



## INVESTMENT MANAGEMENT UPDATE

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January 15, 2010

### MARKET & ECONOMIC UPDATE

Market Index Returns	4 <sup>th</sup> Qtr	1-Year	5-Year
S&P 500 Index	6.0%	26.5%	0.4%
Russell 2000 Small Cap	3.9%	27.2%	0.5%
Foreign Stock Index	3.6%	41.0%	5.1%
Taxable Bond Index	-0.8%	9.9%	3.2%
Municipal Bond Index	1.1%	12.9%	3.9%

2009 finished as a year of remarkable themes for investors. The most visible theme was the dramatic recovery in stock market values. From the low point of most market indexes on March 9, 2009, the S&P 500 rose 64%. Keep in mind that it's still -28% below its peak in October, 2007.

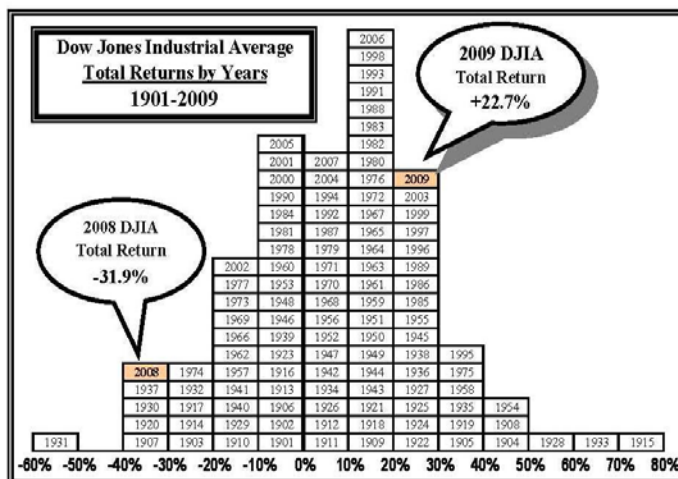
Many investors keep asking, "When will it get back to those peak levels?" as if this drop were some temporary setback. Remember, those previous peaks were generated by an over-leveraged and speculative-minded economy and universe of investors. Those valuation levels will not be attained until economic and investing fundamentals recover to levels that will justify and sustain the valuation levels. So, don't get in a hurry!

We hear much of the same perspective with respect to other segments of the economy, such as housing prices, jobs, personal incomes and production of consumer and industrial goods. Many of these market segments were also the victims of speculative bubbles and it's unrealistic to expect any short-term recovery to previous levels. In fact, as I've stated before, perhaps we've already experienced the recovery – a recovery back down to economically-justifiable price levels. Again, just don't get in a hurry!

### EQUITY MARKET PERSPECTIVE

Our perspective on equity markets is still based on several continuing themes:

- While prices have recovered significantly, **equities still offer attractive total return prospects.** It's our philosophy that diversified equity exposure will always be appropriate for virtually all investors, albeit at different allocations depending upon investors' timeframes and capacity to absorb risk.
- Most analysts and economists predict **greater economic growth in foreign markets vs. the U.S.** We don't disagree with this forecast, but we believe that foreign markets still deserve a good dose of caution due to greater volatility, plus the impact of currency fluctuations. Our portfolio allocations to foreign markets range from about 11% of equities for Conservative Models to 19% for Aggressive Models.



## BOND MARKET UPDATE

The bond market generated a broad range of returns for investors in 2009. First of all, as I cautioned in my January, 2009 *Investment Update*, Treasury Bond rates “may be the next shoe to drop.” As it turns out, this was true. For example, investors in the **Vanguard Long-Term Treasury Fund** lost -12.1% last year due to rising rates . . . and we believe they are still low. Fortunately, our clients didn’t own any U.S. Treasury funds.

Secondly, much of the corporate and municipal bond markets, rebounded from a dismal 2008. For example, our clients’ holdings of **PIMCO High Yield Fund** and **PIMCO Total Return Fund** returned 44.1% & 13.8%, respectively, in 2009. We also added the **Vanguard Short-Term Investment Grade Corporate Bond Fund** to our portfolios to protect against rising rates. This fund returned 14.2%. Finally, our line-up of **Vanguard Tax-Exempt bond funds** provided returns between 5.7% and 20.2%. Again, a nice recovery!

On the other hand, our individual bond portfolios struggled. Our long-used strategy of investing in broadly diversified portfolios of high yielding bonds, many of them small, non-rated issues, has worked well over the years. But it hurt us in 2008 and 2009, largely because of the lack of liquidity in the marketplace.

