



**Investment Strategy
&
Economic Outlook**

Jason DeSena Trennert

February 2009

STRATEGAS' INVESTMENT OUTLOOK

Economic Environment

- 1) Targeting 2010 as economic recovery date.
- 2) Fighting global deflation with all tools available – Fed balance sheet has tripled in 2008.

	2008		2009				2010			
	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP Q/Q Pct. AR	-0.5%	-3.8%	-3.5%	0.0%	1.0%	1.0%	2.0%	2.0%	3.0%	3.0%
Core CPI Q/Q Pct. AR	3.2%	0.4%	1.5%	1.5%	1.0%	1.0%	1.5%	2.0%	2.3%	2.5%
Fed Funds - End of Period	2.0%	0.1%	0.1%	0.1%	0.1%	0.5%	1.5%	3.0%	4.0%	4.5%
10-Year Yield - End of Period	3.8%	2.2%	3.0%	4.0%	4.0%	4.2%	4.5%	4.7%	5.0%	5.5%

F = Forecast

2009 S&P 500 Expected Value Table

Odds	Economy	Fed Posture	S&P Op Earnings	Expected Multiple	S&P 500
10%	Deep Rec.	Easy	\$50	12.0x	600
80%	Recession	Easy	\$58	16.0x	928
5%	Just Right	Neutral	\$68	18.0x	1224
5%	Too Hot	Tighter	\$76	20.0x	1520
Expected Value:					940

Consensus Estimates

	Bottom Up
2007	\$82.54
2008	\$64.94
2009	\$68.58
2007 = Actual	

Strategas Earnings Estimates

	2009		2010	
	Level	Y/Y	Level	Y/Y
1Q	\$13.50	-18.8%	\$16.25	20.4%
2Q	\$14.00	-17.7%	\$16.50	17.9%
3Q	\$14.75	-16.9%	\$17.25	16.9%
4Q	\$16.00	0.0%	\$18.25	14.1%
Year	\$58.25	-13.7%	\$68.25	17.2%

Recommended Asset Allocation

Balanced			B'mark
Equities	65%		60%
Bonds	10%		30%
Cash	25%		10%

Equities			B'mark
Equities	80%		80%
Cash	20%		20%

Size			B'mark
Large-Cap	75%		70%
Mid-Cap	20%		15%
Small-Cap	5%		15%

Style			B'mark
Value	30%		40%
Growth	50%		40%
Blend	20%		20%

Recommended Sector Allocation

Overweight
Staples
Materials
Energy

Market Weight
Health Care
Financials

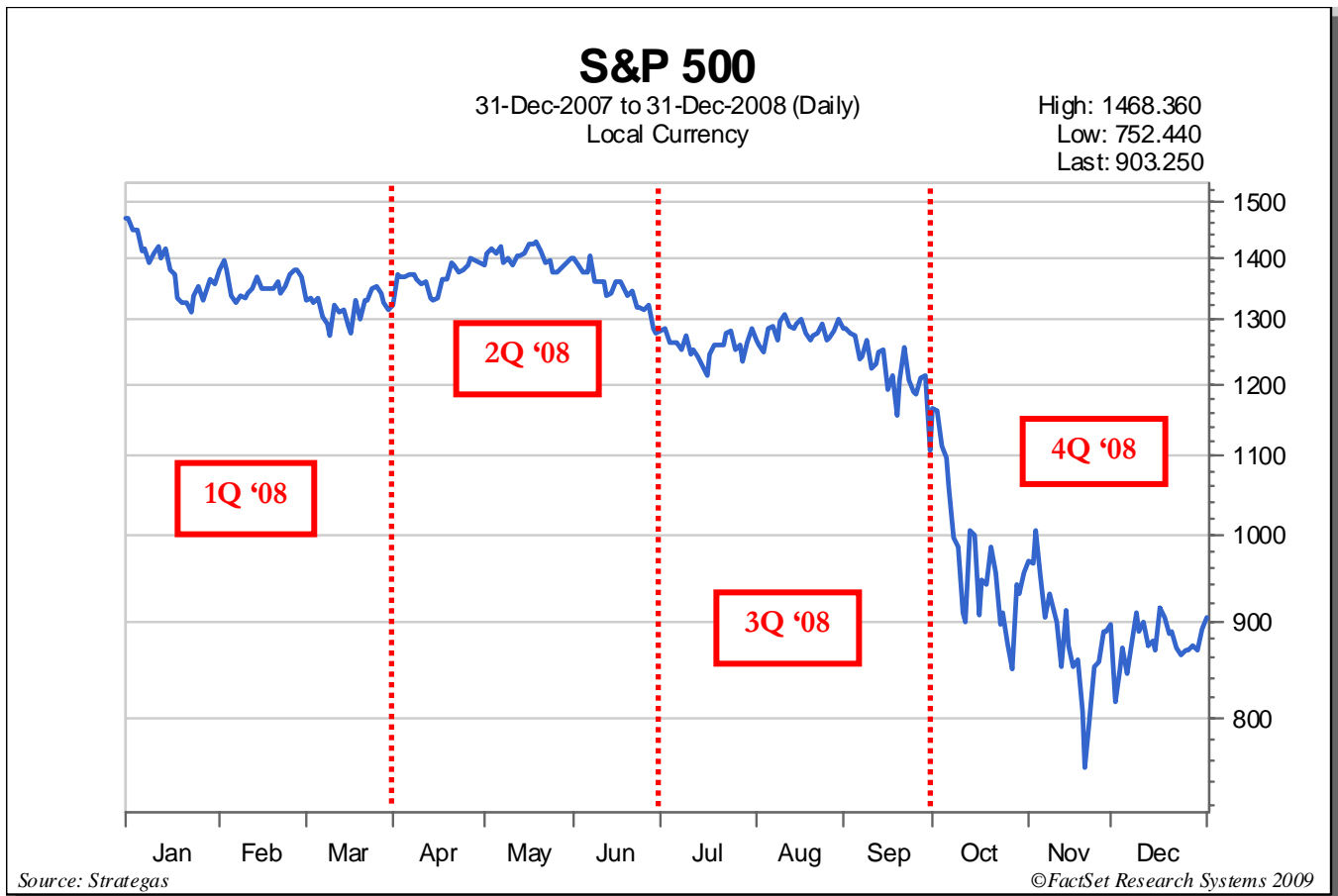
Underweight
Discretionary
Utilities
Technology
Telecom
Industrials

