidelines and into the stock and bond markets.

The Index of Leading Economic Indicators has been positive in April and May and, for the first time since 2007, the Index has been positive for the trailing 6 months. This is supportive of an economic recovery taking hold. Overall, we are beginning to see some steady improvement in economic data that is in line with our thesis of a gradual recovery that may take some time to be fully recognized.

Review of 2nd Quarter 2009

Index	Q2 Performance %	Description
Dow Jones Industrials	11.01%	Large Cap Stocks
S&P 500 Index	15.93%	Large Cap Stocks
NASDAQ Composite	20.05%	Large Cap Tech Stocks
Russell 1000 Growth	16.32%	Large Cap Growth Stocks
Russell 1000 Value	16.70%	Large Cap Value Stocks
Russell 2000 Growth	23.38%	Small Cap Growth Stocks
Russell 2000 Value	18.00%	Small Cap Value Stocks
Russell 3000	16.82%	Small Cap Value Stocks
MSCI EAFE	25.85%	Europe/ Australasia/ Far East
MSCI Emerging Markets Equity	34.84%	Emerging Markets
30-Day Treasury Bill	0.05%	Short-Term Bonds
Barclays Capital US Aggregate Bond	1.79%	US Government Bonds

Fixed Income

We continue to see opportunities in the fixed income markets. We have seen the yield curve turn positive, and investor risk appetites increase as money flows out of U.S. Government instruments and into corporate bonds, municipal bonds and high yield securities. This is evident as the rate on the 10 year Treasury has increased from 2.06% at the end of 2008 to 3.53% on June 30. We still have a bias toward higher quality fixed income in the form of investment grade corporate bonds, mortgage backed securities, and general obligation or central service revenue (water and sewer) municipal bonds. TIPs continue to provide an inflation hedge in a fixed income portfolio and have the guarantee of the government.

Equities

We have seen a significant increase of the over-sold level of early March. However, we are concerned with the sustainability of this rally, given its low quality and the “less worse” economic indicators we are seeing. While these improving indicators could be the beginning of an economic recovery, we would not be surprised to see a short-term correction as the market waits for additional reinforcement. The “green shoots” phase of this rally is over and the market is looking for some “green stalks.”

We have a current bias towards domestic equities over developed international economies. The stimulus in the United States has been more aggressive and applied earlier in this crisis than in other developed international economies. The U.S. was also the first into this global recession so it stands to reason that we may be the first out. In the U.S. stock market we favor quality large-cap and mid-cap positions. We continue to see opportunities in the Emerging Markets as countries such as China, India and some Latin American countries with commodity exposure stand to benefit as the global economy continues to recover and grow.

Alternative Asset Classes

Commercial real estate continues to face its own set of challenges as the economy begins to recover and grow. While residential real estate attempts to find a bottom, we believe the commercial market, and in particular the retail and office space, may begin to experience some issues associated with a weak economy. As a result, we believe REITs have a place in portfolios, but selectivity by real estate property type is especially important during these times. Commodities and commodities futures contracts have performed well and we believe that these asset classes make sense as hedges to possible

future inflation and as a portfolio diversifier.

Finally, for clients seeking a higher level of income in their portfolios, we are reviewing Master Limited Partnerships (MLPs) as possible additions to fixed income portfolios. This asset class can provide higher levels of tax-advantaged income and a possible equity-like hedge to a pure fixed income portfolio.

Recovery and Slower Growth

As we have noted in previous summaries and commentaries, we believe that the worst of this recession is behind us. The Great Depression scenario is probably not going to be a reality, and, in fact, we are beginning to recover from the very serious recession of the past 18 months. The recovery, however, will take time and we need to adjust our expectations to account for that. We are cautiously optimistic on equities in the short term, have a bias to the higher quality areas in fixed income, and are adding non-correlated asset classes to provide potential hedges against inflation in our portfolios.

Investing client portfolios in a prudent manner requires us to address several items. We address your liquidity needs and ensure that assets are available at all times. We invest the core portion of a portfolio to meet market returns and, if appropriate, invest a portion of the portfolio to attempt to outperform the broad markets.

As always, it is a privilege to have you as clients and friends. Please contact us with any questions or comments. We encourage you to exercise patience as investors as the economy begins to move out of recession to recovery. Although the worst may be behind us, we still believe that current market risks warrant prudent, diligent and conservative investment strategies.

Best Wishes!

The views expressed are not necessarily the opinion of FSC Securities Corporation, and should not be construed directly or indirectly, as an offer to buy or sell any securities mentioned herein. Investing is subject to risks including loss of principal invested. No strategy can assure a profit nor protect against loss. With any investment vehicle, past performance is not a guarantee of future results.

S&P 500 Composite Index is an unmanaged index of 500 common stocks and is typically representative of the U.S. stock market. Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs or expenses.

Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

Investments in real estate have various risks including possible lack of liquidity and devaluation based on adverse economic and regulatory changes. As a result, the value of real estate may fluctuate resulting in the value at sale being more or less than the original price paid.

The price of commodities is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities is widely unregulated and concentrated investing may lead to higher price volatility. In addition, investing in commodities often involves international investing in emerging markets, which involve significant risks. Please consider all of these risk factors before making a decision to invest in any product.