The Outlook

April 8, 2009

As of 4/7/2009		
Index	**Market Value**	**YTD % Change**
Dow Jones Industrials	7,789.56	-11.2%
S&P 500	815.55	-9.7%
Nasdaq	1,561.61	-1.0%

During this severe global recession, the interconnections and interdependence of economies have been evident showing the absolute necessity of coordinated financial policies. The impact of the malfunctioning world financial system has presented policymakers with a series of difficult options at a time when confidence is at a post World War II low. At the recent G20 Summit, world leaders gathered to address the difficult challenges of fixing their respective domestic economies while functioning effectively as part of the global community. **The choice for governments and central banks has become either to let the global economy continue to contract, causing rising unemployment on a much larger scale and greater strains on social and political institutions, or to attempt to expand global GDP by creating stimulus programs and increasing the money supply at the risk of depreciating the value of currencies.**

Governments have chosen the latter. Since the crisis began, governments and central banks have announced no fewer than 550 policy initiatives to stimulate the global economic system with the majority of these policies coming in recent months. It may take several months or quarters for these initiatives, which are financed by increasing deficits and central bank monetary creation, to have maximum impact. The Federal Reserve and other central banks have unlimited power to create money, and logic and prior experience would suggest that excessive monetary expansion will likely lead to higher prices over time. Indeed central banks seem to have concluded that the extent of economic weakness combined with the frozen credit system will require monetary expansion in order to prevent deflation.

On March 18th, Federal Reserve Chairman Bernanke took a most significant step to restore confidence and stimulate the U.S. and global economies by implementing an aggressive monetary stimulus policy called quantitative easing. Quantitative easing essentially involves printing money. One of the consequences of monetization is

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that we are continuing to stimulate the existing imbalances (trade and fiscal deficits) in the global system that have been built up over years, which we are now trying to address. The imbalances stem from a global economy that had become U.S. consumer-centric.

In defining the environment for this outlook, it continues to be clear that a select group of equity securities and corporate bonds will be beneficiaries. The areas of focus for equity portfolios continue to be energy, industrial, materials, precious metals (including gold), defense and agriculture companies. In the corporate bond area, we remain focused on strong balance sheet issuers with an emphasis on maturities in the 1 - 4 year range.

The IMF, China and the Shift of Economic Leadership

An important outcome of the G20 Summit is the increased role and broadened scope the International Monetary Fund (IMF) will have in stimulating the global economy. Many countries are dealing with severe economic and social issues as highlighted by the recent collapse of the Czech government after it lost a vote of confidence over its handling of the economic crisis. To enable the IMF to take on a larger role, a decision was made to fund it with up to $1 trillion. Although small details need to be worked out (such as the sources of funding), this could have significant long-term ramifications including reduced reliance on the U.S.

At the same time, we are witnessing the coming-out party for China on the international stage and its continued development as an economic power. With approximately $2 trillion in currency reserves and the status of largest creditor nation and foreign holder of U.S. Treasury debt, China has become one of the most influential countries. While it is early in its development (including its military strength) and not without its own domestic challenges, China's recent call for the consideration of a global reserve currency signaled its intention to play a leadership role as an economic power. However it also served a cautionary warning that in any further policy response requiring borrowing, the U.S. would need to be sensitive to the interests and concerns of its largest lender. The U.S. challenge is that China's concerns are voiced at a time when the U.S., the leading debtor nation, needs to increase its debt still further to stimulate its economy and put its fiscal house in order.

China's economy has been unbalanced by being too dependent on its export markets. The Chinese government has now embarked on an aggressive program to develop its domestic economy so as to lessen its dependence on exports. China has committed $300 billion to building a 100,000 mile state-of-the-art railroad system which involves some 400 million tons of steel, or approximately 25% of the world's annual steel capacity. The Chinese government has implemented a strategic program to meet its long-term needs through acquisition of interests in foreign companies to secure critical resources. Moreover for it to be less dependent on the U.S. Dollar, it has, for the first time, agreed to provide $95 billion

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of its currency to Argentina, Indonesia, Malaysia, South Korea and others through currency swaps so importers can avoid paying for Chinese goods with U.S. Dollars. This will have the effect of elevating the status of its currency (Renminbi) versus the U.S. Dollar.

