

Quarterly Review and Outlook – Fourth Quarter 2009

After a dismal 2008 that bordered on tragic, 2009 was a year of recovery and what a recovery it was in terms of asset prices. Bonds and stocks surged after March 9th and have generated one of the strongest market rallies in history. We were not surprised by the direction of the market this year but the absolute returns were surprising due to what we believe is a recovery that has not proven itself to be self-sustaining. For the year stocks were up across the board. The S&P 500 finished the year up 26% while stocks from developed international markets were up 32%. In the US, Mid Cap stocks led the way up 40% while emerging markets were the strongest market of all up 79%. Bonds were no slouch themselves with the Barclays US Aggregate up approximately 6%. Spreads declined dramatically from disaster scenario levels and pushed high quality corporate bonds up 13% and high yield up 44%.

Much is being made of the lack of return for stocks during our first decade of a new millennium. It's true that the annualized return for the S&P 500 over the last 10 years is -0.95% and -5.7% for the NASDAQ. I think this reflects the level of overvaluation for large caps that we experienced in the last decade of the 20th century. We also faced two recessions during that period that had a major impact on economic activity. However, not all stocks declined during the decade just ended. Mid Caps generated annualized returns of approximately 5% and small caps were up about 3.5%. International stocks were up 2% over that same period. Our point is not to suggest that returns from stocks have been robust. Instead, we want to highlight that not all asset classes within equities experienced negative performance and a well thought out asset allocation allowed for positive returns. In our view, valuation was the major factor driving these returns and will continue to be going forward.

2010 and Beyond

The turn of the calendar is always an interesting time for the investment community because it is time to look ahead. Wall Street becomes littered with outlooks about what is going to happen in the coming year. I have to admit that I welcome these outlooks and spend too much time reading them looking for an astute observation or recommendation that we need to consider. Most of the time they provide insight into the consensus view for the coming year. On top of that, the consensus almost always tends to be bullish...the market/economy will get better, they will be good, or they will be fantastic. Never are we treated with a consensus view that warns of dangers on the horizon indicating it is time to hunker down, but understanding the consensus allows us to make prudent decisions and allocations for our clients while keeping our eyes open for challenges that may arise.

Coming into 2009 the consensus view was that the economy was beginning to back up from the precipice of total financial meltdown, the markets would recover eventually, and the economy would turn out ok. This view was largely correct, however, I would say the recovery is much more unstable than most would prefer. Job losses, totaling over 7 million, have been horrific and while they are getting smaller each month, we are still losing jobs. The financial position of the US has become much more precarious with expanding fiscal deficits and a generally weakening currency. Housing, while becoming more stable, is still a long way from recovery as foreclosure activity is at historically high levels and prices continue to be weak. Challenges remain significant and reversing the effects of financial deleveraging is taking far longer than the consensus expected. Despite these challenges, the equity and fixed income markets experienced a tremendous rally that will go down in history as one of the strongest and most rapid.

Turning to 2010, I would summarize the current consensus as expecting the economy to continue its recovery turning into a self-sustaining recovery lasting several years. The rate of growth in GDP will be positive but

will be more subdued due to overhanging issues affecting the economy like deleveraging, unemployment, and housing. Inflation will remain low due to the output gap between capacity and utilization, but most expect inflation to rear its ugly head at some point in the future. Equities will continue to rally on strong earnings growth and returns from bonds will be acceptable as yields are attractive in a zero percent interest environment. The Fed is in a tough position but will be ready to remove stimulus when the time is right and that may be in the second half of the year or early 2011. We have a hard time arguing against this consensus view and it may very well be correct. Despite the challenges, this performance from the economy and the markets is the porridge that Goldilocks would love. Just right.

My assistant Sallie Chasteen, whom many of you have met, gave me a birthday card last year that still sits on my desk. The front of the card is two men walking past one another and as they pass they both look back at the other. One man is fully clothed and the other is naked (he is the one walking away...thankfully). The quote is from General George S. Patton and reads "If everybody is thinking alike, then somebody isn't thinking." I saved this card because it reminds me that our job is to be prepared for the unexpected and to challenge the consensus. As I said, it is not hard to buy into the current consensus view and such a result would be positive for the markets. In other words, nothing bad happens and we experience positive performance in the market in 2010.

