



INVESTMENT MANAGEMENT UPDATE

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April 13, 2009

MARKET UPDATE & OBSERVATIONS

<u>Market Index Returns</u>	<u>1st Qtr</u>	<u>1-Year</u>	<u>5-Year</u>
S&P 500 Index	-11.0%	-38.1%	-4.8%
Russell 2000 Small Cap	-15.0%	-37.5%	-5.2%
Foreign Stock Index	-11.0%	-46.1%	-0.9%
Taxable Bond Index	-0.1%	-4.8%	1.3%
Municipal Bond Index	3.3%	1.7%	2.3%

The 1st Quarter of 2009 again brought significant declines in virtually all segments of both the U.S. and global stock markets and losses even extended into the Treasury market.

Much of the focus has been on governmental responses to the banking, financial and housing crises, along with criticism of executive compensation. As with past crises, the media and politicians seem most concerned with placing blame and punishing wrongdoers. There is no doubt plenty of blame to go around, but most pundits and politicians fail to appreciate the cyclical nature of economic trends. They also have little appreciation for the limited effect the government can have in contributing to a recovery.

As we look at various segments of the economy, it appears we will continue to face many obstacles. In fact, the news about the economy will probably get worse before it gets better. But for long-term investors, this too shall pass.

“THROWING IN THE TOWEL”

Although the securities markets and the economy are both struggling, some commentators, investors and advisors appear to be drawing some silly and misguided conclusions.

For example, Rob Arnott, a well-known and oft-quoted advisor and researcher, recently published a report in which he observed that the S&P 500 had dropped to a level where the returns on bonds over the past 40 years had surpassed the returns on stocks. Dr. Arnott's point was that the risk premium attributed to equities should not be the historically-accepted figure of +5%, but perhaps merely +2.5%.

However, his report prompted other reporters¹ to question the principle that stocks outperform bonds over the long-term. Perhaps bonds have outperformed stocks in this 40-year period, but it's absurd to suggest that investors abandon equities. In fact, now may be the ideal time for “short-term” investors with timeframes of less than 40 years to buy stocks!

¹ “*Bonds Outperform Stocks Over Last 40 Years,*” Preston Poulter, Advisor Perspectives, April 1, 2009.

You also can't ignore the benefits of equities with respect to diversification and asset allocation. It's well-accepted that even modest equity allocations help reduce portfolio volatility over the long term, but not in every market cycle.

In another publication,² Stan & Hildy Richelson advocate using portfolios invested 100% in bonds. We don't deny that an all-bond portfolio has merit in some cases. In fact, we have clients at The Trust Company who are 100% invested in bonds. But those clients have very specialized portfolio needs that are well-served by total fixed income portfolios.

Our primary objection to the Richelsons' thesis is based on their misunderstanding of how equity works. They assert that:

*The problem with equities, including index funds, is that they rely on the greater fool theory – that some fool will buy your stock at a higher price than you paid.*³

They fail to understand the fundamental feature of equity ownership: profit. Companies generate earnings & profit, and with successful companies, growth of those earnings. And those earnings generate dividends, growth of dividends and capital appreciation. Earnings don't rely on “greater fools!”

The other key component of prudent portfolio management is rebalancing. I'm quite sure a diversified portfolio of both stocks and bonds, periodically rebalanced over the past 40 years, would have outperformed both stocks and bonds.

Unfortunately, this market has delivered a very tough test of our clients' abilities to come to grips with their risk tolerance and capacity. A few have even capitulated in the face of this volatility. We fear they also misunderstand the fundamentals of equity investing, our disciplined process and the long-term virtues of asset allocation.

Of course, this has also tested our role as advisors. Most of our clients, who are suitably-allocated, are comfortable with their equity exposure. And even though they're disappointed with the drop in value of their investment capital, many have told us: “Well, it's not pleasant, but it's not that bad!”

Some clients have also committed to some risk reassessment once their portfolio values experience some recovery, although that may take a few years. In the meantime, we remain firmly committed to our philosophy of diversified asset allocation . . . and we're not throwin' in the towel!

² “*Bonds: The Unbeaten Path to Secure Investment Growth,*” Stan & Hildy Richelson, 2007.

³ “*The Case for the All-Bond Portfolio,*” Robert Huebscher, Advisor Perspectives, February 24, 2009.

MODEL PORTFOLIO UPDATE

In response to market declines in January and February, we rebalanced and realigned portfolios for most clients on March 2, 2009. The low point, to date, as measured by the Dow and the S&P 500, was March 9th.

