

Dear Fellow Investors:

As I write this letter, the fourth quarter has begun in what continues to be a most eventful year for the stock markets and the economy.

In light of that, I believe it is important to briefly summarize where we've been this year, where we are today and the prospects for the period ahead – and also to highlight some lessons from last year's financial collapse.

### ***Where we've been***

Seven months ago, in early March, it truly did feel like the world might be coming to an end – talk of a return to a Great Depression-like economy dominated the media. Understandably, fear was rampant – and stocks responded to these nightmarish scenarios by hitting the lowest levels in years, with financials especially hard hit.

Although no one knew it at the time, that turned out to be a market bottom. Since then, the economy has moved back from the precipice – there is a growing consensus that we'll return to economic growth in the second half of this year. The Economist recently ran a cover story discussing the extent to which the economic recovery is being led by Asia.

As a result, we've had a strong recovery in markets – from their bottom in the beginning of March, stock markets are up over 50%, retracing a good portion of the losses since last fall.

Here are some lessons from the last twelve months:

- *We were reminded of just how volatile stocks can be.*
- *And of the importance of true diversification.*
- *Many investors discovered that they're less comfortable with risk and volatility in their portfolio than they had believed.*
- *Investors were also reminded of the need to focus on what they can control – understanding their cash needs and thinking through how much risk they can tolerate to fund those needs.*
- *In some cases, investors began rethinking retirement plans as a result.*
- *Finally, we were reminded that in today's world, we need to expect the unexpected.*

### ***Where we are today***

Two years ago, the market was characterized by rampant optimism. The U.S. market had hit a new high in November of 2008 and any concerns were set aside as minor annoyances.

By contrast, six months ago the market was overwhelmed by absolute pessimism – there was no sign of hope anywhere.

Today, the market is somewhere between those two extremes and many investors can be characterized as extremely nervous.

As a general rule, a certain level of healthy anxiety is positive – what gets investors in trouble is an excess of either optimism or pessimism. While today's mood may be a bit too pessimistic, being cautious in the current market makes sense . . . provided that prudent caution doesn't cross the line into panicked inertia or hasty decisions. I have learned the best markets climb a wall of worry.

The good news is that there are still excellent opportunities for investors who are prepared for short term volatility. I spend a lot of time listening to the best market minds and to managers who have lived through multiple cycles. I am reassured that most say that they are still finding very good value – not to the extent that they did earlier this year, but still well ahead of what they would have seen a year ago.

### ***The outlook going forward***

In August, Business Week ran a cover story called "The case for optimism."

The premise was simple: Beyond the issues facing the global economy, there are many underlying positives that give cause for optimism if we look out two or three years or beyond.

Powerful forces under the surface will drive economic growth . . . and that economic growth will drive stock prices. Examples include the positive impact of technology, the recovering US housing market, the revitalization of economies and the incredible energy from the developing world's educated youth and emerging middle class.

I'm seeing one fundamental condition for economic recovery play out – confidence. An economic system is, at its heart, a belief system. For there to be growth, Americans must believe the U.S. dollar has value, we must be confident that contracts will be honored, we must believe our money is safe in banks, we cannot doubt that we will have jobs to provide for our families.

The financial crisis shook our faith in the U.S. banking system. Rumors of insolvency at Bear Stearns sparked a run on the investment bank that made the rumors real. The same thing happened at Lehman, but the shockwaves echoed around the world. The financial crisis was a crisis of confidence.

Now, that's not to say that the sudden skepticism of our banks was misplaced. Using obscene leverage, derivative alchemy and making some really dumb decisions, America's banks pushed themselves right to the brink. And in some cases, right over the cliff.

The U.S. government rightly understood its job was to restore confidence to the American people. And that's been the focus of most stimulus actions. The government had to make it clear that our money, our jobs, and our economy are safe.

So, we've had TARP, TALF, Cash for Clunkers and 1<sup>st</sup> Time Homebuyers credits. Accounting rules for banks have been re-written so they could go from insolvent to profitable. Now, the government is considering tax credits for companies that hire new employees.

It's working. Confidence is being restored. And the subsequent rise in equity valuations has helped struggling companies – especially banks – sell stock, raise money, and actually become stronger.

So long as the government is intent in underwriting risk, the rally should roll on.

The next phase of the Stock Rally is to transition to high quality growth. As long as the Federal Reserve continues to print money, the dollar should remain weak and risk assets around the world will benefit. Thus, for now, expect US stocks will grind higher along with stock rallies in developed and

emerging markets. While Fed Chairman Ben Bernanke acknowledged that monetary policy will have to tighten when the US economic recovery eventually takes hold, that point is well into 2010, especially given the Fed's desire to support the still-struggling real estate and mortgage markets. However, with the Fed eyeing its exit strategy, among asset classes I expect high-quality growth stocks to begin outperforming.

One bright side of persistent weakness in US labor and housing markets is an accommodative Fed. If everything were OK, the Fed would be raising rates. Instead, short-term interest rates are near zero percent and the Fed is likely to print an additional half trillion dollars between now and the end of March 2010. However, with the end of the Fed's debt monetization in sight, the character of the stock market rally is likely to shift. The first phase of the rally has been led by low-quality risk assets – e.g. leveraged companies regaining access to credit markets (avoiding bankruptcy) and triple-C rated 'junk' bonds. The next phase of the rally will transition to higher-quality companies with lower leverage, stable earnings and better credit quality. Furthermore, as a group, high-quality growth companies remain inexpensive relative to low-quality companies, presenting a unique opportunity for investors. Lastly, high-quality companies are generally more diversified internationally, which allows them to take advantage of dollar weakness and greater exposure to faster growing foreign economies.

### ***Volatility***

In 1907, U.S. financier J. Pierpoint Morgan single-handedly averted a banking panic among U.S. investors.

Later in life, someone asked him his best guess as to the direction of markets. His answer: "They will go up and they will go down."

One hundred years later, that's still the best answer to someone looking for a short-term market forecast. No one can predict market movements in the immediate period ahead – all we can do is understand clearly how much short term volatility we can live with, adjust our portfolios accordingly and stay focused on the horizon as we deal with the rough waters. No one likes volatility . . . but for most of us it's the necessary price to arrive at our ultimate destination.

### ***Direction of portfolios***

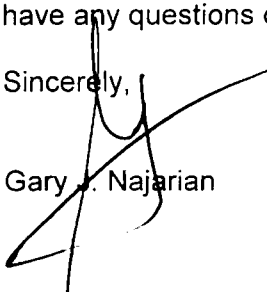
This is one section of the letter I cannot complete for mass distribution, simply because there is no one portfolio that fits all households and more importantly, risk/return options. My best work only occurs with your input and interaction. There are a number of major items to consider as we enter 2010. The ability for Roth conversions, the expiration of tax legislation tied to the Economic Growth and Tax Relief Reconciliation Act of 2001, changes in gifting limits, long-term care issues, etc. I close each of these letters with an invitation, at a place and time best suited for us to get together.

Over the past year, I've talked to most clients about their portfolios. If we missed for whatever reason or you would like to discuss your investments in more detail, I am always delighted to have that conversation.

Thanks you for the continued opportunity to work together – remember, I am always here should you have any questions or wish to talk about anything related to your portfolio or your finances.

Sincerely,

Gary J. Najarian

A handwritten signature in black ink, appearing to read 'Gary J. Najarian', is written over the printed name. The signature is stylized and somewhat cursive.