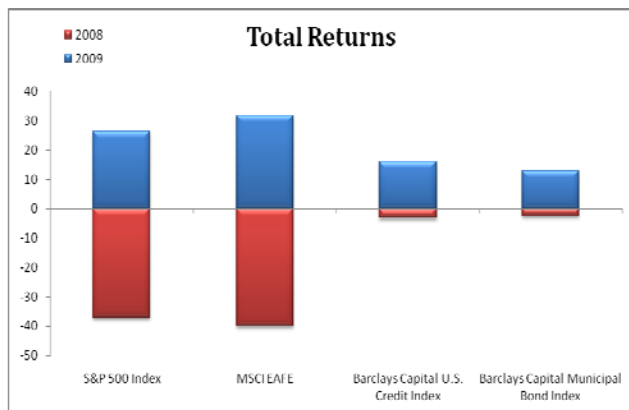




Quarterly Investment Commentary

Last year provided a nearly unprecedented roller coaster ride for investors. During the first few months of 2009, U.S. equity markets declined approximately 30% amid fears that the U.S. banking system was insolvent and that the U.S. could be headed for another Great Depression. Nine months later, the situation looks far less dire. Since bottoming in March 2009, the stock market has risen dramatically, the Federal Reserve has restored confidence in the banking system, and economic conditions have improved both in the United States and abroad.

For the full year, the U.S. stock market, as measured by the S&P 500 Index, advanced 26.46%. International markets, aided by a decline in the U.S. dollar, performed even better, with the MSCI EAFE Index climbing 31.78%. Over the course of the year, the U.S. dollar gave back nearly all of its gains from the crisis period in late 2008. Stock prices still sit well below their 2007 highs, but the rebound in 2009 reminds us that the principles of patient, long-term investing still hold true.



Source: Commonwealth/FactSet

Bond market returns in 2009 were also strong. Investment grade corporate bonds, as measured by the Barclays Capital U.S. Credit Index, returned 16.04%, while municipal bonds, as measured by the Barclays Capital Municipal Bond Index, gained 12.91%.

Looking Ahead at 2010

As we begin 2010, there are many reasons to doubt the sustainability of the economic recovery. We don't necessarily share them. The domestic economy has now experienced two consecutive quarters of positive, albeit modest, economic growth. We believe the recovery will continue, although the expansion will likely be tepid, especially compared to the level of economic growth we usually experience after a recession.

Much of the economy's improvement has been the result of the \$787 billion federal stimulus package approved in early 2009. Eventually, the effects of that stimulus will dissipate, but it's important to remember that only 25% of the stimulus has been spent so far. The majority of the money will be allocated in 2010, meaning the effects of the stimulus on gross domestic product (GDP) will be longer-lasting.

Nevertheless, at some point in the coming year, good economic news may become detrimental to the market. As the recovery strengthens, the Federal Reserve is likely to begin raising short-term interest rates from the current record lows in an effort to avoid overheating the economy.

The Fed's zero percent interest rate policy and other extraordinary stimulus measures flooded the economy last year with a sea of excess capital on which the stock and bond markets have been floating. When investors begin to anticipate Fed tightening, the equity markets may become more volatile, and the ultimate withdrawal of this stimulus could reduce the market's appetite for stocks and other risk assets.

This will also be a difficult period for Fed Chairman Ben Bernanke as he attempts to walk an economic tightrope. The balancing act will require keeping interest rates low for long enough to promote economic recovery and job growth while at the same time being mindful that keeping rates too low for too long could create inflationary pressures or another asset bubble. The risks of a policy mistake in this scenario are substantial.

Investment Implications

It was only a year ago that the global economy and financial system were teetering on the brink. Now, with stocks and bonds having recouped most of their sell-off from the financial panic, the issue facing investors, already, is whether all of the good news has been priced into the markets.

While no one knows exactly what is going to happen in 2010, our assessment is that investors should have more modest return expectations for the year. Following the outsized gains of 2009, returns in 2010 may be only average or even below average.

We are confident, though, that high quality blue-chip stocks will outperform lower-quality small company stocks this year. The rally in 2009 was strongest in the smallest, lowest quality stocks, which is fairly typical coming out of a recession. Market leadership can be expected to shift this year to higher quality companies with strong free cash flow and sustainable growth.

We also wouldn't be surprised to see at least a short-term rebound in the U.S. dollar and outperformance by domestic stocks relative to their international counterparts. The market is not anticipating this, as bearishness on the dollar continues to be widespread. But we can envision this scenario playing out, especially if the U.S. economic recovery gains momentum and Federal Reserve moves before other Central Banks to withdraw stimulus from our economy.

In the case of fixed income, we are maintaining our focus on investment grade and other corporate bonds, which should benefit from the economic recovery, and deemphasizing U.S. Government bonds, which are likely to feel the sting of higher interest rates most directly.

We look forward to another fascinating year and will remain diligent in trying to identify opportunistic investments and to protect against undue risk.

We wish you and your family the best of health and happiness in the New Year. As always, please don't hesitate to contact us if you have any questions or concerns.

***Disclosure:** Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. All indices are unmanaged and investors cannot invest directly into an index. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The Barclays Capital U.S. Credit Index is comprised of the U.S. Corporate Index and the non-native currency sub-component of the U.S. Government-Related Index. It includes publicly issued U.S. corporate, specified foreign debenture, and secured notes denominated in USD. The Barclays Capital Municipal Bond Index includes investment-grade, tax-exempt, and fixed-rate bonds with long-term maturities (greater than two years) selected from issues larger than \$50 million.*