Our portfolio changes primarily included:

- Reduced allocations of **Vanguard GNMA Fund**
- Increased allocations of **PIMCO High Yield, Mairs & Power Growth Fund, Goldman Sachs Structured Large Cap Value Fund** and **Dodge & Cox Stock Fund**
- Sold half our allocation in **Ariel Appreciation Fund**
- Reduced our Cash Allocations.

While we have no idea whether equity valuations have bottomed-out, we believe there is certainly less risk now, particularly relative to bonds. We're also unenthusiastic about cash right now with interest rates dipping below 1%.

Our Investment Committee has also made further changes to our Model Portfolios, which should be executed in mid-April. These changes primarily will include:

- Elimination of our remaining allocation in **Ariel Appreciation Fund**. This decision is based on performance and its fairly high expense ratio, although the fund has been one of our stronger performers recently. This equity allocation will be reinvested in our other equity funds, primarily: **Vanguard Value Index, Fidelity Low-Priced Stock, Buffalo Small Cap** and **Mairs & Power Growth Fund**.
- Broaden our corporate and municipal bond holdings and shorten durations by adding the **Vanguard Short-Term Investment Grade Bond Fund** and **Vanguard Limited-Term Tax-Exempt Fund**.
- We are still researching dividend-oriented and equity-income funds, but with dividend cuts facing many companies, we are being cautious.

In terms of performance, our Model Portfolios solidly outperformed our investment benchmarks during the Quarter. This was attributable to strong relative performance from a broad group of our equity funds, mostly non-value funds, along with our bond funds, which had little exposure to U.S. Treasury markets.

MUTUAL FUND FOCUS

- **Value v. Growth Index Funds** – Our decision last year to divide our large-cap index holdings into two separate funds has mostly hurt our performance. This short-term setback is due to value-oriented stocks having been hit hard in this recession. Value-oriented stocks generally include banking and financial stocks, along with other low-P/E and high dividend blue-chips. However, recent deviations in performance between the **Vanguard Growth Index** and the **Vanguard Value Index** provide a good opportunity to buy the underperforming value fund. We'll have to wait and see how this strategy pays off over multiple market cycles.

- **Buffalo Small Cap Fund** has made a dramatic turnaround. A year ago, it was one of the poorest performers in our lineup. The past year it has been one of our strongest, although it has still delivered a return of -11% the past year. One interesting note – during a conference call last summer with their managers, they commented that they had never seen such attractive values within the small-cap market in which they invest. In the first quarter of 2009, the fund dropped only -1% versus -15% for the Russell 2000 Small Cap Index.
- **PIMCO Total Return** continues to deliver. Despite being the largest bond fund, its manager, Bill Gross, is still adept at navigating the broad sectors of the bond market.

BOND MARKET UPDATE

Municipal Bond Market. The municipal bond market has provided one of the most interesting investing opportunities over the past 3 to 4 months. Sizable discounts have been available to buyers, particularly for top-quality housing bonds. These bonds, which are usually collateralized with GNMA securities, are AAA-rated, although most are also subject to the Alternative Minimum Tax. For these reasons, we have even purchased these “tax-free” bonds in IRAs and other types of “tax-free” accounts. Despite the tax free income offering no advantage within the tax free accounts, the rates are still attractive. In addition, many of them appreciated 5-18% during the Quarter as the market recognized their solid values.

General Motors Bonds. Our most troublesome holdings within our bond portfolio have been bonds issued by **General Motors** and **GMAC**. While they continue to make scheduled interest and principal payments, their prices have dropped to levels that anticipate a bankruptcy filing. At these prices, we believe our opportunities from a bankruptcy settlement provide a better option than selling them at current prices. Most of these declines in value were already felt in prior periods going back throughout 2008.

Recessionary Impact on Bond Holdings. The recession has also had an impact on a few of our other bond holdings. There have been a few defaults, a few slow payers and a number of technical defaults. Technical defaults typically occur when a borrower fails to meet a requirement of the bond covenant. Some of these bonds have been sold either at discounts or sometimes at attractive prices prior to the recent economic problems. We are carefully monitoring the others to assess the adequacy of collateral, improvement in cash flows or restructuring of the bonds.