Prices on such issues suffered in 2008 with the rest of the market, and many haven’t yet fully recovered. Some of these issues deserved discounts due to credit problems and devaluation of collateral. But many others traded at large discounts for no apparent reason. We managed to take advantage of these declines by buying bonds last spring at sizable discounts and client portfolios were rewarded. But that window for good quality issues closed quickly. With patience and some favorable workouts, we are confident our strategy will continue to pay off over the long run.

## MUTUAL FUND & MODEL PORTFOLIO UPDATE

- **Mutual Fund Model Realignment.** Last August we realigned and rebalanced our mutual fund model portfolios by reducing stock fund allocations and adding to our bond funds. As we commented at the time, we’re not necessarily negative about stock market valuations, we just needed to get our portfolios back to more neutral allocations.
- **Portfolio Rebalancing.** We continue to periodically rebalance portfolios, which we believe is one of the simplest and most efficient methods of reducing risk. This methodology ensures that we “sell high” and “buy low.” It also ensures that you maintain consistent portfolios.

## The Trust Company’s Current Model Portfolio Asset Allocation Ratios Effective August 17, 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
<b>MONEY MARKET FUND</b>	5%	5%	7%	7%	9%	9%	10%	10%	13%	13%
<b>FIXED INCOME FUNDS</b>										
Vanguard S/T Investment Grade	4%	-	8%	-	12%	-	13%	-	16%	-
Vanguard GNMA Fund	-	-	-	-	-	-	7%	-	10%	-
PIMCO Total Return	2%	-	7%	-	11%	-	15%	-	18%	-
PIMCO High Yield	8%	-	10%	-	14%	-	16%	-	18%	-
Vanguard Ltd Term Tax-Exempt	-	4%	-	8%	-	11%	-	17%	-	20%
Vanguard Intermediate Tax-Exempt	-	2%	-	7%	-	11%	-	17%	-	21%
Vanguard Hi-Yield Tax-Exempt	-	8%	-	10%	-	15%	-	17%	-	21%
<b>Total Fixed Income Funds</b>	<b>14%</b>	<b>14%</b>	<b>25%</b>	<b>25%</b>	<b>37%</b>	<b>37%</b>	<b>51%</b>	<b>51%</b>	<b>62%</b>	<b>62%</b>
<b>EQUITY FUNDS</b>										
Dodge & Cox Stock Fund	6%	6%	5%	5%	4%	4%	3%	3%	3%	3%
Goldman Sachs Struct’d Large Value	5%	5%	5%	5%	4%	4%	3%	3%	2%	2%
Mutual Beacon – Z	7%	7%	6%	6%	5%	5%	3%	3%	3%	3%
Vanguard Value Index	8%	8%	7%	7%	6%	6%	5%	5%	3%	3%
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	7%	7%	6%	6%	5%	5%	3%	3%	2%	2%
Vanguard Growth Index	7%	7%	6%	6%	5%	5%	4%	4%	3%	3%
Fidelity Low-Priced Stock	8%	8%	7%	7%	5%	5%	4%	4%	3%	3%
Buffalo Small Cap Fund	8%	8%	6%	6%	4%	4%	2%	2%	-	-
Capital World Growth & Income	9%	9%	7%	7%	5%	5%	3%	3%	2%	2%
Templeton Instl Foreign Equity	6%	6%	4%	4%	3%	3%	2%	2%	-	-
<b>Total Equity Funds</b>	<b>81%</b>	<b>81%</b>	<b>68%</b>	<b>68%</b>	<b>54%</b>	<b>54%</b>	<b>39%</b>	<b>39%</b>	<b>25%</b>	<b>25%</b>

We have also been pleased with the performance of our model portfolios. Returns ranged from +29.8% for our Aggressive Model to +21.7% for our Conservative Model. This type of rebound from 2008 further enhances our conviction that asset allocation, stringent security selection and periodic rebalancing provide the most prudent combination of portfolio management strategies.

Regarding particular funds, the leader last year was actually a bond fund, **PIMCO High Yield**, which returned +44.1%. Small cap funds were the leaders among equity funds, with **Fidelity Low-Priced Stock Fund** returning 39.1% and **Buffalo Small Cap Fund** returning 37.5%. Note that Fidelity Low-Priced has been part of our model portfolios for over 15 years.

Also, all of our model portfolios have generated positive returns the past five years and have also outperformed the S&P 500, which was also positive, but only 0.4% annually.