United States: Shiller's Cyclically-Adjusted Price-to-Earnings Ratio*
(percent)

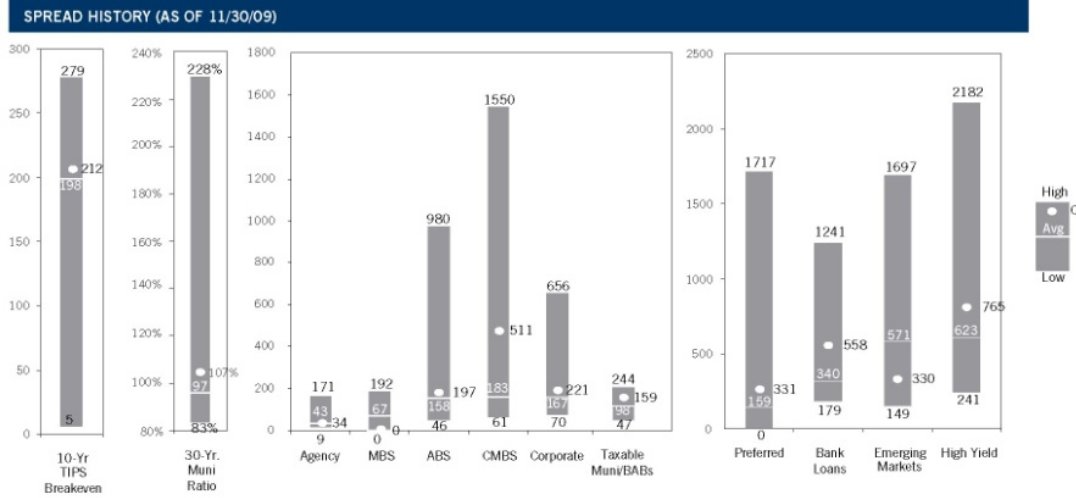


*Robert Shiller's measure of the price-to-earnings ratio for the S&P 500 uses the 10-year average of as reported earnings. Both earnings and prices are inflation-adjusted.
Source: Robert Shiller ("Irrational Exuberance"), Gluskin Sheff

Our general view is that 2010 is going to be a more difficult year for earning good returns. We achieved very attractive returns in 2009, but we benefitted from a rising tide that lifted all boats. We believe the equity market is no longer cheap and is much closer to fair value. The following chart is the P/E ratio on the S&P 500 from Shiller. It shows stocks to be overvalued on this measure. Other valuation metrics show it to be fair value assuming earnings continue to recover, while other metrics argue that stocks remain very cheap. We believe

stocks can continue to generate attractive returns but good things have to keep happening. Because we recognize that stocks are priced for a positive environment, it also means that the market can be disappointed. Therefore, we are relying on good asset allocation decisions to protect capital if we are wrong. We have often said we would rather be too conservative and wrong than be too aggressive and wrong.

With respect to bonds, credit spreads have declined dramatically. The following chart is provided by Eaton Vance and shows general spread levels to US Treasuries for many segments of the credit market. Early in 2009, buying spread product was an easy trade but today the cheapness in bonds has declined dramatically as spreads tightened and bond prices rose discounting a better economic environment. Bonds represent good value if the economy continues to improve; however, good asset allocation is our best remedy to guard against another economic decline. The big issues relating to fixed income will continue to be inflation and the prospect for higher interest rates and our short duration position will help protect against those two possible outcomes.