2009's MAJOR INVESTMENT THEMES

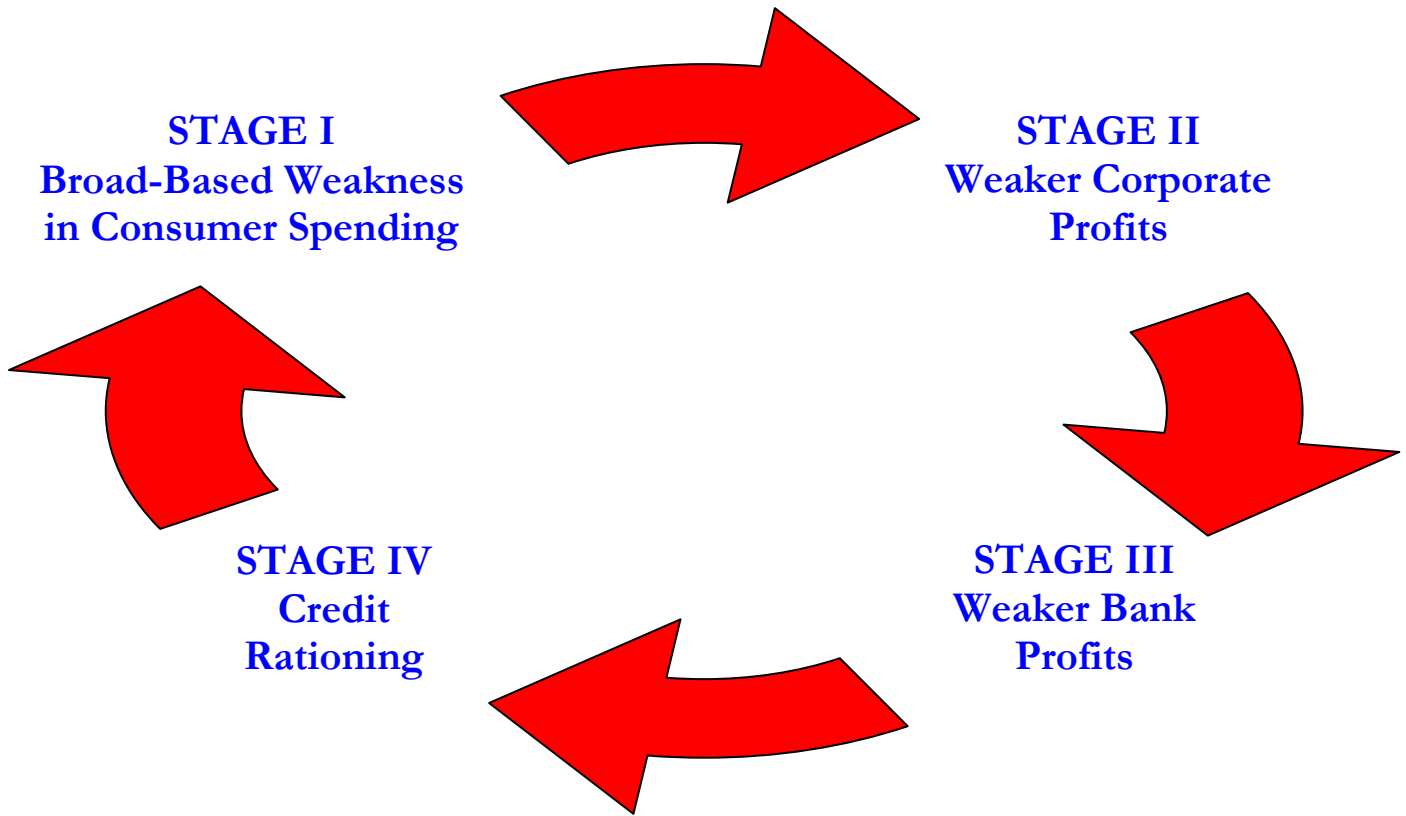
1. "Reversion to the Mean" Reverts to the Mean
2. Monetarism Makes a Comeback
3. The Balance Sheet: Not Just for Sissies Anymore
4. A New "New Deal" & The Start of the Great Bond Bear Market
5. Geopolitical Tensions as the Sticky Residue of Economic Dislocation