### ARE TAX POLICY CHANGES AHEAD?

There's a lot of fear regarding possible changes to our U.S. tax laws. Bear in mind that nothing has yet been approved or even heavily debated, but tax policy pundits believe we may face some or all of the following changes:

- Higher marginal tax rates
- Elimination of 15% preferred qualified dividend tax rate (I would support this change, but only if corporations would then be allowed to deduct dividend payments to stockholders. This would eliminate double-taxation and taxpayers would be taxed at their own marginal rates. This would address Warren Buffett's concern that the U.S. tax system is unfair. He cited the example that his secretary is in a higher tax bracket than he is because of this qualified dividend tax rate. We agree!)
- Increasing maximum capital gain tax rate from 15%
- Phase-outs of itemized deductions for high income taxpayers
- The Federal Estate Tax Exemption will likely be set at \$3,500,000 permanently. This proposal has passed the U.S. House, but not the Senate. The Senate appears to be holding out for a \$5 million exemption. But if a proposal passes Congress, President Obama will likely sign it.

**Roth-IRA Conversions.** Congress has eliminated the \$100,000 Adjusted Gross Income limit to be eligible to make a Roth-IRA Conversion. This powerful tool will now benefit a broader group of taxpayers and investors.

This tax strategy allows the owner of a Traditional IRA to withdraw any amount from his or her IRA and roll it over to a Roth-IRA. The withdrawal is subject to income tax, but the rollover to the Roth-IRA and all future earnings are exempt from income tax . . . forever!

Prior to 2010, taxpayers with AGI over \$100,000 were ineligible for a Roth Conversion. Now there is no limit. But the tax advantages and disadvantages of Roth Conversions are very tricky.

We recommend that you confer with your tax advisor to assess your eligibility and the impact on your personal tax situation.

### UPCOMING SEMINAR – PLEASE SAVE THE DATE



## 2010 Investment Summit

**Manhattan Country Club**  
**Wednesday, February 17, 2010**  
**3:00 p.m. – 5:30 p.m.**

### Special Guest Presentation

**Mr. Kent Gassaway**  
**Chief Investment Officer & Portfolio Manager**  
**Buffalo Funds - Kansas City, MO**

*Personal Invitations will be sent in late January.*

### LARGEST STOCK HOLDINGS IN THE TRUST COMPANY'S MODEL PORTFOLIOS

<u>Aggressive Growth</u>		<u>Growth</u>		<u>Balanced Growth</u>		<u>Balanced Income</u>		<u>Conservative Income</u>	
Microsoft	1.12%	Microsoft	.97%	Wells Fargo	.79%	Wells Fargo	.63%	Wells Fargo	.42%
Wells Fargo	1.05%	Wells Fargo	.93%	Microsoft	.78%	Microsoft	.53%	Microsoft	.40%
ExxonMobil	.74%	ExxonMobil	.67%	ExxonMobil	.57%	ExxonMobil	.46%	General Electric	.30%
General Electric	.72%	General Electric	.63%	General Electric	.53%	General Electric	.43%	ExxonMobil	.28%
J.P. Morgan Chase	.64%	J.P. Morgan Chase	.59%	J.P. Morgan Chase	.48%	Johnson & Johnson	.37%	Hewlett-Packard	.26%
Pfizer	.59%	Pfizer	.52%	Pfizer	.44%	J.P. Morgan Chase	.36%	Pfizer	.24%
Hewlett-Packard	.58%	Hewlett-Packard	.51%	Johnson & Johnson	.43%	Pfizer	.36%	J.P. Morgan Chase	.23%
Johnson & Johnson	.56%	News Corp	.49%	Hewlett-Packard	.41%	Hewlett-Packard	.31%	News Corp	.23%
News Corp	.56%	Johnson & Johnson	.48%	News Corp	.40%	AT&T	.29%	Johnson & Johnson	.22%
AT&T	.54%	AT&T	.48%	AT&T	.39%	Bank of America	.28%	Occidental Petroleum	.20%
Bank of America	.50%	Bank of America	.45%	Bank of America	.37%	News Corporation	.27%	United Health	.19%
Google	.48%	Occidental Petroleum	.43%	Google	.35%	Chevron Corp	.27%	Chevron	.19%
Occidental Petroleum	.47%	Google	.42%	Occidental Petroleum	.35%	3M Company	.27%	AT&T	.19%
United Health	.47%	Chevron Corp	.42%	Chevron Corp	.34%	Occidental Petroleum	.26%	Bank of America	.18%
Chevron Corp	.46%	United Health	.42%	United Health	.32%	Medtronic	.25%	Schlumberger	.18%
<b>Total Stocks</b>	<b>81%</b>		<b>68%</b>		<b>54%</b>		<b>39%</b>		<b>25%</b>

