

INVESTMENT MANAGEMENT UPDATE

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MARKET UPDATE & OBSERVATIONS

Market Index Returns	4th Qtr	1-Year	5-Year
S&P 500 Index	-21.9%	-37.0%	-2.2%
Russell 2000 Small Cap	-26.1%	-33.8%	-0.9%
Foreign Stock Index - EAFE	-21.6%	-44.4%	2.7%
Taxable Bond Index	-0.3%	-4.5%	1.7%
Municipal Bond Index	0.5%	-1.3%	1.8%

The 4th Quarter of 2008 brought devastating declines in virtually all segments of both the U.S. and global economies and all types of securities markets. **So, where do I start?**

As is my custom, I first look back at prior Updates to reflect on our comments, perspective, insight and strategies. While we have no serious misgivings about those previous comments, we've been shocked by the magnitude and breadth of this market chaos.

While prior downturns were often limited in scope, no segment or region was spared this time around. As a result, we have spent vastly more time with clients recently helping them assess their risk tolerances, financial security and appropriate asset allocations. And also a good bit of handholding, much of it focused on the importance of remaining committed to their long-term financial plan.

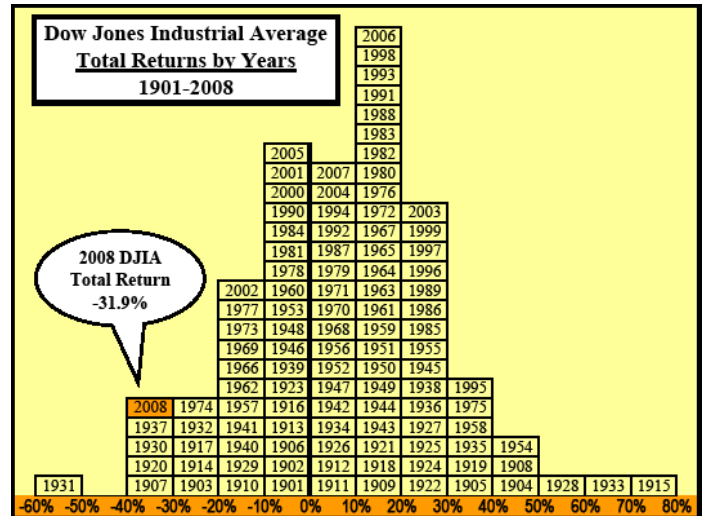
We also remain firmly committed to our philosophy, despite the economic and portfolio devastation, as this too shall pass.

EQUITY MARKET

Let's first put the stock market performance in perspective.

Please refer to the following chart that plots the annual investment returns of the Dow Jones Industrial Average for every year since 1900. This tells us a lot.

- The dispersion of returns displays the classic "bell-shaped curve, which we associate with the powerful forces of statistical probability. The peak returns fall near +10% and the median is in the range of 0%-10%. But, it's amazing that only 17 times out of the past 108 years did the Dow's return actually fall within that range of 0%-10%. So, we should expect volatility, but also long-term returns near the historical average of 5% to 10%.
- Also, 85 times out of the past 108 years (79%) returns fell within the range of -20% to +30%, and only **once** out of 108 years did the Dow's return fall in a range lower than 2008's return of -31.9%. That was 1931, during the Great Depression. So, 2008 should be considered a statistical outlier, but also reflective of our troubled economy.



Although they can be powerful indicators, enough about statistics. Let's look at the economy and the stock market.

The economy is certainly a wreck. Unemployment, mortgage foreclosures, bankruptcies, budget deficits, falling commodity prices, and bank failures are all symptoms of the severe recession. But as an economist-friend reminded me, over the past 150 years or so, we have had 21 recessions . . . and 21 recoveries. These are normal, albeit difficult, consequences of business cycles. That is the beauty of capitalism, free markets and a relatively free society. When there are extremes, either positive or negative, there will eventually be a market-driven response to bring those extremes back to or near historical averages and sometimes, overshooting them.

But some folks don't seem to get it. During a recent TV interview between CNN's Lou Dobbs and Treasury Secretary Henry Paulson, Dobbs asked Paulson about when, specifically, housing prices would recover. Paulson offered a rather misguided response. Instead, he should have pointed out to Dobbs that "They already have! Home prices have recovered by dropping back to more affordable, realistic and economically-justifiable levels."

In the meantime, homebuyers overpaid and over-borrowed for these homes and lenders over-leveraged their loan portfolios. The same can be said for investors, including us at The Trust Company, who overpaid for stocks, bonds and mutual funds, and now we are "paying the price."

But this cycle does not diminish the long-term value of diversified portfolios of stocks, bonds and mutual funds. It merely magnifies the inherent risk in these and other markets.

