July 6, 2009

Client
Address
City

Dear Client:

Another quarter, another panic. However, this panic was different than the last two; it was a mirror image. While the fourth quarter of 2008 and the first quarter on 2009 were panics to sell everything except for government bonds, this latest was a buying panic of everything but government bonds. The cause for this reversal was the recognition that it appears the global financial system will avoid a complete collapse.

The markets are currently in a bit of a stalemate, with a lousy economic environment, both current and projected, on one side and non-existent returns on safe investments and significant levels of liquidity on the other. Many of the attractive opportunities in municipal and corporate bonds have dissipated of late and the stock market rallies have left many companies fairly valued or overpriced, with the exception being large, quality, dividend paying stocks, which still have some investment appeal.

The biggest concern voiced by my clients recently has been about inflation. While I can argue with equal vehemence the case for inflation, deflation or price stability, please be aware that I have built portfolios that take all three possibilities into account.

Our bond maturities are one to seven years with decent yields that will serve us well in deflationary and stable price scenarios, while an inflationary environment would allow for reinvestment of maturing bonds at higher rates. The majority of the companies we own have very little debt, nice dividends and the ability to raise prices to ward off the negative effects of inflation, if that becomes an issue. These companies also have significant exposure to overseas markets, a benefit in a weaker dollar situation.

I am not a fan of Treasury Inflation Protected Securities (TIPS) issued by the government as these securities are fairly complex in regards to pricing and the yields offered are just not attractive. I also don't care for commodities, whether gold, oil or other piles of stuff, as they provide no income and the companies that produce commodities are some of the worst in terms of economics and environmental impact. Probably the best inflation hedge is money borrowed long-term at low, fixed interest rates used to buy appreciating assets. Think of your home, with a 30 year mortgage.

The final point that I want to make is about the 4% solution. In order to determine how much money is enough for retirement, take your projected annual expenses, less any pension, social security or other income, and divide that number by 4% to arrive at the required size of your investment portfolio. This gives a rough idea as to how much is enough to retire on. There are important details that should be considered that I'd be happy to review with you if this is a concern.

Attached please find your portfolio report for the periods including the second quarter of 2009. Please feel free to call if you have questions or concerns that we need to address before I contact you.

Best regards,

Peter V. Hedberg