The chart below illustrates the extent of the shift in economic fortunes by showing the amount of China's reserves versus that of the United States and the continuing trade deficit of the U.S. as expressed in the current account balance column. As can be seen from the current account balance, the United States continues to pour significant amounts of dollars into the world economy. **Rebalancing the global economy will require China to build its own consumer-driven economy which it has committed to do. However, this will occur only over a period of years.**

The Currency/Gold Reserves, Current Account Balances And Debt of Leading Nations

Country	Currency Reserves + Gold (Billions)[1]	Currency Reserves (Billions)[2]	Gold (Tons)[3,4]	Gold as a % of Total Reserves[4]	2008 Current Account Balance (Billions)[5]	2009E GDP (Trillions)[5]	Gov't Debt to GDP (2009)[5]
China	**$ 1,963.77**	$ 1,946.03	600.0	0.9%	**$ 399.325**	$ 4.50	**22.2%**
Japan	$ 1,002.76	$ 980.14	765.2	2.2%	$ 194.269	$ 4.71	217.0%
Eurozone	$ 497.15	$ 190.96	10,357.4	61.6%	$ (70.691)	$ 13.92	NA
Russia	$ 390.76	$ 376.10	**495.9**	4.0%	$ 115.286	$ 1.77	6.5%
United States	**$ 279.36**	$ 38.91	8,133.5	78.9%	**$ (664.125)**	$ 14.10	**81.2%**
India	$ 248.74	$ 238.16	357.7	4.2%	$ (34.580)	$ 1.30	82.7%
Brazil	$ 204.19	$ 203.20	33.6	0.5%	$ (29.215)	$ 1.69	64.7%
United Kingdom	$ 46.36	$ 37.19	310.3	18.7%	$ (101.454)	$ 2.71	61.0%
Saudi Arabia	$ 31.86	$ 27.63	143.0	12.4%	$ 171.662	$ 0.53	11.6%
Australia	$ 30.33	$ 27.97	79.8	7.3%	$ (52.555)	$ 1.07	7.9%

1 Gold valued by the World Gold Council at the end of January at $919.50 per troy ounce
2 Bloomberg
3 There are 32,151 troy ounces in a metric ton
4 World Gold Council
5 International Monetary Fund projections

Restoring Growth and Confidence

Until recently, interest rates could be lowered by most central banks to generate increased economic activity, but once their short-term rates were lowered to near zero there was no room to lower rates further. **Therefore, in order to put more stimulus in the system, the only remaining lever left to most central banks was to create more money.** During the first week of March, the Bank of England received permission from the Parliament to print money for the purpose of buying U.K. government bonds to attempt to lower long term rates by causing those bond prices to rise. This move put additional pressure on other central banks to follow suit, and on March 12th, the Swiss National Bank acted to weaken the Swiss Franc by deciding to purchase foreign currency on the foreign exchange markets, lowering the Franc's value in relation to the Euro. This would have the effect of making Swiss

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exports more competitive by making them more attractively priced in foreign currencies. This in turn placed more pressure on the exports of Switzerland's trading partners, and logically it could be said that we had started down a path of competitive currency devaluations.

On March 18th, the Federal Reserve shocked the markets with its own aggressive program of quantitative easing totaling approximately $1.5 trillion, including large additional purchases of mortgage-backed securities to reduce mortgage rates. Since none of these moves occurs in isolation, we expected other export-dependent countries to do the same, with the most likely next candidate being Japan whose interest rates have been virtually zero for an extended period of time. In spite of those low rates, the Japanese economy has suffered a contraction and sure enough, the Bank of Japan (BOJ) has begun a similar program. The BOJ is increasing its purchases of Japanese government bonds by nearly a third to offset the pressures created by the global financial crisis.

These moves may not end here as the ECB now stands out as having the highest interest rates among the G7 countries and accordingly is perceived as being behind the curve. The largest economy in the Eurozone is Germany, and Germany is slowing rapidly as they are quite export-dependent. After the Fed's announcement, the dollar weakened against the Euro by more than 7 cents, putting further pressure on the ECB to do something similar. In fact, as a result of the Fed's move, the sharply higher Euro ended at its highest point this year. We believe this will force the ECB to act more aggressively beyond the recent 25 basis point rate cut. A decision made by the G20 to avoid competitive currency devaluations suggests the likelihood of coordinated Central Bank intervention (increasing money supply simultaneously) in future policy actions.

