



## INVESTMENT MANAGEMENT UPDATE

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### MARKET & ECONOMIC UPDATE

<u>Market Index Returns</u>	<u>3<sup>rd</sup> Qtr</u>	<u>1-Year</u>	<u>5-Year</u>
S&P 500 Index	15.6%	-6.9%	1.0%
Russell 2000 Small Cap	19.3%	-9.5%	2.4%
Foreign Stock Index	19.9%	6.7%	8.0%
Taxable Bond Index	5.9%	11.7%	3.9%
Municipal Bond Index	5.5%	11.2%	3.5%

The 3<sup>rd</sup> Quarter of 2009 continued the recovery of security prices that began late in the 1<sup>st</sup> Quarter. However, a broader economic recovery will take a long time, perhaps 3-5 years. This outlook is also the basis for our modest concern about inflation. Remember, inflation requires heightened demand for consumer and industrial goods, services and labor.

Many investors and citizens are concerned about inflation and higher interest rates. Higher interest rates would likely be caused by large government borrowing and budget deficits. Actually, interest rates have already started to rise, but only in the Treasury market. Corporate, high yield, mortgage and municipal bond rates, on the other hand, have actually declined this year. So it may take some time for Treasury rates to increase enough to catch up and be competitive with non-Treasury bond rates. In the meantime, that does not necessarily translate into high inflation. We believe there is still too much weakness in the economy to drive up prices.

### BOND MARKET UPDATE

The corporate and municipal bond markets have also rebounded quite well this year. This can be seen in the performance of our bond mutual funds. For example, the PIMCO High Yield and Total Return Funds have returned 35% & 12% YTD, respectively. Even the Vanguard Short-Term Investment Grade Corporate Bond Fund has returned 12.7%. But much of this positive performance stems from a recovery of price declines in 2008 for the mutual funds.

On the other hand, the performance of our individual bond portfolios has lagged, primarily due to the pricing of many of our individual bonds, many of which are small, non-rated issues that are thinly-traded. During the general bond market declines in 2008, prices of our bond holdings held up well, but often because market changes were not yet fully-reflected in these prices. During the 3<sup>rd</sup> Quarter of 2009, we started using a new pricing process, which has impacted the quoted prices of many of these bonds, with most of them being lower. In some cases, the re-pricing reflects some decline in credit quality. However, for other bonds issues, the quoted prices do not reflect what we believe is their true value based on their payment ability and/or the value of underlying collateral.

As a result, the performance of our Fixed Income and Tax-Free Bond segments are lagging this year. However, we believe this trend is just another phase in the economic downturn and prices will normalize over time.

Here's an example. We've owned a muni bond for several years, which was priced a month ago at \$94 per \$100 of face value. On Sept. 30 our pricing service priced the bond at \$81, a decline of -14%; however, this week the bond paid-off about 10% of its outstanding principal balance at face value. That early payment of principal was made from excess cash in the bond's debt repayment fund. It makes little sense that such a bond would be priced at a 19% discount to its face value.

It's certainly hard to explain these market and pricing conditions. Of course, while it has worked against us this year, remember it worked in our favor last year. And for long-term investors, it will balance out as these bonds return to par.

We're also trying to take advantage of these market conditions by adding to our holdings at bargain prices. That was the case last winter when we bought high-quality, tax-exempt mortgage bonds at very cheap prices. That market has now recovered nicely and many of those bonds are now being called away at face value, which is much higher than our cost. We expect this trend to offer the same opportunities.

### MUTUAL FUND & MODEL PORTFOLIO UPDATE

- **Mutual Fund Model Realignment.** On August 20, 2009, we realigned our mutual fund model portfolios by reducing stock fund allocations and adding to our bond funds. Clients have naturally asked, "Have we grown negative on the stock market?" No, actually we haven't. But we've decided to take a more **neutral** position on stocks. For example, equity allocations in our Conservative Models had grown to 34% of portfolios. That's too high, so we reduced it to 25%, a more typical allocation for our Conservative Income clients.
- **Portfolio Rebalancing.** We also rebalanced portfolios in conjunction with the August 20 realignment, and again a month later on September 17 due to further equity gains.

### FINANCIAL STRATEGIES – A "BROKEN RECORD!"

I was recently explaining to a client the virtues of some of our financial & investing principles: diversify, don't try to time the market, use a consistent asset allocation, pay attention to valuation, and live within your means. He responded that, "I always sound like a broken record." I replied that, "I hope so, because sound investing principles don't change." You can trust that we'll keep playing that tune . . . over and over!