| | 10-Yr TIPS Break-Even | Muni Ratio | Agency | MBS | ABS | CMBS | Corporate | Taxable Muni/BABs | Preferred | Bank Loans | Emerging Markets | High Yield |
|--------------------|-----------------------|------------|----------|----------|--------|----------|-----------|-------------------|-----------|------------|------------------|------------|
| Max Spread Date | 3/22/05 | 12/18/08 | 11/20/08 | 12/23/08 | 1/5/09 | 11/20/08 | 12/5/08 | 4/7/09 | 3/9/09 | 3/10/09 | 9/10/98 | 12/15/08 |
| Min Spread Date | 11/20/08 | 1/23/98 | 4/3/98 | 11/25/09 | 4/8/98 | 2/10/05 | 12/31/97 | 3/10/05 | 3/8/06 | 3/13/07 | 6/1/07 | 6/1/07 |
| Spread on 12/31/08 | 12 | 197% | 87 | 165 | 967 | 990 | 604 | 236 | 773 | 1028 | 690 | 1812 |
| Spread on 12/31/07 | 232 | 100% | 49 | 92 | 211 | 176 | 203 | 100 | 318 | 312 | 239 | 592 |
| Spread on 12/31/06 | 230 | 87% | 25 | 45 | 51 | 63 | 91 | 54 | 19 | 205 | 169 | 289 |

Past performance is no guarantee of future results. It is not possible to invest directly in an index.

Source: Merrill Lynch, S&P/LSTA, JP Morgan, Bloomberg and Eaton Vance. Data inception dates: 12/31/97 for all indices except the Bank Loan Index which starts on 9/30/01.

Skate to where the puck is going to be

The above quote is from Wayne Gretsky who is widely regarded as one of the greatest if not the greatest hockey player in history. In fact, his nickname is "The Great One" telling you what people thought of his abilities. His greatness was due in part to his ability to skate to where the puck is going not where it was.

We are not so bold to compare ourselves to Wayne Gretsky, but our objective is to find these opportunities when the risk is low and returns are attractive. Each day we ask ourselves whether client portfolios are positioned to meet their individual goals and objectives based on how we view the opportunities in the markets. As this letter is written, we believe returns will be harder to generate than 2009 so we must be cautious in our allocations and continue to make good decisions.

We have already stated our belief that stocks and bonds represent good value and should continue to help generate good returns. But we also believe that the rally in both stocks and bonds last year make our outlook for returns in 2010 more subdued. We believe this will be a market where skilled managers who have a team, philosophy, and process can generate good returns while protecting capital when markets decline. Alternative strategies where our managers have more ability to hedge their risk to the market remain one of the more compelling allocations. We believe distressed debt continues to offer a compelling risk/reward tradeoff. We have been analyzing a potential manager that invests in sovereign debt and currencies, which is not that unique, but they also hedge their allocations and do this in a liquid mutual fund vehicle. We heard one of the portfolio managers for this fund speak recently and we are attracted to the very low correlations to the equity and fixed income market but our research continues.



The role of the US Government in the financial markets

This is not a political statement, but as the heavy hand of government gets more involved in the financial markets it is more relevant for us as investment managers. Our government has dealt with aspects of this current financial crisis in ways that has distorted a normal working market. It has taken actions that are unsavory for certain investors who rely on fairness from our government. The bankruptcy of GM and Chrysler and the merger between Bank of America and Merrill Lynch are examples where government got involved and investors were harmed. Now we are learning about the Federal Reserve Bank of New York forcing certain information relevant and material to AIG investors to be withheld.

Withholding information, forcing certain actions, and changing the rules are likely to become more prevalent in an environment where government is more involved in the process. This behavior breeds mistrust and uncertainty and weakens the capital markets ability to allocate capital efficiently and effectively. Some may say these were necessary actions and we may not argue that point. But the larger point is that going forward we need to be mindful of potential intrusions into the capital markets and accept more uncertainty as investors. To us, more uncertainty means we must require a greater margin of safety for our investments. We will continue to keep a keen eye on this trend.

In closing, our view continues to be cautious, however, we are very optimistic that the global economy will fully recover in time and stock and bond positions will be rewarded. Our focus on tailoring each client's asset allocation to ensure we meet individual goals and objectives will continue.

As you review your quarterly report, please do not hesitate to contact me with any questions. I look forward to seeing you soon. Thank you.

Best regards,

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