BOND MARKET

While the stock market has certainly gotten more media coverage, I have found the bond market displaying more dramatic and volatile reactions to these economic and market conditions. It's also offering some of the more compelling investment opportunities. But, we need to look at market segments individually because they have varied so much.

- **U.S. Treasury Market** – Treasuries (along with FDIC-Insured C.D.s) have been the only place to “hide” the past year. Even money market funds encountered a brief scare when their underlying short-term investments came under the clouds of illiquidity and credit concerns. Now with rates on 30-Year Treasury Notes dropping as low as 2.5%, investors won't likely want to hide there anymore. In fact, rising Treasury Rates may be the “next shoe to drop!” The economy won't likely have enough buyers to support the Treasury's borrowing demand, which may lead to higher rates and price losses suffered by Treasury note investors.
- **Corporate Bond Market** – Both the investment grade and high yield markets suffered sizable losses in 2008. A big part of the problem was the market's inability to find a dividing line between these two segments. So, they all tumbled. In addition, bonds exposed to the finance, housing, commodities, auto and retail industries were particularly hard hit. For example, Vanguard's Investment Grade Bond Fund lost over -6% and PIMCO's High Yield Bond Fund declined -24%.

But it may be an overreaction. We recently had a conference call with PIMCO's management. They asserted that junk bonds are being priced as if there will be a 20% default rate, but they predict defaults will actually be around 10%. Also, in 2008 the actual defaults in their fund were less than 1%. They are cautiously optimistic.

- **Municipal Bond Market** – The muni market has diverged dramatically from historical norms. Most tax-free bonds now offer yields exceeding taxable Treasury notes. Much of this pricing structure and lack of liquidity is driven by mutual funds and hedge funds that've been forced to sell bonds because of investor redemptions – a classic case of investors selling-out at what appears to be a bottom.

Even high-quality muni bonds, such as those backed by AAA-rated GNMA bonds, have tax-free rates above 6%. We've been buying blocks of these bonds and they have responded by moving up quickly in price. Even if we encounter higher inflation and interest rates, there is still lots of room before these bonds would lose their appeal.

- **Individual Bond Holdings** – We faced trouble spots in several segments of our clients' bond portfolios:
 - **Corporate Bonds** – Over the past 5-6 years, we've bought a handful of issues from lower-rated companies, primarily GM, GMAC and Ford, because we thought they had the ability to pay. GMAC also offered some diversification because of their large and profitable mortgage business, but that back-fired when the home mortgage problems surfaced.Many of these issues have been paid off, but the remaining holdings have dropped substantially in price. The companies continue to pay this debt, but

the bonds are priced at bankruptcy-type levels. At current prices, it makes sense to hold them as terms may be renegotiated with creditors privately, in bankruptcy court, or supported through the TARP.

- **Mortgage Debt** – Our holdings of FNMA & Freddie Mac bonds recovered when the Federal government backed these bonds. In fact, many of them have been called and paid off at face value. On the other hand, we owned two blocks of Lehman bonds that have declined to about 20% of their face value. We're unsure of any settlement as Lehman is going through the bankruptcy process. This default was particularly shocking as Lehman was AA-rated on a Friday and declared bankruptcy the next Monday.

We also own four blocks of collateralized debt obligations (CDOs) that are invested in mortgages and/or corporate debt. These are complicated securities, but the series (or “tranches”) we own were rated A or AA, so were confident they offered attractive, relatively low-risk returns. We also bought most of them at attractive discounts, so that offered another cushion of security.

At this point, two of our CDOs have performed as planned, but the two others, managed by TIAA and JP Morgan (Galleria), have not met collateral covenants. So they are required to redirect interest payments to the senior series of the bond. Trustee reports indicate that the redirection of interest will be temporary. In the case of the TIAA bond, the senior class has paid off 83% of the face amount and our series is next in line. In the meantime, the market for these CDOs at reasonable prices is limited at best.

- **There is some good news!** Many of the bonds we've bought are aggressively paying down balances with partial redemptions, sinking funds and full calls. This is generating cash to redeploy into cheaper equities and other bonds or to merely replenish cash holdings.

ENHANCED PERFORMANCE INFORMATION ON STATEMENTS

We have enhanced the Performance Reports on the last two pages of your statement. The primary enhancement is the addition of performance index comparisons. This information will allow you to compare the performance of your portfolio with index benchmarks, both for particular market segments and your portfolio as a whole.

The selected indices will not necessarily mirror the market segments for your account; however, the results should at least provide good discussion points for you and your Account Manager. You may want to review why we have used a particular asset allocation or certain market sectors and how they relate to these market benchmarks.

Nonetheless, we believe you will find the information interesting and helpful.

