



O'BRIEN MANAGEMENT QUARTERLY REVIEW

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Economic Overview

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The year 2009 felt like two years wrapped into one. It was a year in which the stock market fell 25% from January 1st to the March lows, only to rebound 65% from those lows through year end. It was a year in which the economy continued to lose jobs, contributing to the approximately 8 million lost during this recession, but then finished the year with some strong indications that job losses were bottoming. It was a year of nearly-zero percent short-term interest rates and falling home prices, of tight credit, ballooning national debt and attention to personal balance sheets. Unprecedented monetary and liquidity efforts by policymakers are righting the ship and steering the U.S. toward economic growth. Expect to see more progress as the U.S. emerges from the Great Recession, but with the knowledge that there are a number of areas that could make the recovery vulnerable, namely employment, consumer deleveraging and the housing market.

EMPLOYMENT

Over 4 million jobs were lost in 2009, and the December payroll employment report closed a dismal year on a weak note. However, the November payroll figures were encouraging and came as a complete surprise to economists and investors. Many of the November report's details could prove positive for business confidence. Hours-worked and wages rose, as did the hourly work week. Temporary-help employment has risen for five consecutive months. A lengthening in the workweek and increases in temporary help suggest growing demand in the economy for labor and have historically been leading indicators of an improvement in overall employment. Due to the math behind calculating the employment rate, as more workers become more encouraged, come off the sidelines and begin looking for work, the

current 10% employment rate is likely to tick up, peaking at around 11% later this year. Layoffs may be slowing, but the hiring situation is still weak. Policymakers will likely continue to support the job market until it is clear that businesses have begun permanent hiring again.

INTEREST RATES

Some pundits would argue that the November employment report gives the Fed reason to discontinue loose monetary policy and to withdraw some of their stimulus support. However, the Fed has signaled that they will remain accommodative for an extended period. Historically, the Fed does not tighten monetary policy for many months, and sometimes years, after a clear improvement in the employment picture. Thus, we should continue to see short-term rates near zero for at least the first half of the year. Longer-term interest rates have increased from the crisis low levels at the beginning of 2009. Longer-term interest rates were low due to several factors. First, there had been a flight to the perceived safety of Treasuries. Second, policy makers purchased Treasuries and mortgaged backed securities as part of an effort to reduce long-term interest rates. (Reducing rates created cheaper residential mortgage funding options for consumers, which, in turn, helped support home sales.) Third, low interest rates reflected the low real growth and deflation in the economy. Now that the crisis has passed, and with the Fed and Treasury indicating that their support of long-term rates will end during the first half of 2010, and with signs of growth returning to the economy, long-term rates have begun to rise.

HOUSING MARKET AND FORECLOSURES

Low government interest rates supported recent improvements in the housing market as resulting low mortgage rates provided cheap financing and incentive

for home buying. Home sales improved throughout the year. Additionally, government supported tax credits have helped temper home price declines. The majority of U.S. home price declines are likely behind us. However, it is hard to draw broad generalizations on the state of the U.S. housing market as certain areas of the country have seen larger price declines than others from their respective peaks. For example, prices in Las Vegas have fallen approximately 56% from their peaks, but in Dallas, they've only fallen 6%.

Foreclosures continue to be a concern for the housing market. Historically, negative equity and unemployment are two of the most common causes of foreclosures. As a result of steep price declines, 25% of U.S. homeowners with a mortgage have negative equity, in other words, situations where the mortgage on the property is of greater value than the property itself. However, this negative equity phenomenon is heavily concentrated in particular regions of the country, notably Nevada, Arizona, Florida, Michigan and California. Although the worst of the negative equity situations are concentrated in these five states, foreclosures are rising nationwide. The government has implemented mortgage modification plans, which they continue to tweak, with the hope that the programs will quell foreclosures, keep people in their homes and remove the downward pressures that foreclosures have on home prices. Most Americans' wealth is concentrated in their home, so removing downward price pressure on this asset will significantly impact the average American consumer's confidence. Given that various broad valuation measures, such as price-to-rent ratios, indicate that housing prices are no longer overvalued, foreclosures seem to be the last major factor that could weigh on home prices.

THE CONSUMER AND BUSINESSES

If the Great Recession were a typical recession, at this point in the recovery we'd begin to see consumers and businesses take on debt and increase spending. But

this was not a typical recession. This recession resulted from too much consumer and financial company debt and negative consumer savings. Consumers are in the early stages of repairing their balance sheets. Available credit has decreased, and savings rates have risen. If consumers continue to restrain their spending, it will limit consumer-driven growth opportunities for businesses. Business spending is unlikely to immediately and entirely make up for any "missing" consumer spending. Businesses have seen profits improve, but that has been primarily as a result of cost cutting efforts, not top line sales growth. Credit conditions have started to improve for businesses but it is still difficult for them to borrow from banks. Small businesses especially still seem to be feeling the pinch. The December 2009 survey of small businesses by the National Federation of Independent Businesses (NFIB) said that their single biggest problem was poor sales. Poor sales and price reductions were leading to weaker profits. Their inventory investment plans were at historically low levels, loan availability was still difficult and more firms still plan on reducing employment than plan on adding to payrolls. Small businesses are important because, according to the Department of Commerce, small businesses have produced more than 60% of the total net new jobs over the past ten years. It is understandable that businesses remain cautious when they see such NFIB survey results.

We are seeing progress as the U.S. emerges from the recession. GDP growth has turned positive as a result of public policy makers' stimulus measures and business inventory rebuilding. As the year progresses, growth will be weaned of these two catalysts and new business investment and spending will be required to fill the gap such that the economic recovery becomes self-sustaining. Historically, growth after a severe recession has been vigorous. However, given the uniqueness of the Great Recession, growth in 2010 will be tepid compared to past post-recession rebounds.