...AND THE NEXT FIVE YEARS

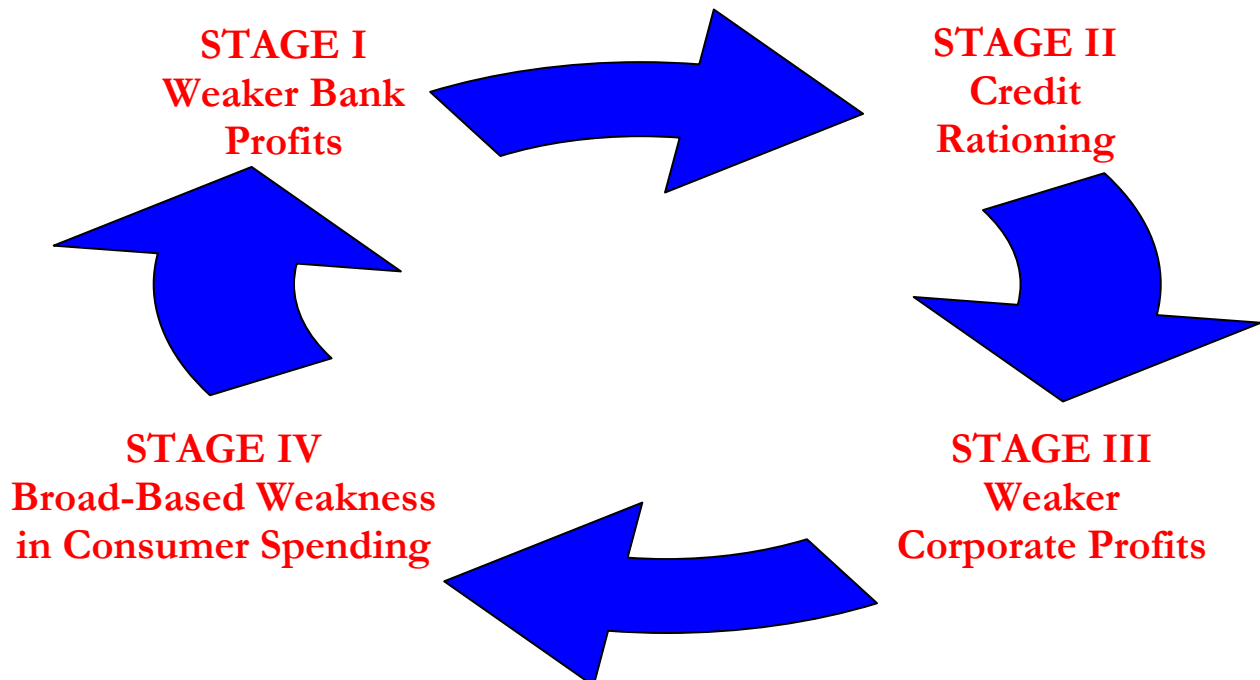
1. Companies Without Borders
2. Aging in the Developed World
3. Green is Green
4. China Becomes Cyclical
5. The Eradication of Extreme Poverty