Please refer to the **Commentary** on Page 2 of your statement for more detail regarding the structure of this performance comparison data.

MUTUAL FUND UPDATE

We rebalanced portfolios for most clients at least twice in the fourth quarter of 2008. This enabled us to purchase underperforming funds and sectors at cheaper prices. This has been painful, though, because these funds got even cheaper as we progressed through November and December. This trend will eventually reverse, but performance has suffered.

On a relative basis, our funds performed about on average with market benchmarks. Domestic Equity fund performance ranged from -28.5% for **Mairs & Power Growth Fund** down to -43.3% for **Dodge & Cox Stock Fund**. The **S&P 500** returned -37% and the **average U.S. Stock Fund** lost -39.1%.

The **EAFE Foreign Stock Index** lost -44.4%, while our two holdings, **Capital World Growth & Income** and **Templeton Foreign Equity**, declined -38.4% and -42.2%, respectively.

However, our models underperformed the Composite Benchmarks for several other reasons:

- Our holdings of **Legg Mason Value Fund**, which we sold in April due to poor performance, pulled down returns.
- We use the ML Government-Corp Bond Index to benchmark the Taxable Bond Segment. This index includes Treasury securities and does not include high yield bonds, both of which caused our portfolios to lag the index in 2008. We expect both of these strategies to provide a boost to portfolios in 2009.
- Our value orientation at The Trust Company caused our models to lag in 2008 because of their larger exposure to financial stocks. But over the long-term, value investments will eventually reward patient investors.

Note: We swapped our **American Funds** from the F-1 Retail share class to the cheaper F-2 Institutional class in December. This lowers the expense ratio our clients pay by about 35%.

FINANCIAL ADVICE FOR HARD TIMES (& GOOD)

With all the turmoil in the market, we think it's essential to refocus on solid, long-term principles of personal finance and also seek opportunistic strategies:

- **Live on Your Income** - Most of our clients are committed to living on their income and not spending their principal. This prudent strategy diminishes client concerns about market volatility. This reminds me of several recent discussions with clients who were concerned about portfolio declines. I had pointed out to them that they were still spending less than their dividends and interest. But they expressed concerns about declining income. I then showed them that in the past year their dividend and interest income had actually increased. Some were pleasantly surprised. Another questioned how he could have lost that much in assets and still produce the same income. I clarified for him that he hadn't lost that in assets; he still had the same assets, but the value of those assets had declined. Thus, by living on his income it gives an investor staying power for the value of that portfolio to recover.
- **Maintain Asset Allocations** - It's critical to maintain your long-term asset allocation and financial plan. No one can predict markets, but this will keep investors from making two mistakes - selling low and later buying high!

- **No IRA Required Minimum Distributions in 2009 - Consider a Roth-IRA Conversion.** Congress and President Bush recently adopted new legislation that suspends RMD payments from IRAs and retirement plans for 2009. You are still permitted to take distributions, but you won't be required to do so, but just for 2009.

That presents a golden planning opportunity -- consider taking a distribution anyway, paying the tax on it and then rolling it over to a Roth-IRA. Your Roth will never again be subject to income tax, plus they're exempt from the RMD rules. Please call your Account Officer for details.

- **Consider Refinancing your Home Mortgage** - Rates have been dipping down to and even below 5%.
- **Diversify** - I'll say it again: "DIVERSIFY!"
- **One Final Comment.** I appreciated the perspective of the recent headline on the cover of the Nov. 17th issue of *Forbes*: "**Still In Cash? What Are You Waiting For?**" Over the long run, this is likely to be good advice!

UPCOMING SEMINAR - SAVE THE DATE



2009 Investment Summit

Manhattan Country Club

Tuesday, February 10, 2009

5:30 p.m.

Special Guest Presentation

Mr. Rush Harding, CEO

Crews & Associates, Inc.

Little Rock, Arkansas

Institutional Fixed Income Specialists

Mr. Harding is a 30-year veteran of the institutional bond business. He will provide insightful, entertaining and hard-nosed comments on a variety of investment topics, including securities markets, investment valuation, due diligence, portfolio management, and the current economic environment.

Cocktails & Hors d'oeuvres to be served following the Presentation.

Seating is Limited.

