



Quarterly Commentary
January 2010

Following a perilous but ultimately rewarding 2009, we start 2010 with all eyes on our fiscal and monetary health providers.

For the time being, it feels good to have moved along the recovery path. As the chart below shows, the twelve month period ended with healthy returns in virtually all major investment categories. The notable exception was U.S. Treasuries, which posted a 3.7% loss as a group, and losses of 10% or more for maturities beyond ten years. This means 2009 was a mirror image of 2008, a year in which Treasuries posted a double digit gain, having benefited from a dramatic investor flocking to safety while everything else suffered major declines. In 2009, RINET portfolios definitely were helped by their tactical shift back into a number of stock and bond categories at the beginning of the year, the move based on the belief that depressed pricing levels were reflecting an overly fashionable bearish view.

	Q409	2009	10 Year Cumulative Return
S&P 500 Index	6.04	26.46	-9.10
Domestic Equity Growth	7.65	37.01	-32.03
REITs	11.50	30.50	179.80
International Equity	2.18	31.78	12.38
Emerging Markets	8.55	78.51	154.28
U.S. Treasury	-1.32	-3.72	81.32
Municipal Bond	-1.27	14.45	87.95
International Bond	-1.54	7.80	95.94
Corporate Bond	1.22	19.76	88.89
High Yield	6.04	57.51	88.05

Data as of 12/31/09 Indices: S&P 500; Russell 3000G; NAREIT; MSCI: EAFE, EM; Merrill Lynch: Treasury, Muni, Global Broad x U.S., Corporate, High Yield II

As the chart also shows, the decade as a whole was mixed, to say the least. It was a horrendous ten years for the overwhelming majority of U.S. investors who favored their home stock market. The 9.1% cumulative loss for the S&P 500 including dividends puts the decade behind even the 1930s, until now the worst calendar decade on record for the index; the earlier period, marked by the Great Depression, ground out a 10.1% cumulative gain thanks to a higher dividend. (The spread between the two decades is even worse if you inflation-adjust the numbers, as the 1930s were a deflationary period.) Investors unfortunate enough to be only in U.S. growth stocks – an equity group that many favored following its surge in the late 1990s – suffered a dizzying 32% decline in the 2000s, never recovering from steep losses in the early years.

The table also speaks well for diversification over longer periods. Having emerging market stocks certainly would have been a plus. While the U.S. stock market entered the new decade in a frothy state, emerging markets had been impacted by various late 1990s currency crises, notably in Thailand, Russia, and Korea. Ten years later, the stocks proved to have been relatively cheap. The table also illustrates the stabilizing effect of fixed income exposure. For all the recent gyrations within the various bond categories, the five listed provided remarkably uniform returns over the ten year stretch, about 6.5% on an annualized basis. Finally, a commonly watched real estate investment trust (REIT) index listed in the table turned in a healthy ten year return, overcoming a 47% plunge over 2007 and 2008, the years that the real estate crisis took full hold of investor consciousness.

The recent stock market gains, bringing us to about a 70% rise from the March 2009 lows, have been supported by the early stages of economic recovery, as most developed countries emerged from recession over the last several months. In the U.S. economy, after a second straight very negative quarter to start 2009, followed by a smaller second quarter decline and then a 2.2% gain in the third quarter, we may see growth of around 5% in the fourth quarter. This would trim the 2009 slide to about 2.5% and set the stage for growth in 2010. The other G7 economies also appear poised to grow in 2010. In addition, stocks are pricing in a healthy improvement in corporate earnings. A sharp increase is all but guaranteed in the fourth quarter, as it will be compared to the all-time lows of a year ago. This will break a nine quarter string of earnings declines compared to the corresponding period twelve months earlier.

Continued firmness in equity prices will depend on solid evidence in 2010 that this improvement in economic and corporate fundamentals has staying power. Any signs that it is only a brief awakening could bring stocks significantly lower. In order to weigh the sustainability question, investors will closely follow private sector performance as massive federal support programs run their course. As we've seen, the first ever synchronized global recession that hit peak impact a year ago was met by a first ever coordinated response by an array of "health providers" – the world's main central banks, and fiscal entities such as our Treasury and its counterparts overseas. It is somewhat telling that what turned out to be roughly a \$2 trillion loss of global economic output (a 3.6% drop off a run rate of \$55 trillion) was matched by fiscal stimulus programs in various countries that add up to about the same number, the largest two being our \$787 billion and China's \$586 billion, along with some \$400 billion across Europe and \$155 billion in Japan. While in various stages of implementation, these programs are one-timers, and their impact will ebb this year and next.