Transferring the U.S. Debt Burden - Private to Public

After the failure of Lehman Brothers, the policy decisions of the United States have been called into question. It is our view that the complexity of the financial problems and the U.S government's role in solving them is compounded by its position as the leading reserve currency and debtor nation. The now-flawed expectations of consumers, municipalities and financial institutions for continued prosperity had been based on excessive borrowings and continued economic growth. Accordingly the Government has had to initiate unconventional stimulus policies that have had no historical precedent. **What makes the solution particularly difficult is the need for balance between the desire for an immediate recovery, which requires vast amounts of money, and the threat of unintended consequences. The government has begun the process of transferring the debt burden from the private sector to the public sector by expanding its balance sheet. At the same time, it has struggled to balance the needs of the domestic economy with its global leadership role.**

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An important responsibility of the U.S. Government is preserving the dollar's role in international finance. Failure to preserve the dollar's role as the international reserve currency will introduce an economic and political outcome which can weaken the U.S. global role. In transferring the debt burden to the government, the total balance sheet expansion of the Federal Reserve ultimately could be in the range of $4-6 trillion up from $950 billion a year ago. According to U.S. Budget Watch, the U.S. has committed to finance and backstop nearly $12 trillion of financial assistance which represents 85% of the Gross Domestic Product.

Ben Bernanke, the Chairman of the Federal Reserve, has emphasized the Fed's ability to remove excess liquidity from the system before inflation becomes a problem. However, we should be aware that a muted economic recovery is likely to be the outlook, and under those conditions the Fed's removal of excess liquidity could have the effect of raising interest rates thereby slowing the economy from an already sub-par level of growth**. Therefore, the Fed could be forced to maintain higher than normal levels of liquidity for an extended period of time. Based on the scale of monetary creation it is reasonable to expect a higher cost of living to emerge from this environment.**

Gold

Monetary creation will continue to be required to finance the banking system and economic growth. This has not been lost on investors who have been sensitive to the necessity of protecting the purchasing power of their currencies. Since no currencies have any tangible asset backing and governments can produce whatever quantities are needed, the only historical store of value that has no default risk has been gold. In 2008, the price of gold averaged $872, up 25% from its $695 average in 2007. Investment demand for gold, including exchange-traded funds, bars and coins, was 64% higher in '08 than in '07. For the year, demand was $102 billion, a 29% increase over the prior year, while tonnage rose 4% to 3,659 tons**. It is important to recognize that gold prices have risen over the past several years from $276 per ounce in December 2001 to the current $880 per ounce. This increase has preceded the monetary expansion currently being unleashed.**

Importantly, gold as a percentage of many countries' reserves had been declining over the past decade and, as a result of continued monetary creation, can be expected to become significantly smaller unless this trend is reversed. **One indication of this reversal is Russia's recently announced intention to increase its gold stock from 500 tons to 1,200 tons which would cost $20 billion. This was followed by news that another exchange traded fund (ETF) backed by gold was introduced for investors in the Middle East.** With the significant increase of global money supplies to stimulate growth, it is reasonable to expect that prices of gold and other assets traded in world markets will rise over time at a rate different from the past decade.

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Global Impact of Underinvestment on Critical Resources

During recessions, capital spending is reduced in order to match supply and demand. **In this global slump, the degree of capital spending reduction has been unprecedented in the post World War II period because the entire global economy has been weakened. Unlike past periods, the stimulus being injected into the system now involves the industrialization of several billion people.** This means that as demand increases for the resources necessary to raise living standards, producers could encounter greater strains to match required supplies with the large and sudden increases in demand that can be foreseen. This has been made particularly difficult by the shortage of credit which has resulted in capacity reductions through cancellations or delays in planned expansions.

The American Society of Civil Engineer's recent report (see the attached Scorecard) indicates that U.S. infrastructure spending needs have now grown to $2.2 trillion over the next 5 years much of which can no longer be postponed. To put this in further perspective, these needs are for a population of only 320 million people, while China's and India's industrial needs are for an estimated 2.2 billion people.

