



Q3 2009

Crosscurrents: The Watchword for the Third Quarter of 2009

For those of you who visit our website/blog regularly, you know that we have had several posts about the crosscurrents the markets have been experiencing in the past few months as the economy has started to recover. The stock market which is a leading indicator has improved dramatically, up 15.6% for the third quarter, and 19.3% for the year. In the plus column was the Federal Reserve's Beige Book report which showed stabilization in retail sales, and a recovery in manufacturing activity. This data, coupled with continued low interest rates, low inflation, and improved consumer confidence, seems to be a recipe for a solid recovery.

However, staying with the "crosscurrent" theme, it is important to point out that there are some existing data points of real concern to a lasting recovery. The primary risks to the recovery include: stubbornly high unemployment, an end to the government stimulus, rising defaults in commercial real estate, and rising foreclosures in residential housing. The recovery of 2009-2010 is being called a jobless recovery. If that turns out to be the case, the consumer will continue to be stressed. In addition, when programs like "cash for clunkers" and the first time home buyers credit expire, car and home sales may slump again.

The U.S. real estate market must stabilize and improve as well. An increasing number of foreclosures on residential and commercial properties will burden bank balance sheets and create more unsold inventory, unless the financial institutions can expedite the process of moving these assets off their books by selling them.

Creating a strategy in the middle of receiving a plethora of mixed signals from the economy can be challenging. As we try to project which sectors and countries will prosper in the current environment, several themes continue to look promising. Investing in companies that are well positioned for growth overseas, and a recovery in China, remain areas of great interest here at Crossvault. In conjunction with this thesis, energy and materials companies should also do well, and we will focus some of our portfolio decisions accordingly.

Staying nimble and alert to any changes in coincident or leading data will inform our tactical strategy as we look toward the fourth quarter and year end. Please feel free to contact us regarding the information in the letter, or to set up a meeting to review your individual portfolio and asset allocation.

Laura Ehrenberg-Chesler
Marilou Long
Jacque Smith

www.crossvault.com