THE TRUST COMPANY TO LAUNCH COMMON FUNDS

The Trust Company is in the early stages of developing a series of Collective and Common Trust Funds for use within client portfolios. These funds, which operate much like internal mutual funds, will be used for taxable and tax-free bond investing. The benefits of these common funds include: broader diversification, avoidance of single issue risk, more refined asset allocation management, enhanced liquidity, and simpler client statements & tax reporting. We hope to have these funds fully introduced in the 4th Quarter of 2009.

2009 INVESTMENT SUMMIT

The Trust Company hosted a **2009 Investment Summit** on February 10 at Manhattan Country Club. This was our inaugural effort for this type of client event.

We had a very nice turnout of about 80 clients, plus other professionals from the community, in spite of a blustery, stormy evening. The program focused on The Trust Company's investment results, methodology and role as an independent investment advisor and trustee.

Rush Harding, CEO of Crews and Associates, of Little Rock, Arkansas, shared his observations about the current bond market, particularly the municipal bond market. He emphasized the importance of understanding the nuances of

the multitude of fixed income securities, plus the dangers of merely relying on bond ratings or bond insurance. He also emphasized the problems generated by borrowers' over-leveraged balance sheets and inadequate liquidity.

The presentations and Q&A were followed by a social hour with hors d'oeuvres, beverages and conversation. It also gave us a chance for each of us to meet some of our newer clients who work with other Advisors at The Trust Company.

We say "Thank You" to all who attended, particularly given the stormy weather, and hope you enjoyed yourselves.

We hope to host another similar event next year and would welcome your suggestions.

The Trust Company's Current Model Portfolio Asset Allocation Ratios **Effective April 16, 2009**

	Aggressive Growth	Aggressive Growth T/L	Growth	Growth Tax Ltd	Balanced Growth	Balanced Growth T/L	Balanced Income	Balanced Income T/L	Conserv Income	Conserv Inc T/L
MONEY MARKET FUND	4%	4%	7%	7%	9%	9%	10%	10%	13%	13%
<u>FIXED INCOME FUNDS</u>										
Vanguard S/T Investment Grade	-	-	4%	-	7%	-	10%	-	11%	-
Vanguard GNMA Fund	-	-	-	-	-	-	7%	-	10%	-
PIMCO Total Return	-	-	4%	-	8%	-	12%	-	15%	-
PIMCO High Yield	6%	-	9%	-	12%	-	15%	-	17%	-
Vanguard Ltd Term Tax-Exempt	-	-	-	4%	-	7%	-	14%	-	15%
Vanguard Intermediate Tax-Exempt	-	-	-	4%	-	8%	-	15%	-	19%
Vanguard Hi-Yield Tax-Exempt	-	6%	-	9%	-	12%	-	15%	-	19%
Total Fixed Income Funds	6%	6%	17%	17%	27%	27%	44%	44%	53%	53%
<u>EQUITY FUNDS</u>										
Dodge & Cox Stock Fund	7%	7%	6%	6%	5%	5%	4%	4%	4%	4%
Goldman Sachs Struct'd Large Value	5%	5%	5%	5%	5%	5%	4%	4%	4%	4%
Mutual Beacon - Z	8%	8%	7%	7%	6%	6%	4%	4%	4%	4%
Vanguard Value Index	9%	9%	8%	8%	7%	7%	6%	6%	5%	5%
Davis New York Venture	5%	5%	5%	5%	4%	4%	3%	3%	2%	2%
Mairs & Power Growth	5%	5%	4%	4%	4%	4%	4%	4%	2%	2%
Growth Fund of America	8%	8%	7%	7%	6%	6%	4%	4%	3%	3%
Vanguard Growth Index	8%	8%	6%	6%	6%	6%	4%	4%	3%	3%
Fidelity Low-Priced Stock	9%	9%	8%	8%	6%	6%	4%	4%	3%	3%
Buffalo Small Cap Fund	9%	9%	7%	7%	5%	5%	3%	3%	-	-
Capital World Growth & Income	10%	10%	8%	8%	6%	6%	4%	4%	3%	3%
Templeton Instl Foreign Equity	7%	7%	5%	5%	4%	4%	2%	2%	1%	1%
Total Equity Funds	90%	90%	76%	76%	64%	64%	46%	46%	34%	34%