With the worldwide population estimated to grow by 74 million people annually, another area of concern is the prospect of growing food shortages for the world's population. According to a recent policy document of the G8 agricultural ministerial meeting, global food production needs are expected to double by 2050. In the more immediate term, excess crop inventory relative to consumption is near a 30-year low. Despite global back-to-back record crops, crop prices remain well above 10-year averages, and the world could be one major drought away from facing serious food shortages. As a result of the financial crisis, farmers in many countries are reducing their plantings setting the stage for price increases for agricultural products.

One of the world's most critical resources is energy and it is also one where capital spending has been significantly reduced. Since last year, the number of North American drilling rigs in operation has declined by an estimated 50%. A recent International Energy Agency (IEA) report highlighted the challenge of maintaining global production because capital expenditures had been running at approximately $350 billion annually and now those expenditures have been reduced by 50%. At this reduced rate of investment it is estimated that global production capacity will fall by 3 million barrels per day over a 1 year period from 86 million barrels. When global demand for energy increases, it could be difficult to meet world needs without prices rising from current levels.

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Investment Implications

Investors should bear in mind that what took many years to create cannot be undone overnight. Even with stimulus spending, U.S. consumers will need time to rebuild their balance sheets, a situation that is further compounded by rising unemployment and an increasing savings rate. **Given the infrastructure needs and the need to rebalance the global economic system, portfolios should be represented by the primary beneficiaries of monetization, major stimulus programs and eventual economic recovery. The investment values that currently exist could result in significant investment returns over the coming years.** It is important to keep in mind that it is a multi-year process to build capital and protect purchasing power. An investment approach should not be confused with short-term trading and speculation which has become a focus by many in the marketplace.

As a result of the many months of market declines, there are now many trillions of dollars, historically record levels, on the sidelines waiting for the opportunity to achieve better returns than those offered by cash. The March equity market surge was a reflection of some capital seeking higher returns in the form of select equity and corporate bond securities. **At ARS we remain focused on 3 key drivers for portfolio strategy: preservation of principal, capital appreciation, and protection of purchasing power. The emphasis for equity portfolios remains on energy, industrial, material, precious metals (including gold), defense and agriculture companies. In the corporate bond area, we remain focused on strong balance sheet issuers targeting maturities in the 1 - 4 year range.**

As we look out over the coming months, there is no doubt that governments around the world will spend whatever it takes to repair the global financial system, the global economy and to restore confidence in countries and the markets. The actions of the G20 leaders, central banks and local governments in the past month alone highlight the global commitment. While there may be some unintended consequences of these actions, it is important to bear in mind that, as a result of the economic downturn, distinct undervaluations have been created in many of the beneficiaries of these policy initiatives. Investors with judgment, understanding and patience should benefit from these opportunities. As we emerge from this period, the great values that are being created could result in investment returns that are the most attractive that have been seen in years.

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APPENDICES

APPENDIX A ★ Previous *Report Card* Grades

SUBJECT	1988*	1998	2001	2005	2009
Aviation	B-	C-	D	D+	D
Bridges	–	C-	C	C	C
Dams	–	D	D	D	D
Drinking Water	B-	D	D	D-	D-
Energy	–	–	D+	D	D+
Hazardous Waste	D	D-	D+	D	D
Inland Waterways	B	–	D+	D-	D-
Levees	–	–	–	–	D-
Public Parks and Recreation	–	–	–	C-	C-
Rail	–	–	–	C-	C-
Roads	C+	D-	D+	D	D-
Schools	D	F	D-	D	D
Solid Waste	C-	C-	C+	C+	C+
Transit	C-	C	C-	D+	D
Wastewater	C	D+	D	D-	D-
America's Infrastructure G.P.A.	**C**	**D**	**D+**	**D**	**D**
Cost to Improve	**–**	**–**	**$1.3 trillion**	**$1.6 trillion**	**$2.2 trillion**

* The first infrastructure grades were given by the National Council on Public Works Improvements in its report *Fragile Foundations: A Report on America's Public Works*, released in February 1988. ASCE's first *Report Card for America's Infrastructure* was issued a decade later.