TRADITIONAL U.S. RECESSION STARTS WITH CONSUMER

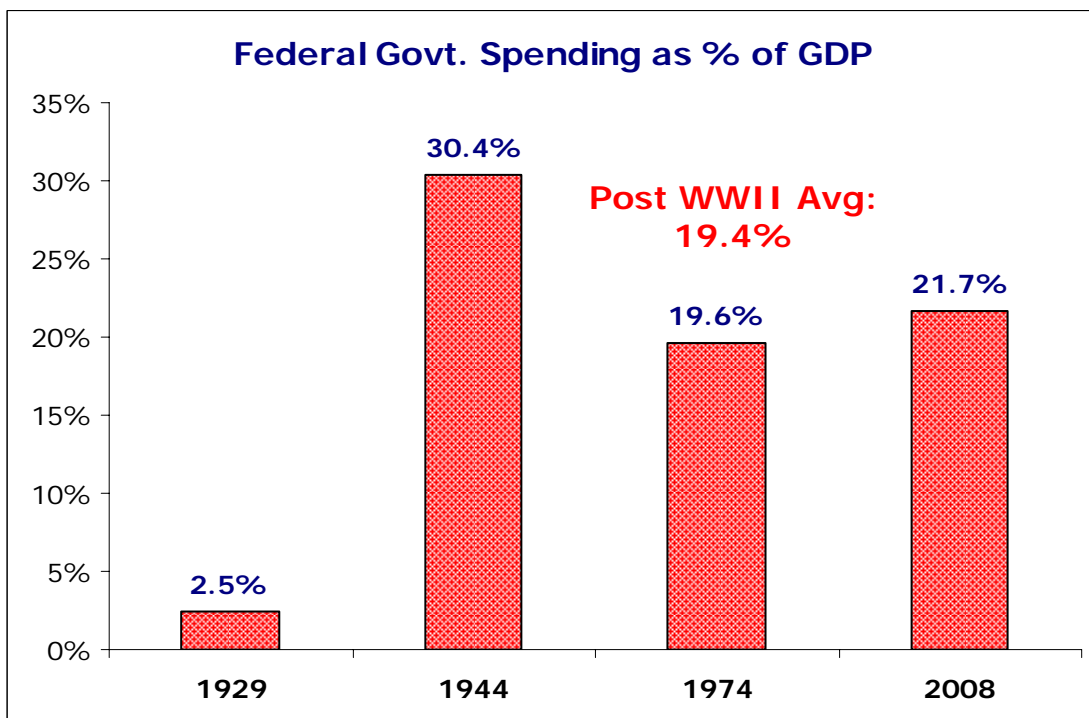
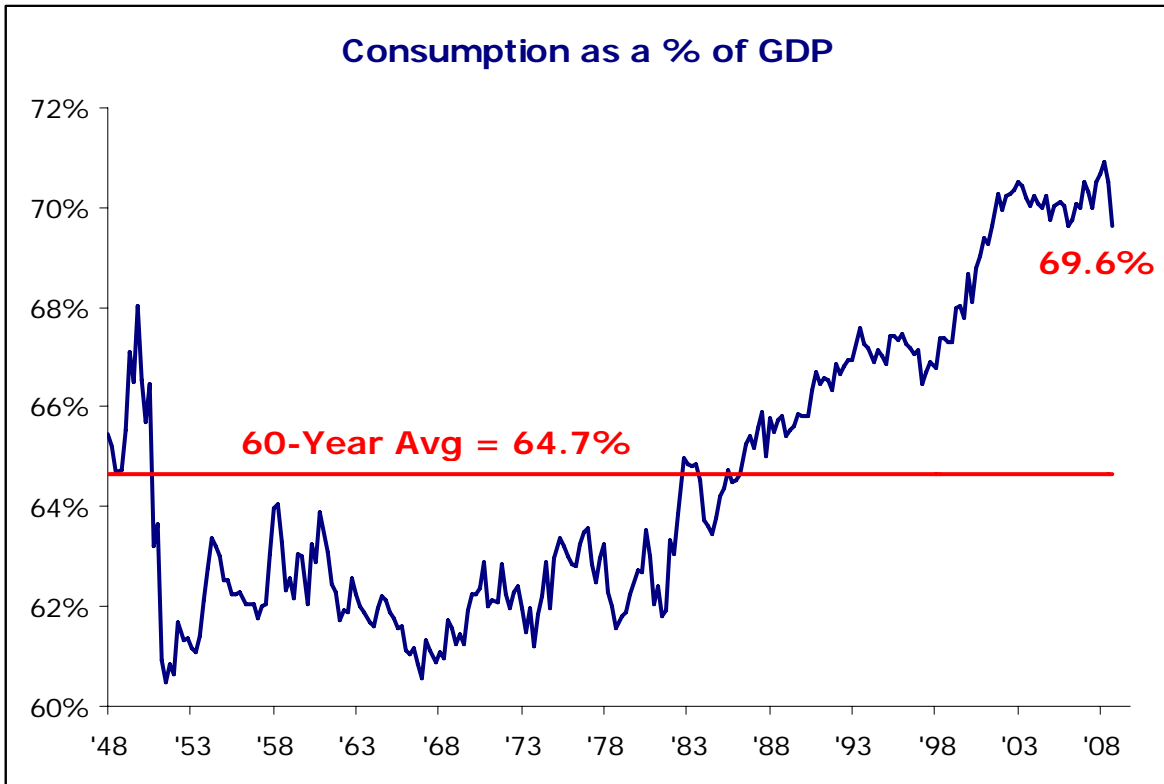


