



Q1 2009

The First Quarter of 2009 was notable for its mixture of good news and bad news. Furthermore, because it was not all bad, the U.S. equity market had its biggest rally since the Great Depression. Whether or not this rally turns into anything more than a Bear Market bounce will remain to be seen. The good news for the market included selected bank earnings that were better than expected, retail sales that were modestly improved as opposed to getting worse, a China stimulus package, and housing numbers that actually showed an increase.

It is highly likely that although credit remains tight, actions taken by the government, under the previous administration as well as the current one, are beginning to work their way through the banking and finance system. These steps included lowering interest rates to a range of 0%-.25%, and buying Treasuries and mortgage backed securities in order to bring down mortgage rates. At the end of the quarter the 30 year mortgage rate had dropped below 4.75% for qualified buyers, and refinancing activity had picked up dramatically. All of this is good news for stocks and bonds.

Along with the good news, some bad news still persists. Unemployment rose to its highest level since 1983, and will probably continue to rise for the next several quarters. As we have previously discussed on our blog, unemployment is a lagging indicator, but negatively affects current consumer confidence and psychology. This may mean that while retail sales have recently moved up, it may not be a sustainable improvement. The deleveraging of the consumer balance sheet, while healthy in the long-term, will certainly be a drag on the economy in the short term. In addition, the health of bank balance sheets is still an unknown. Hard-to-value “toxic” assets and rising levels of loan defaults continue to weigh on the banking sector. These two factors have been major contributors to the tight credit conditions, making it difficult for businesses and individuals to secure credit to invest in new, productive ventures.

Once again we conclude that time is required to allow the various government actions to have a positive impact on the financial system. As the hard-to-value assets find a clearing price, and as low mortgage rates continue to attract homebuyers, we should see the healing process take hold for the markets and become more sustainable. Patience is the watchword of the day.

Thank you for your continued confidence, and we look forward to meeting with you at your convenience. In the meantime, please visit our blog at [www.crossvault.com](http://www.crossvault.com) for our updated reflections on the market environment.

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