EARL M. FOSTER ASSOCIATES

INVESTMENT MANAGEMENT

MARKET UPDATE

MAY 13, 2009

Stocks rebounded sharply from their March 6th lows in response to an improving outlook for the economy. In the past we have alluded to sharp stock market rallies following bear market troughs. The advance from the March 6th lows has been no exception. Normally, stocks advance about 14% during the first month of the recovery and in the 30% - 40% range over the course of the first twelve months from the trough. From its March low of 677, the Standard & Poor's Index has risen as much as 36%. Does this mean that much of the normal first year rebound may have already occurred? Can we expect some of the recent price gains to be reversed in the form of a market "correction"?

While the recession does appear to be moderating with declines incrementally less severe than prior periods, business conditions could remain tepid in the coming quarters as a significant rebound in business activity is unlikely to develop until 2010 due to a number of lingering headwinds. These include a banking system plagued with mounting loan losses, rising foreclosures, an unemployment rate approaching double digit levels, and household financial health sorely in need of repair. In this environment, consumer spending, which accounts for 70 percent of the economy, will be sluggish and temper the vitality of the subsequent rebound in business conditions. This should also impact the continuing rise in the stock market.

This does suggest that while the stock price lows of March 6th could represent the lows for this cycle, the advance over the last two months generously anticipates the stabilization in the economy expected during the second half of the year. Thus, some retracing of recent gains would be in order. A pullback, if it were to occur, would be consistent with the normal pattern of stock market recoveries and the seasonal weakness which often develops at this time of year.

Our strategy has been to gradually build the stock position in anticipation of an economic recovery in 2010 with a focus on the larger, quality companies, particularly in the healthcare and technology sectors, which are able to withstand a prolonged business downturn should that occur. While our analysis indicates that further market gains are likely and could be significant, the recent rise in stock prices has been somewhat aggressive in light of the economic outlook. As such, we would prefer to see some pullback in stocks before additional purchases are resumed.