CURRENT U.S. RECESSION STARTED WITH BANK PROFITS - CONSUMER WEAKNESS STILL IN EARLY INNINGS

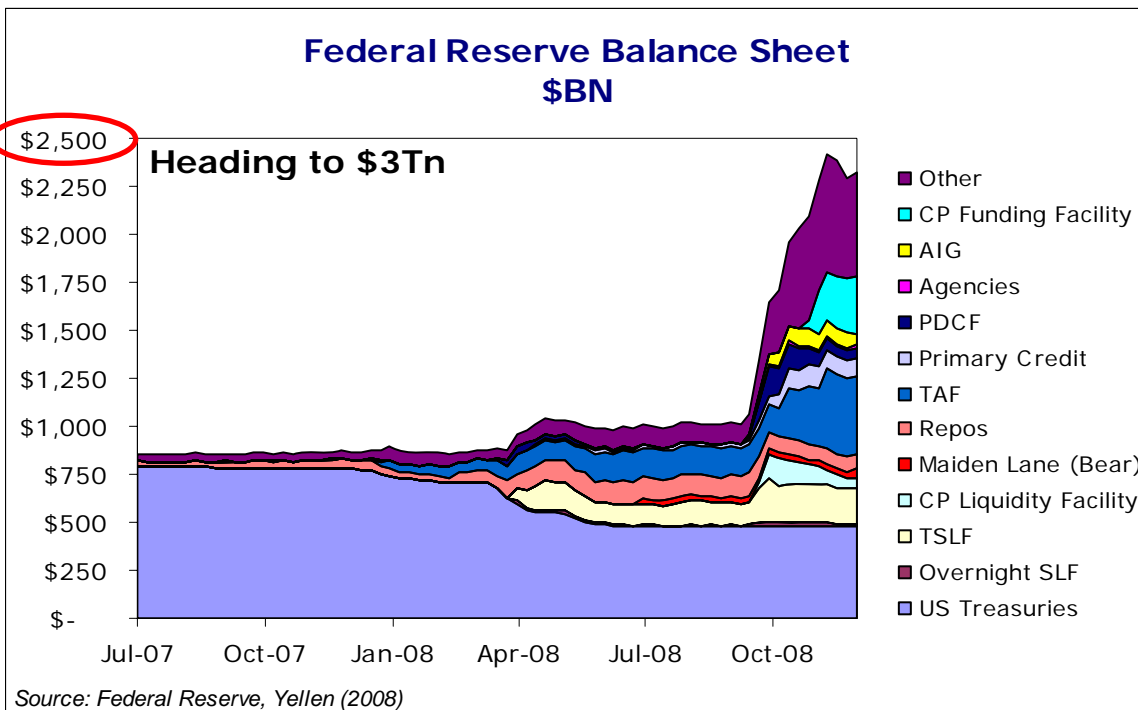


CONSUMER RESTRUCTURING COULD TAKE A LONG TIME

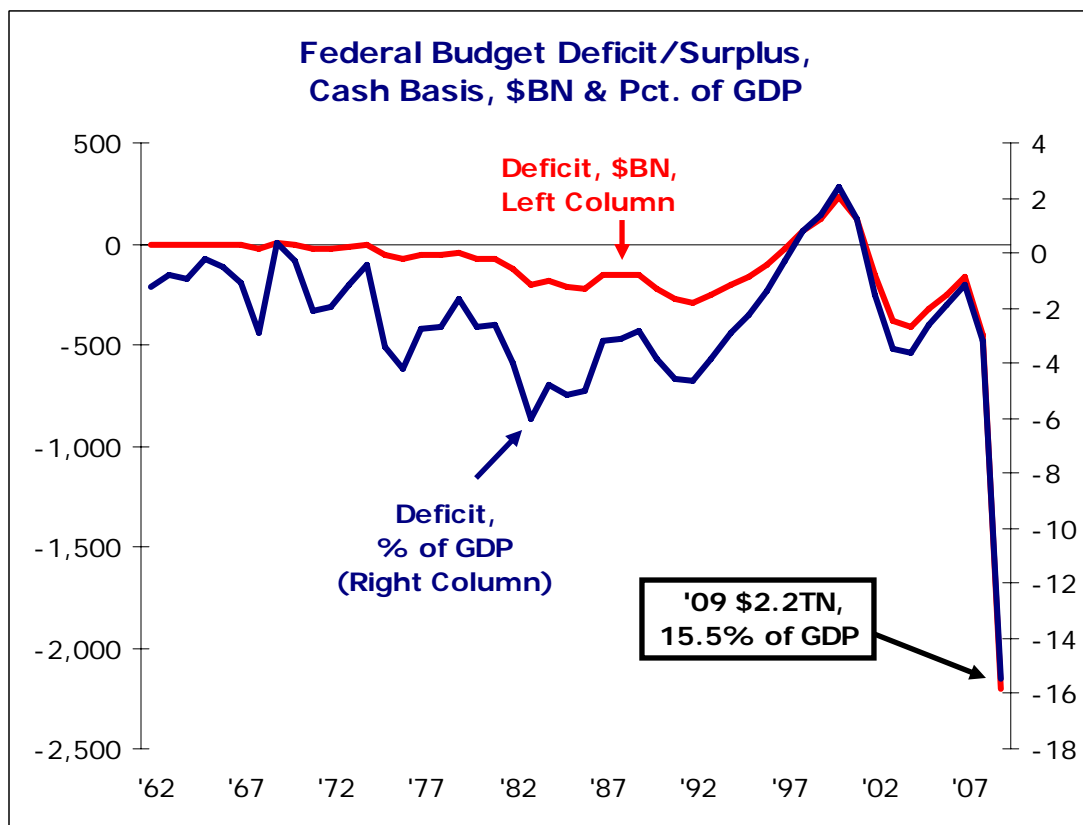
It has become part of the standard pabulum of economic commentators to say that consumer spending is 2/3 of the economy. That is indeed the long-term average, but it ignores the fact that consumer spending as a percentage of GDP actually peaked at roughly 71% in early 2008. In a \$14 trillion economy, the difference between 71% and 66% is significant and not easily corrected.



