INVESTMENT COMMENT — March 20, 2009
Market "Snapshot", Perspective, and Political Risk

On March 9, the US stock market closed at its lowest level of the year. In the 8 trading days since then, markets have improved dramatically. In fact, all asset classes we track had positive returns in this short period. Although picking "winning" asset classes over any particular period of time never works with any consistency, during recent weeks it would have been even more difficult as several asset classes saw wild reversals. Benchmark portfolios structured with static levels of exposure to various asset classes now range from -2.6% to -7.7% year-to-date, depending on risk allocation.

The question on many people's mind is: Have we seen the lows? Is the rally sustainable? No one knows – there are simply too many variables to determine future corporate profits, which the capital markets can value. We have macroeconomic uncertainty, financial system concerns, and a political process that is, at best, distracting policy-makers from real issues. While there has been substantial progress made in stabilizing the financial system, many important areas remain "under repair".

Selected Asset Classes March 19, 2009	Since 3/9/09	YTD Return
TOP-5 EQUITY RISK ASSET CLASSES		
International Real Estate	**+26.0%**	**-18.3%**
US Small Cap Value	**+22.6%**	**-21.4%**
US Small Cap Core	**+20.5%**	**-16.9%**
US Mid Cap Value	**+19.7%**	**-16.6%**
US Small Cap Growth	**+18.5%**	**-12.0%**
TOP-5 FIXED-INCOME ASSET CLASSES		
International (Non-US Dollar)	**+7.0%**	**-2.9%**
US Treasury Inflation-Protected	**+5.4%**	**+3.1%**
Emerging Markets Bonds	**+3.8%**	**+1.4%**
High Yield Intermediate	**+3.1%**	**+1.5%**
US Treasuries 7-10yr	**+2.5%**	**-1.2%**
EQUITY INDICES		
MSCI World Index	**+16.7%**	**-12.2%**
S&P 500 Index	**+16.0%**	**-12.6%**
BALANCED PORTFOLIOS		
Vanguard 60/40 Fund	**+10.1%**	**-7.1%**
DFA 60/40 Fund	**+12.1%**	**-7.7%**
DFA 25/75 Fund	**+5.5%**	**-2.6%**

Source: Bloomberg Professional
Note: Returns include reinvested dividends.

There is reason for optimism. The Federal Reserve and FDIC have established and are implementing numerous programs targeted at stabilizing and restoring important aspects of our financial system. *Just today, the first securitizations of credit cards and auto loans have come to market with the help of a Fed program aimed at restoring this important aspect of our financial markets*[1]*.*

There is also cause for concern. The $700 Billion TARP program, initially devised to remove complex, illiquid securities from bank balance sheets morphed into a government investment program across most firms in our financial system[2]. TARP provided immediate capital injections to bank balance sheets and served to assuage near-term liquidity concerns. The real issue of creating a mechanism for banks to clean-up their balance sheets by removing so-called "toxic assets" has yet to be resolved. Market participants are eagerly awaiting the announcement of public-private initiatives focused on this issue. ***Unfortunately, this week's major populist reaction to AIG's payments made on contractual compensation agreements has been seized-upon by Congress as an opportunity to utilize TARP as a tool to abrogate such***

[1] There are several substantial programs. Call me if you are interested in discussing details.
[2] See Investment Comment, November 23, 2008 at www.marylandcapitaladvisors.com.

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contracts. This sets a dangerous precedent for non-employee contractual counterparties and raises concern among market participants now considering involvement in public-private programs aimed at restoring financial markets.

The implications for our financial system from current Congressional antics are important for investors to understand and monitor. First, as taxpaying owners in many important financial institutions, we should be concerned that our collective investments are now being dominated by politics, rather than serious concern for financial stability. Second, the politics of TARP will incent financial firms to repay TARP loans early – which will result in taxpayers owning investments in only the worst firms that are unable to repay early. In business we call that adverse selection, and that is not good for taxpayers. Third, the financial system is far from healed and early repayment of TARP loans may increase investment risk in institutions that choose to return TARP capital. ***Essentially, the purpose of TARP and ultimate return on investment has been placed at risk.***

This week's announcement by the Fed that it will purchase $300 Billion in long-dated US Treasury Notes, an additional $750 Billion of mortgage-backed securities, and another $100 Billion of agency debt was perfectly-timed to offset the negative impact of a degraded TARP program. In a television interview earlier this week, Fed Chairman Bernanke stated that the biggest risk to economic recovery was a lack of "political will" to do what is necessary. *Judging by the experience of this week, that seems like a very real risk, indeed.*

As investors with long-term horizons, how can we ensure that we adhere to a strategic approach to portfolio management in the midst of increased market volatility, political and regulatory change, and economic turmoil? We continue to focus on the following questions:

- Is my level of risk-taking prudent given my circumstances?
- Are my investments providing the risk exposure intended?
- Are there risks embedded in some investments for which the portfolio is not being compensated enough?

For the first question, it is always important that we update the answer in light of our changing personal situations. It is also good to be cynical – in making the initial decision on how much risk to take, did we rely too much on recent historical experience? If so, perhaps a longer-term perspective that considers the worst of historical periods as possible future outcomes would lead to a more successful long-term strategy, because we can let periodic risk-rebalancing "buy low" and "sell high" over time. The next two questions are the basis for daily work in evaluating portfolio investments and relative value.

Our year-to-date investment activity has been centered on client bond allocations. We have continued to accumulate attractively-priced holdings in Investment Grade corporate bonds, GNMAs, and some Asset-Backed Securities. We remain mindful of our discipline by holding a considerable amount of FDIC-insured Bank CDs.

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