Trust Company Mutual Fund Model Performance					Market Index & Sector Performance				
Returns to December 31, 2009	4th Qtr	1-Year	3-Year	5-Year	Stock Market	4th Qtr	1-Year	3-Year	5-Year
Aggressive Growth	4.2%	29.8%	-4.6%	1.3%	S&P 500 Index	6.0%	26.5%	-5.6%	0.4%
Aggressive Growth / Tax-Ltd	3.5%	27.9%	-5.0%	N/A	Dow Jones Indus Avg	8.1%	22.7%	N/A	2.0%
Growth	3.9%	28.6%	-2.6%	2.1%	Russell 2000 Small Cap	3.9%	27.2%	N/A	0.5%
Growth / Tax-Limited	3.0%	25.7%	-3.2%	1.7%	Foreign Stock Index	3.6%	41.0%	N/A	5.1%
Balanced Growth	3.7%	26.9%	-1.1%	2.6%	Science & Tech Funds	7.4%	53.8%	N/A	1.5%
Balanced Growth / Tax-Ltd	2.3%	23.1%	-2.3%	1.8%	<b>Bond Market Indexes</b>				
Balanced Income	3.2%	24.2%	1.4%	3.5%	Govt / Corp 5-Year	-0.8%	9.9%	3.7%	3.2%
Balanced Income / Tax-Ltd	1.6%	20.2%	-0.3%	2.4%	Mortgage Bonds	1.0%	8.7%	5.1%	4.2%
Conservative Income	2.8%	21.7%	3.1%	4.1%	5-Year Muni Index	1.1%	12.9%	4.6%	3.9%
Conservative Income / Tax-Ltd	1.0%	17.4%	N/A	N/A	T-Bill Index	0.0%	0.2%	2.1%	3.0%

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

STOCK FUNDS	4th Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
<b><u>LARGE-CAP VALUE FUNDS</u></b>						
Dodge & Cox Stock Fund	4.5%	31.3% - A	-9.3% - D	-0.7% - D	5.7%	0.5%
Goldman-Sachs Structured Lg Value - Inst'l	4.2%	14.8% - E	-12.0% - E	-2.6% - E	N/A	0.6%
Mutual Beacon Fund - Z	4.8%	29.8% - C	-7.3% - C	1.1% - B	5.4%	0.8%
Vanguard Value Index- Inst'l	4.5%	19.8% - D	-8.4% - D	0.2% - C	1.4%	0.1%
<b><u>LARGE-CAP BLEND FUNDS</u></b>						
Davis New York Venture	6.7%	31.3% - A	-6.0% - D	1.3% - B	2.6%	0.6%
Mairs & Power Growth	5.6%	22.5% - E	-2.8% - B	1.1% - C	6.9%	0.7%
<b><u>LARGE-CAP GROWTH FUNDS</u></b>						
Growth Fund of America - F-2	5.9%	34.9% - C	-3.0% - C	3.0% - B	2.4%	0.5%
Vanguard Growth Index - Signal	7.9%	36.4% - C	-1.7% - B	1.7% - B	-2.7%	0.2%
<b><u>SMALL &amp; MID-CAP FUNDS</u></b>						
Fidelity Low-Priced Stock	5.2%	39.1% - B	-2.9% - B	3.2% - B	11.0%	1.0%
Buffalo Small Cap	-0.1%	37.5% - A	-1.3% - A	2.5% - B	11.1%	1.0%
<b><u>FOREIGN &amp; GLOBAL FUNDS</u></b>						
Capital World Growth & Income - F-2	4.1%	32.7% - C	-1.3% - A	6.2% - A	7.2%	0.6%
Templeton Institutional Foreign Equity	1.4%	33.6% - C	-2.9% - A	6.1% - A	5.1%	0.8%
BOND FUNDS	4th Qtr	1-Year	3-Year	5-Year	10-Year	Expense Ratio
<b><u>TAXABLE FUNDS</u></b>						
PIMCO High Yield - Institutional	6.1%	44.1% - C	4.5% - B	5.5% - B	6.2%	0.6%
PIMCO Total Return - Institutional	1.0%	13.8% - C	9.2% - A	6.9% - A	7.7%	0.5%
Vanguard GNMA Fund - Admiral Shares	0.4%	5.4% - D	6.6% - A	5.5% - A	6.3%	0.1%
Vanguard Short-Term Inv Grade Admiral	1.3%	14.2% - A	4.9% - B	4.4% - A	5.0%	0.1%
<b><u>TAX-FREE FUNDS</u></b>						
Vanguard Ltd Term Tax Exempt-ADM	0.5%	5.7% - C	4.3% - A	3.5% - A	4.0%	0.1%
Vanguard Intermediate Tax-Exempt - Admiral	-0.9%	10.3% - B	4.5% - A	4.1% - A	5.0%	0.1%
Vanguard High-Yield Tax-Exempt - Admiral	-1.2%	20.2% - B	3.1% - B	3.8% - B	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.