FED'S BALANCE SHEET CHANGING IN SIZE & COMPOSITION



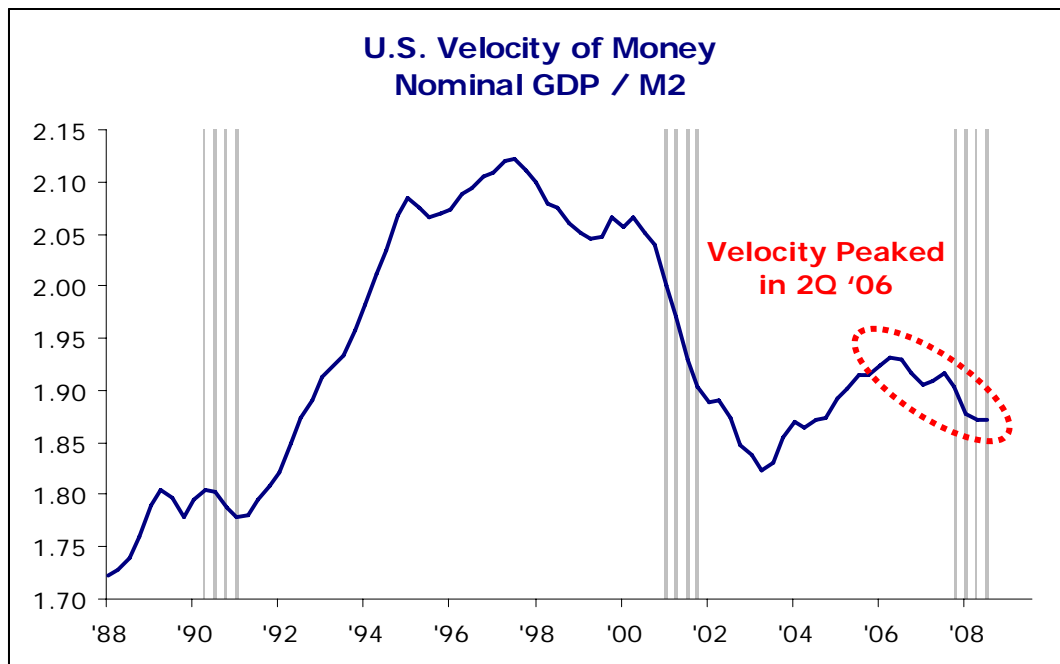
BUDGET DEFICIT COULD APPROACH \$2.2TN



VELOCITY OF MONEY CHECK-LIST

As monetarists we believe the market typically bottoms before the economy, because the monetary authorities create conditions under which money is generated faster than the underlying economy's ability to use it. An increase in the velocity of money creates an incentive for investors to buy riskier assets to play the eventual rebound in the economy. The list below might be a pretty good start in determining when accommodative monetary conditions could pave the way for a sustainable rally and when investors might believe that a switch from deflation to inflation is at hand. The re-intermediation of the banking system might mean that the "money number" may once again become an important economic release for the money management industry.