The central banks also are looking at exit plans, and the coordinated approach borne from the crisis has given way to a more normal focus on doing what's best for their respective home markets. Our Federal Reserve faces a daunting array of delicate issues. Because it is positioned at such an extreme in its monetary ease – notably the 0-25 basis point federal funds rate in effect since December 2008 and the dramatic expansion of its balance sheet to accommodate the purchase of up to \$1.25 trillion of mortgage-backed securities along with \$300 billion of U.S. Treasuries – many feel the bank needs to start

moving back to a more normal stance now, even if it seems early given the newness of the housing and broader economic recovery. Market historians who worry about this move coming too late don't have to reach very far back for a cautionary parallel: Alan Greenspan's persistently low rates during the middle part of last decade, following the recession in 2001 and 2002, are cited as the main culprit behind the housing bubble.

At the same time, it will take a great deal of fortitude for Ben Bernanke to embark on a policy path away from ease at a time of severely idled workers, whose weakened state threatens any recovery in our economy given its heavy reliance on consumer spending. A return to measurable monthly job growth remains elusive after two years of losses totaling more than seven million. The latest reported unemployment rate of 10.0% translates to 15.4 million people out of our current workforce of 154 million; adding on those that are underemployed, which includes those working short hours and/or at low wages, or who simply have stopped looking for work, brings the percentage to a very sobering 17.5%, meaning there are nearly 27 million workers who do not enjoy productive employment as the new decade begins. Clearly, this points to an extended period of diminished economic output.

The Fed also is navigating through a fragile housing recovery as it considers whether to stick to its stated plan to end, by March 31st, its direct support of the mortgage market through the \$1 trillion-plus security purchase program. The program has helped keep mortgage rates around 5%, a historic low, since December 2008, when the plan was unveiled. The combination of 20-25% lower house prices and low rates has significantly improved affordability levels. Recent reports indicate meaningful recovery in the rate of existing home sales, which has led to a reduction in inventories back toward reasonable levels – just over six months' worth compared to more than nine months a year ago. Pricing also appears to have stabilized. But in recent weeks, mortgage rates have begun to creep higher – to 5.2% recently, up from 4.9% a month earlier – as the possible end date of the Fed program approaches.

Needless to say, this has been no garden variety crisis. The scale of its impact and the unprecedented direct effect it had on the financial system itself called for extreme measures to prevent even greater catastrophe. Many of these measures appear to have achieved their immediate objectives. But extremes are, by definition, temporary. In theory, the Fed could expand or extend its security purchase and other quantitative easing programs without limit. But in reality, they are a stop-gap response to extenuating circumstances that brings a major inflation threat down the road, given the large amount of dollars that are injected into the system. Therefore, they cannot be open-ended.

In the near term, many sectors of the economy are likely to benefit from the early stages of recovery. Manufacturers in many technology, capital equipment and construction-related businesses have been operating at bear minimum inventory levels, and now face a need to restock within a growing economy. This could result in labor call-backs and improved business along the supply chain. After a very difficult and unforeseen experience a year ago, retailers entered this past holiday season much more prepared and kept their inventories lean as well; following reasonably solid holiday sales,

replenishment of shelves may be needed. And as indicated by strong movie attendance in recent weeks, consumers are not house-bound.

As 2010 progresses, we will get a better sense of the recovery's sustainability, and most critically, whether it will prompt a meaningful restoration of permanent hiring. While we would not discount the power of entrepreneurialism and a basic drive to get ahead in market economies, and what that implies for longer term growth and job creation, our inclination is to be careful with the current times. It would not surprise us to see economic output in the G7 taper over 2010, leading to something around a 3% growth rate here for the year and lesser rates in Europe and Japan. This would represent a well below average performance for an initial year following a recession. China enjoys strong economic growth, and it has accelerated to the 9% level recently, but may face a need to clamp down on aggressive borrowing, which has contributed to its own overheated real estate market.

The hand-off from public to private sector growth will be rife with uncertainty and false starts. This tends to work against financial markets. At the same time, it will create opportunities. As we move away from the globally synchronized monetary and fiscal support to normal go-it-alone policies, we should see enhanced investment opportunities, on both the long and short ends, in a broadly diversified, global program such as ours. The key in our view will be to maintain an adequate level of flexibility, a quality bias and, always, the highest possible standard for manager selection.

Going into this year, we are slightly trimming our exposure to non-U.S. stocks, reducing U.S. bond commitments, and removing the Treasury Inflation Protected Security (TIPS) investment. All three were increased a year ago – at that time, additions were made to U.S., non-U.S. and emerging market stocks, along with U.S. bonds, TIPS and high-yield bonds. This was a sizeable program on a portfolio basis and these investments have done well in the intervening twelve months. Additions this year are being made to hedge funds that focus on global macro and arbitrage strategies, as they should be well-positioned to exploit various spreads that result from the return of non-synchronized policy approaches among the world's central banks. Finally, we are moving the REIT allocation from zero back to its small neutral weight, as worst-case scenarios now are well established and appear baked into valuations.

We hope the early days of the year and decade are treating you well. Thank you for your continuing support and loyalty. As always, we are easy to find if you have any questions, comments, or concerns.

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