Market Update

By: Allison S. Gates
Investment Research Associate

The stock market continued its rebound in the fourth quarter of 2009, making the rally that began in March one of the fastest, most dramatic rebounds in history.

The S&P 500 has risen 70% since its low on March 9, 2009. According to data from TD Ameritrade that analyzes rebounds from the five major bear-markets of the 20th century, the S&P grew 35% on average during the 12 months following those market troughs. This

time, in just over nine months, the stock market rally has produced double those returns.

Broadly, emerging market stocks led the way with the strongest performance in 2009, followed by domestic mid-cap growth stocks. Our clients' funds were no exception: on average, our emerging markets funds returned 70% and our mid-cap growth funds returned 42%. A few of the factors that helped emerging markets stocks in particular are the following: the fact that their banking systems were less exposed to toxic assets, the rebound in commodity prices, and the rising internal consumer demand in these developing countries. Our major "developed" international holdings performed quite well also, averaging a 39% return during the year, thanks in part to their hefty allocation to emerging markets stocks. The mid-cap growth section of the market benefited from a strong year in the technology sector. As measured by the Technology SPDR (XLK), technology stocks grew 33% in 2009.

The bond market had a solid year, with the Barclay's Aggregate Bond Index returning almost 6%. But O'Brien Management's chosen bond funds performed even better: the Vanguard Short-Term Investment Grade Bond Fund, PIMCO Total Return Fund, and the Vanguard Intermediate-Tax Exempt Bond Fund were up 14%, 13%, and 10% respectively. The Vanguard Short-Term Investment Grade Bond Fund performance is especially significant because the average annual return for this fund over the past ten years was 5.02%.

Index Performance as of 12/31/2009		
Stock Indexes	Q4 2009	One Year
<i>S&P 500 (Large U.S. companies)</i>	6.02%	26.41%
<i>Russell 2000 (Small U.S. companies)</i>	3.87%	27.16%
<i>MSCI EAFE (Large Foreign companies)</i>	2.18%	31.78%
<i>MSCI Emerging Markets</i>	8.55%	78.51%
Bond Indexes		
<i>Barclays Aggregate (U.S. bond market)</i>	0.20%	5.93%
<i>Barclays Corporate Index</i>	1.35%	18.68%
<i>Barclays High Yield</i>	6.19%	58.21%
<i>Barclays Municipal</i>	-0.96%	12.91%
<i>Citi 3-month T-Bill</i>	0.03%	0.16%
Alternative Asset Indexes		
<i>Barclays TIPS Index</i>	1.76%	11.41%
<i>Dow Jones-AIG Commodity Index*</i>	9.60%	20.09%

* As measured by the iPath Dow Jones Commodity Index Total Return ETN

Some clients may have noticed that, during the fourth quarter, we made changes to our holdings in the large-cap value stock category. In the fall, we reviewed each of our long-time holdings: Allianz NFJ Dividend

Value Fund, American Beacon Large-Cap Value Fund, and Dodge & Cox Stock Fund. In the case of Allianz NFJ, we felt that poor management decisions based on too stringent investment criteria caused significant underperformance in 2009. American Beacon, on the other hand, did not seem well-poised to outperform in the upcoming market environment. Being a "fund of funds", American Beacon Large-Cap Value has four separate sub-advisers who each manage portions of the fund using very different approaches. Given our expectations for tepid economic growth and potentially lackluster stock market returns in the near term, we think that it is extremely important for a manager to be able to make judgments that may separate the winners from the losers. In this environment, we would prefer a more focused, selective fund to an all-encompassing fund of funds. Lastly, the Dodge & Cox Stock Fund has altered their stock selection strategy in our view. After their dismal performance in 2008, they moved into many new areas of the market in order to compete in the 2009 rally. We were pleased with their returns in 2009 but this sort of alteration in a long-term strategy gives us pause. It changes the role that the fund plays in our overall diversification strategy, and therefore, overweights our stock exposure in certain areas, leaving us underexposed to others.

Given our growing questions about each of these funds, and the managers' inability to address our questions with satisfying answers, we decided to move large-cap value assets into two new funds: Columbia Dividend Income and Mainstay ICAP Select Equity. These new funds initially attracted us because of their impressive long-term track records. As of year-end 2009, both these funds had handily beaten their benchmark, the Russell 1000 Value Index, and most of their peers during the three- and five-year time periods. As we researched each fund further, we found sensible each fund's investment selection process and their supportive reasoning.

The management of the Columbia Dividend Income Fund seeks to invest in value stocks, putting a major emphasis on cash flow, dividend payout ratio, and other quantitative statistics that indicate financial health. As we move into the potentially slow growth period ahead, companies that exhibit the financial discipline of paying dividends will be more desirable because dividends could potentially play a much greater role in stock returns. We also feel confident in the Columbia management team's experience, depth

and cohesiveness. The Mainstay ICAP Select Equity Fund also focuses on companies that they believe to be undervalued and financially healthy. In addition to this, they identify near-term market catalysts and select stocks that will participate in them. We feel that these two funds can stand alone securely but also complement one another.

The stock market reacted ebulliently last March, and throughout the rest of 2009, when it became clear that

the Federal Reserve and the Treasury intended to pull out all the stops to keep the market from a lasting free-fall. This rally has been a welcome respite for investors everywhere. In 2010, the market may need to face the reality of a still struggling economy and the massive fiscal debt overhang, both of which could dampen returns for some time. We will work hard to maximize the growth potential of our clients' assets moving forward, and also to protect these assets as best we can against volatility and potential downturns.

The O'Brien Management Investment Committee

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