- 1) BAA Corporate & Jumbo Mortgage Spreads Recede
- 2) U.S. Dollar Strength Ebbs & the Yen Stabilizes
- 3) China's Stock Market Sustainably Outperforms
- 4) 10-Year Yields Move Higher
- 5) Unemployment Claims Reverse Path & Trend Lower
- 6) Fed's Senior Loan Officer Survey Shows Improvement

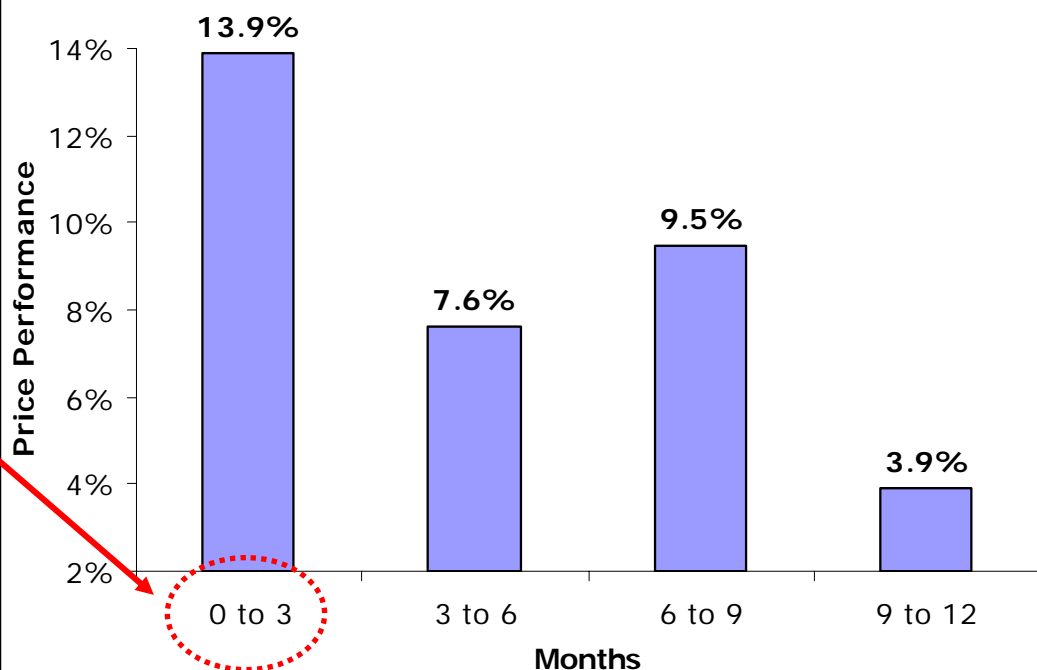


HISTORICAL BEAR MARKETS IN CONTEXT

Past Bear Markets

Start	End	Start Price	End Price	Months	S&P 500 Pct. Change
03/06/37	04/29/42	18.68	7.47	62	-60.0%
05/29/46	06/14/49	19.25	13.55	37	-29.6%
08/02/56	10/22/57	49.64	38.98	15	-21.5%
12/12/61	06/27/62	72.64	52.32	6	-28.0%
02/09/66	10/07/66	94.06	73.20	8	-22.2%
11/29/68	05/26/70	108.37	69.29	18	-36.1%
01/11/73	10/03/74	120.24	62.28	21	-48.2%
11/28/80	08/12/82	140.52	102.42	20	-27.1%
08/25/87	12/04/87	336.77	223.92	3	-33.5%
07/16/90	10/11/90	368.95	295.46	3	-19.9%
03/24/00	10/09/02	1527.46	776.76	31	-49.1%
AVERAGE				20	-34.1%
10/09/07	11/20/08	1565.12	752.44	13	-51.9%