Please RSVP to Karen or Marilyn at (785) 537-7200

or

by E-mail to KarenT@TheTrustCo.com

Trust Company Mutual Fund Model Performance					Market Index & Sector Performance				
Returns to December 31, 2008	4th Qtr	1-Year	3-Year	5-Year	Stock Market	4th Qtr	1-Year	3-Year	5-Year
Aggressive Growth	-21.1%	-36.0%	-8.0%	-1.4%	S&P 500 Index	-21.9%	-37.0%	-8.4%	-2.2%
Aggressive Growth / Tax-Ltd	-20.9%	-35.8%	N/A	N/A	Dow Jones Indust.Avg	-18.4%	-31.9%	N/A	-1.1%
Growth	-17.9%	-31.4%	-6.4%	-0.7%	Russell 2000 Small Cap	-26.1%	-33.8%	N/A	-0.9%
Growth / Tax-Limited	-17.4%	-30.6%	-6.3%	-0.7%	Foreign Stock Index	-21.6%	-44.4%	N/A	2.7%
Balanced Growth	-15.3%	-27.3%	-5.0%	-0.3%	Science & Tech Funds	-24.5%	-44.7%	N/A	-5.2%
Balanced Growth / Tax-Ltd	-15.2%	-27.0%	-5.3%	-0.5%	Bond Market				
Balanced Income	-10.8%	-20.2%	-2.6%	0.6%	Govt / Corp 5-Year	-0.3%	-4.5%	1.1%	1.7%
Balanced Income / Tax-Ltd	-11.1%	-20.2%	-3.3%	0.1%	Mortgage Bond Index	0.9%	1.3%	N/A	3.2%
Conservative Income	-7.4%	-14.5%	-0.8%	1.2%	5-Year Muni Index	0.5%	-1.3%	1.4%	1.8%
Conservative Income / Tax-Ltd	-7.8%	-14.9%	N/A	N/A	T-Bill Index	0.1%	1.5%	3.8%	3.2%

Trust Company Fund Performance & Comparative Rankings (A = Best; E = Worst)

STOCK FUNDS	4th Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
Dodge & Cox Stock Fund	-23.3%	-43.3% - E	-12.4%	-2.6% - D	4.7%	0.5%
Goldman-Sachs Structured Large-Value - Inst'l	-22.0%	-37.3% - C	-11.1%	-1.7% - C	N/A	0.6%
Mutual Beacon Fund - Z	-24.4%	-40.4% - C	-9.4%	-1.4% - B	4.3%	0.8%
Vanguard Value Index- Inst'l	-20.4%	-35.9% - B	-7.7%	-0.6% - B	0.7%	0.1%
Davis New York Venture	-24.5%	-39.9% - D	-9.9%	-1.8% - B	1.5%	0.6%
Mairs & Power Growth	-22.2%	-28.5% - A	-6.1%	0.4% - A	5.5%	0.7%
Growth Fund of America - F	-23.1%	-39.1% - B	-9.1%	-0.8% - B	3.2%	0.6%
Vanguard Growth Index - Signal	-23.8%	-38.2% - B	-8.8%	-3.1% - B	-3.3%	0.1%
Ariel Appreciation	-29.9%	-40.7% - D	-13.5%	-5.5% - E	1.7%	1.2%
Fidelity Low-Priced Stock	-20.7%	-36.2% - B	-8.1%	0.6% - A	8.0%	1.0%
Buffalo Small Cap	-18.3%	-29.8% - A	-7.3%	1.2% - A	10.9%	1.0%
Capital World Growth & Income - A	-19.3%	-38.4% - B	-4.0%	3.9% - A	6.7%	0.7%
Templeton Institutional Foreign Equity	-20.2%	-42.2% - A	-4.0%	4.0% - A	4.5%	0.8%
BOND FUNDS	4th Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
PIMCO High Yield - Institutional	-13.1%	-23.7% - B	-4.7%	-0.2% - B	2.7%	0.5%
PIMCO Total Return - Institutional	5.0%	4.8% - A	5.9%	5.2% - A	6.2%	0.4%
Vanguard GNMA Fund - Admiral Shares	4.0%	7.3% - A	6.3%	5.3% - A	5.8%	0.1%
Vanguard Intermediate Tax-Exempt - Admiral	1.7%	-0.1% - C	2.6%	2.7% - A	4.0%	0.1%
Vanguard High-Yield Tax-Exempt - Admiral	-6.1%	-10.4% - D	-1.3%	1.1% - C	3.1%	0.1%

Explanatory Notes: This chart reports independent, comparative performance data and rankings assembled by the Investment Staff of The Trust Company of Manhattan. Sources for this information include: Morningstar, Lipper and the Wall Street Journal. The fund performance figures are provided by Morningstar and Lipper. The letter rankings or "grades" for 1-Year and 5-Year Performance are assigned by the Wall Street Journal. These rankings are based on the WSJ-assigned sector for the fund, which may not necessarily correspond to the fund's objective as defined by its own prospectus, or the sector to which we have assigned the fund within The Trust Company's Model Portfolios. However, we believe this format provides the fairest and most effective method of displaying fund performance comparisons.