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# PORTFOLIO COMMENTARY

FROM THE ALDER FINANCIAL MANAGEMENT TEAM

ISSUED JULY, 2009

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## Second Quarter Review

Having seen most individual investors, pension plans and fund managers lose three-fifths of their equity wealth in less than 12 months, it would be fair to describe the market sentiment going into the second quarter as one of fear. Stock averages were down approximately 12% in the first quarter on top of the roughly 40% decline in the previous year, and the market was plagued with constant bad news. That fearful attitude has now shifted to a belief that the worst is behind us and we're in for a long and slow recovery. In the most recent quarter, the U.S. stock market staged a promising spring rally to recover most of the losses from earlier in the year, and this was a much needed psychological boost for the markets after a horrific start to 2009.

The biggest improvement this quarter was in the banking sector. In the last few months we have seen an impressive recovery in the common and preferred share prices of banks. The improved outlook for the banking sector began with the release of the Fed's stress test results. Among other things, these results revealed the target amount of capital that the banking regulators wanted systemically important institutions to maintain. These targets allowed many banks to set goals to repay their TARP borrowings. To date, much of the TARP money has now been repaid (with interest and warrants), freeing those institutions from the whims of Congress. While our clients generally do not hold the common stock of banks, we have been buyers of the preferred shares. During the second quarter we have seen those shares nearly double in price.

Our client portfolios saw significant gains in both the equity and fixed income categories. While the gains in the equity category only represent a recuperation of first quarter declines, the fixed income group was another story. The gains in that category typically ranged from 10 to 15 percent. A meaningful contributor to those numbers came from our distressed asset-backed bond purchases during the quarter. As the economic fears subsided in the credit markets, institutional buyers renewed their appetite for risky investments. This in turn has added enough liquidity to the bond market to improve prices for a wide range of fixed income securities.

The mortgage-backed bond market still has a long way to go before we would call it healthy, but the fire-sale prices that we saw earlier in the year have mostly disappeared. This improved mortgage-backed bond pricing along with the gains in our bank preferred shares helped propel our year to date fixed income gains to between 6 and 7 percent in most client accounts. In addition to these gains, the portfolio cash yields for most of our clients are now in excess of 5 percent. The majority have now seen total year-to-date returns of around 7 percent.

Looking forward, we are still focusing on the high-yield part of the market. The bargain basement prices that we enjoyed earlier in the year have largely disappeared, so our buying opportunities have slowed significantly. That being said, we still feel that these opportunities do exist and will invest accordingly. On the equity front we are still cautious as the rate of economic decline has slowed significantly since March but unemployment is still rising sharply. We view unemployment as the biggest obstacle to GDP and stock market growth.

The recovery in stock prices to date probably reflects optimism that the worst is behind us. In order to have lasting gains from here, we believe that the employment situation needs to stabilize. Even at a ten percent unemployment rate, ninety percent workers are still employed. The problem is that many of those ninety percent are behaving as though they might lose their jobs tomorrow. Once that sentiment changes, we believe the economy and the stock market will improve meaningfully. At that point we'll be more inclined to jump back into the stock market, and our best guess is that will occur sometime in the fourth quarter.