Trust Company Mutual Fund Model Performance					Market Index & Sector Performance				
Returns to March 31, 2009	1st Qtr	1-Year	3-Year	5-Year	Stock Market	1st Qtr	1-Year	3-Year	5-Year
Aggressive Growth	-9.0%	-36.1%	-12.8%	-3.8%	S&P 500 Index	-11.0%	-38.1%	-13.1%	-4.8%
Aggressive Growth / Tax-Ltd	-8.9%	-35.8%	N/A	N/A	Dow Jones Indus. Avg	-12.5%	-35.9%	N/A	-3.6%
Growth	-7.1%	-31.4%	-10.3%	-2.7%	Russell 2000 Small Cap	-15.0%	-37.5%	N/A	-5.2%
Growth / Tax-Limited	-6.7%	-30.2%	-10.0%	-2.6%	Foreign Stock Index	-11.0%	-46.1%	N/A	-0.9%
Balanced Growth	-5.9%	-27.6%	-8.3%	-1.9%	Science & Tech Funds	2.6%	-32.8%	N/A	-5.0%
Balanced Growth / Tax-Ltd	-5.2%	-26.3%	-8.2%	-2.0%	Bond Market				
Balanced Income	-3.8%	-20.6%	-4.8%	-0.4%	Govt / Corp 5-Year	-0.1%	-4.8%	1.3%	1.3%
Balanced Income / Tax-Ltd	-2.4%	-18.8%	-5.0%	-0.7%	Mortgage Bond Index	2.3%	2.6%	N/A	3.4%
Conservative Income	-2.4%	-15.4%	-2.3%	0.5%	5-Year Muni Index	3.3%	1.7%	2.6%	2.3%
Conservative Income / Tax-Ltd	-1.0%	-13.6%	N/A	N/A	T-Bill Index	0.1%	1.0%	3.4%	3.2%

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

STOCK FUNDS	1st Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
<u>LARGE-CAP VALUE FUNDS</u>						
Dodge & Cox Stock Fund	-14.9%	-45.2% - E	-18.4% - D	-6.6% - D	2.6%	0.5%
Goldman-Sachs Structured Large Value - Inst'l	-17.2%	-42.8% - D	-18.1% - D	-6.3% - D	N/A	0.6%
Mutual Beacon Fund - Z	-8.2%	-39.8% - C	-14.0% - B	-3.8% - B	2.9%	0.8%
Vanguard Value Index- Inst'l	-16.3%	-41.1% - D	-14.5% - C	-4.5% - B	-1.3%	0.1%
<u>LARGE-CAP BLEND FUNDS</u>						
Davis New York Venture	-12.0%	-41.8% - E	-14.6% - D	-5.0% - C	-0.1%	0.6%
Mairs & Power Growth	-14.3%	-34.6% - A	-12.3% - B	-3.6% - B	4.3%	0.7%
<u>LARGE-CAP GROWTH FUNDS</u>						
Growth Fund of America - F-2	-4.0%	-36.5% - B	-11.6% - B	-2.3% - B	2.1%	0.6%
Vanguard Growth Index - Signal	-4.2%	-34.3% - C	-11.1% - B	-4.2% - B	-4.3%	0.1%
<u>SMALL & MID-CAP FUNDS</u>						
Ariel Appreciation	-11.9%	-42.5% - E	-17.5% - E	-8.5% - E	0.5%	1.2%
Fidelity Low-Priced Stock	-7.9%	-36.3% - B	-13.0% - A	-2.2% - A	7.9%	1.0%
Buffalo Small Cap	-1.0%	-18.0% - A	-11.2% - A	-2.0% - A	11.0%	1.0%
<u>FOREIGN & GLOBAL FUNDS</u>						
Capital World Growth & Income - F-2	-10.4%	-40.2% - B	-9.3% - A	0.8% - A	5.3%	0.8%
Templeton Institutional Foreign Equity	-13.6%	-44.0% - B	-10.8% - A	0.4% - A	2.8%	0.8%
BOND FUNDS	1st Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
<u>TAXABLE FUNDS</u>						
PIMCO High Yield - Institutional	0.4%	-22.1% - D	-5.3% - C	-0.3% - B	2.6%	0.6%
PIMCO Total Return - Institutional	1.5%	3.0% - A	6.7% - A	4.9% - A	6.4%	0.5%
Vanguard GNMA Fund - Admiral Shares	2.0%	7.1% - A	7.0% - A	5.4% - A	6.0%	0.1%
<u>TAX-FREE FUNDS</u>						
Vanguard Intermediate Tax-Exempt - Admiral	3.1%	3.0% - B	3.6% - B	3.1% - A	4.2%	0.1%
Vanguard High-Yield Tax-Exempt - Admiral	5.4%	-4.3% - D	0.3% - D	1.8% - C	3.6%	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.