Trust Company Mutual Fund Model Performance					Market Index & Sector Performance				
Returns to Sept 30, 2009	3rd Qtr	1-Year	3-Year	5-Year	Stock Market	3rd Qtr	1-Year	3-Year	5-Year
Aggressive Growth	15.9%	-1.7%	-3.7%	2.5%	S&P 500 Index	15.6%	-6.9%	-5.4%	1.0%
Aggressive Growth / Tax-Ltd	15.5%	-2.2%	-3.9%	N/A	Dow Jones Indus. Avg	15.8%	-7.4%	N/A	1.9%
Growth	14.4%	1.6%	-1.9%	3.0%	Russell 2000 Small Cap	19.3%	-9.5%	N/A	2.4%
Growth / Tax-Limited	13.8%	0.8%	-2.2%	2.8%	Foreign Stock Index	19.9%	6.7%	N/A	8.0%
Balanced Growth	13.2%	3.8%	-0.5%	3.4%	Science & Tech Funds	16.5%	7.7%	N/A	3.0%
Balanced Growth / Tax-Ltd	12.4%	2.1%	-1.4%	2.7%	<b>Bond Market Indexes</b>				
Balanced Income	11.2%	7.3%	1.7%	4.0%	Govt / Corp 5-Year	5.9%	11.7%	4.6%	3.9%
Balanced Income / Tax-Ltd	10.3%	5.2%	0.5%	3.1%	Mortgage Bonds	3.4%	8.5%	5.2%	4.2%
Conservative Income	9.7%	9.7%	3.2%	4.2%	5-Year Muni Index	5.5%	11.2%	4.2%	3.5%
Conservative Income / Tax-Ltd	8.9%	7.1%	N/A	N/A	T-Bill Index	0.0%	0.2%	2.6%	3.1%

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

STOCK FUNDS	3rd Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
<b><u>LARGE-CAP VALUE FUNDS</u></b>						
Dodge & Cox Stock Fund	19.9%	-3.7% - A	-8.8% - E	0.8% - C	6.0%	0.5%
Goldman-Sachs Structured Lg Value - Inst'l	16.9%	-14.1% - E	-11.3% - E	-1.5% - E	N/A	0.6%
Mutual Beacon Fund - Z	15.9%	-6.3% - D	-6.2% - C	2.0% - B	5.7%	0.8%
Vanguard Value Index- Inst'l	17.4%	-8.7% - C	-7.4% - C	1.2% - C	1.8%	0.1%
<b><u>LARGE-CAP BLEND FUNDS</u></b>						
Davis New York Venture	16.5%	-6.3% - C	-5.4% - C	1.9% - B	3.2%	0.6%
Mairs & Power Growth	15.0%	-9.8% - E	-2.7% - B	2.0% - C	6.5%	0.7%
<b><u>LARGE-CAP GROWTH FUNDS</u></b>						
Growth Fund of America - F-2	13.4%	-2.0% - C	-2.8% - B	3.7% - B	4.1%	0.4%
Vanguard Growth Index - Signal	14.2%	-3.7% - C	-2.3% - B	2.0% - B	-1.7%	0.2%
<b><u>SMALL &amp; MID-CAP FUNDS</u></b>						
Fidelity Low-Priced Stock	17.6%	4.5% - A	-1.6% - B	4.8% - B	11.1%	1.0%
Buffalo Small Cap	15.2%	12.4% - A	1.2% - A	5.4% - A	13.1%	1.0%
<b><u>FOREIGN &amp; GLOBAL FUNDS</u></b>						
Capital World Growth & Income - F-2	18.8%	2.9% - B	0.3% - A	8.0% - A	8.4%	0.6%
Templeton Institutional Foreign Equity	21.3%	5.2% - B	0.3% - A	8.9% - A	6.6%	0.8%
BOND FUNDS	3rd Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
<b><u>TAXABLE FUNDS</u></b>						
PIMCO High Yield - Institutional	15.4%	18.0% - A	3.7% - B	5.1% - B	5.8%	0.6%
PIMCO Total Return - Institutional	6.0%	18.3% - A	9.2% - A	6.9% - A	7.6%	0.5%
Vanguard GNMA Fund - Admiral Shares	2.3%	9.1% - B	7.0% - A	5.7% - A	6.3%	0.1%
Vanguard Short-Term Inv Grade Admiral	4.1%	10.1% - B	4.9% - B	4.2% - A	5.0%	0.1%
<b><u>TAX-FREE FUNDS</u></b>						
Vanguard Ltd Term Tax Exempt-ADM	2.3%	6.8% - C	4.5% - A	3.5% - B	4.0%	0.1%
Vanguard Intermediate Tax-Exempt - Admiral	6.2%	13.2% - A	5.2% - A	4.4% - A	5.1%	0.1%
Vanguard High-Yield Tax-Exempt - Admiral	9.9%	14.3% - C	3.9% - B	4.4% - A	5.4%	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.