EARL M. FOSTER ASSOCIATES

INVESTMENT MANAGEMENT

MARKET UPDATE

FEBRUARY 18, 2009

January's 8.6% decline in the Standard & Poor's Index provided little solace to investors after last year's devastating plunge. With yesterday's close, the Dow Average is returned to its low last November and the Standard & Poor's Index is less than five percent away.

Our outlook for 2009 has not changed from that presented in our ***January 2009 Newsletter***. The economy is in the midst of its worst decline in more than a half a century, and news of rising unemployment rates, dismal retail sales, rising bankruptcies, and disappointing corporate earnings is contributing to continued stock market weakness. Business conditions declined an estimated 3.8% during last year's fourth quarter and a sharper drop of 4% - 6% can be expected for the current quarter. However, the rate of decline is expected to moderate in the second quarter and transition to a modest up tick during the second half of the year. A significant recovery in the economy is more likely in 2010.

The economic news and anecdotes about the state of business conditions are now, perhaps, at their worst. While this recession will test our fortitude and patience, it is unlikely we are facing a 1930's environment. Unlike the early 1930's, the Federal Reserve is aggressively adding liquidity to the financial system. The money supply (M2) is now nearly ten percent greater than at this time last year. While funds from TARP (Troubled Assets Relief Program) have not yet flowed to the corporate and consumer sectors as fast as hoped, the banking system is getting unprecedented support, and those funds will become more visible to the end borrower in time. Furthermore, the stimulus package has been signed into law. While it may be plagued with a wide range of imperfections, the combination of tax benefits and spending programs will, undoubtedly, cushion the current downturn. The urgency with which it was passed and its magnitude eclipses what was undertaken in the 1930's. Thus, government policy and its commitment to mitigate the decline in business conditions are markedly different today. While that may not be sufficient to preclude a severe recession, it certainly diminishes the likelihood of a 1930's environment.

Our analysis suggests that the lows reached last November in the Standard & Poor's Index discount a 40% decline in corporate earnings and could represent a bear market trough. That does not preclude stocks from penetrating those lows; although, we do feel that if the market were to go to lower lows, it would be temporary in light of low equity valuations and the application of aggressive monetary and fiscal stimulus.

Nevertheless, we have taken a cautious posture since the beginning of the year and reduced our stock exposure by raising cash reserves to insulate portfolios against the onslaught of recent economic news. Our focus on large capitalization companies has also reduced the volatility within the equity component. This tactical move does not alter our longer-term objective of positioning for the next economic recovery, where consistent with individual portfolio objectives. Our focus remains with the larger and better quality companies.