Economic & Market Outlook

- In March, the Treasury unveiled details of the Public-Private Investment Program (PPIP). This program is designed to remove toxic assets from bank balance sheets, and subsequently increase the flow of credit. The program will offer qualified private investors to invest in troubled real estate loans and securities currently held by banks, with the help of attractive government financing.
- The U.S. stock market rallied in March primarily due to a positive response to the Treasury's proposed Public-Private Investment Program, as well as some positive news on the economy. U.S. stocks as measured by the S&P 500 rose 8.76%, and foreign stocks as measured by the Morgan Stanley-EAFE were up 6.34%.
- The Commerce Department recently confirmed that U.S. GDP declined at an annualized rate of 6.3% in the fourth quarter of 2008. This marked the steepest decline for the economy since 1982. Looking ahead, we expect the global economy to contract over the next several quarters, with U.S. recovery coming in late 2009 or possibly early 2010.
- Due to the slowing economy, unemployment reached 8.1% according to the most recent report. We expect the level of unemployment to rise even higher in the coming months.
- Federal Reserve officials have cut interest rates to historic lows, and are now targeting rates in the range of 0%-0.25%. The Fed has indicated rates will continue to stay low for an extended period of time.
- On March 18, the Fed announced that to reduce consumer and business borrowing rates, it was purchasing $300 billion in U.S. Treasury securities, and buying an additional $750 billion agency mortgage-backed securities on top of $500 billion in purchases announced in November. While longer-term Treasury yields will fluctuate, we expect the Fed to be successful in limiting large upward moves in interest rates. After the Fed completes its purchases, and if evidence of an economic recovery appears in the next 12 months, Treasury yields will likely rise. In the meantime, money market yields will likely remain near zero for all of 2009. We conclude that investors are better off purchasing intermediate-term non-Treasury bonds with significantly higher yields than waiting in money market for the Fed to hike rates.

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- We favor agency mortgage-backed securities, taxable municipals with A or better underlying credit ratings, and AAA-rated agency bonds with low or no call risk. We believe regulatory and political risk is too high to merit purchasing financial bonds issued by financial firms at this time. While many industrial and utility bonds represent good values, their prices may suffer in a negative investor reaction if Chrysler and General Motors make bankruptcy filings.
- Tax-exempt municipal bonds continue to be attractively priced relative to Treasuries and historical average yields. The supply of Minnesota tax-exempt municipal bonds continues to be tight, which has increased prices and lowered yields, especially in shorter maturities. The high-grade national market offers good value, but is not cheap enough for residents of high-tax Minnesota to switch to a national portfolio.
- We continue to buy and hold municipal bonds with strong credit ratings, and see value in the 11-20 year part of the curve, as the 0-10 year segment is crowded with more buyers than sellers.
- With Treasury yields falling, the dividend yield on the S&P 500 now slightly exceeds the yield on the 10-year Treasury, a relationship not seen since the late 1950s.
- We believe the equity markets can achieve better returns in the latter part of this year compared to the first half of the year, as investors anticipate an improving economy. Overly optimistic expectations of a quick revival of the U.S. economy starting the year dimmed and expectations will have to remain muted for the next several months, although recent data is somewhat encouraging.
- Within the equity markets, we remain fully diversified but continue to prefer domestic stocks over international stocks, large cap over small cap and growth over value on a relative basis. Returns year-to-date have followed this hierarchy, however developing markets have done better than other sectors on the international side.

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- We believe stocks of high quality companies with less exposure to problems in the credit markets should do relatively well in a slowing economy. Companies with significant international sales should benefit if the dollar weakens. We remain conservative and defensive in nature. We think it is still too early to stress a more progressive, riskier strategy within equities at this time.
- We encourage investors to stay focused on their long-term goals in the midst of this current market volatility. It is especially important to stay diversified and to reaffirm that our clients' current asset allocation is consistent with their long-term goals. We advise clients with time horizons of less than 3 years to remain cautious toward risky assets.

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