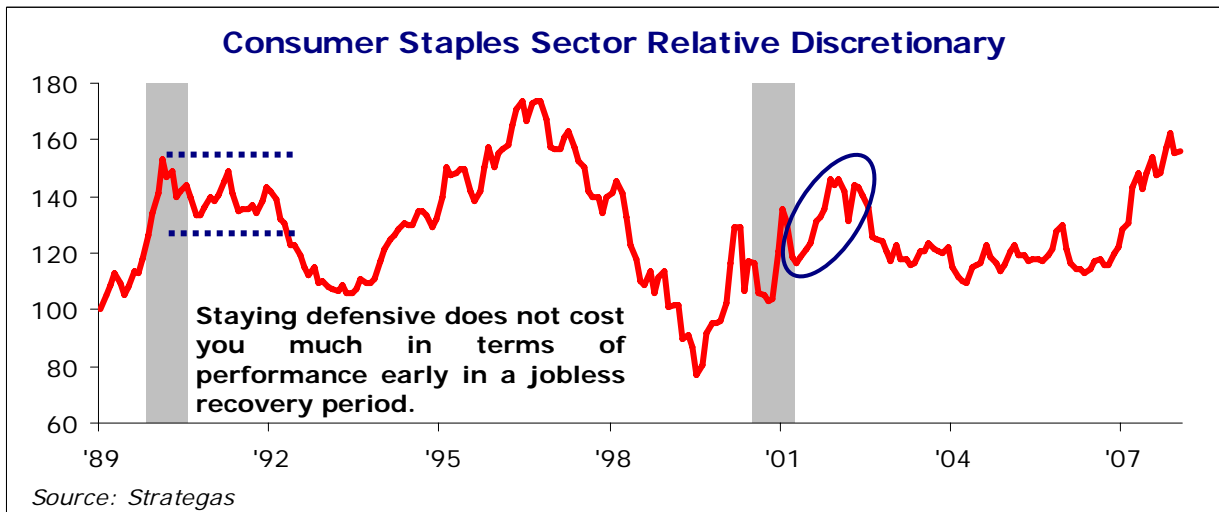
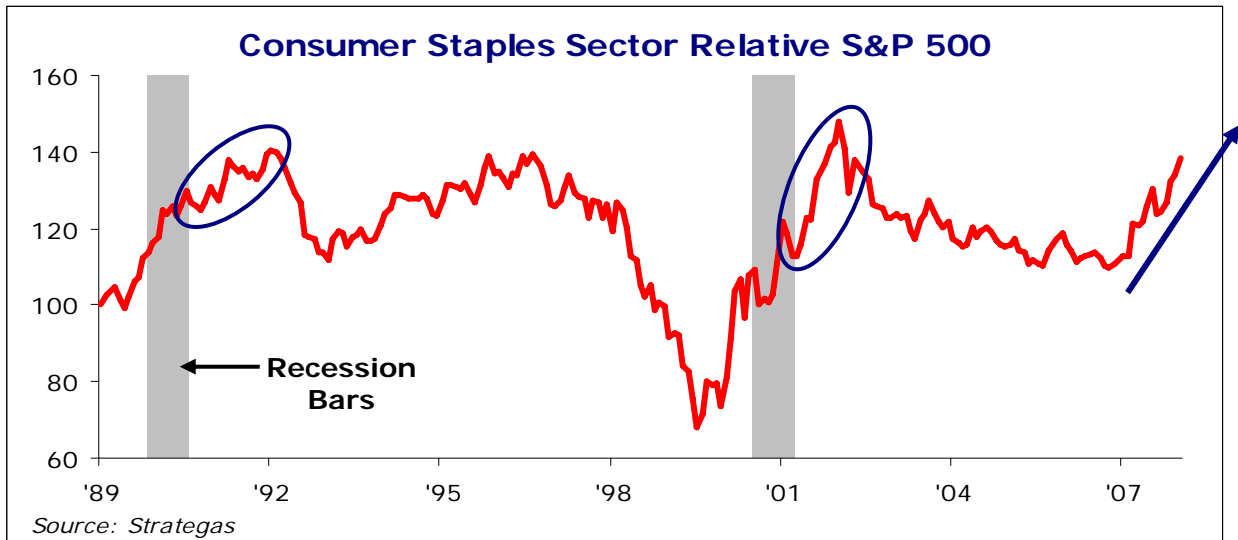
Market Performance Following End of Bear Market



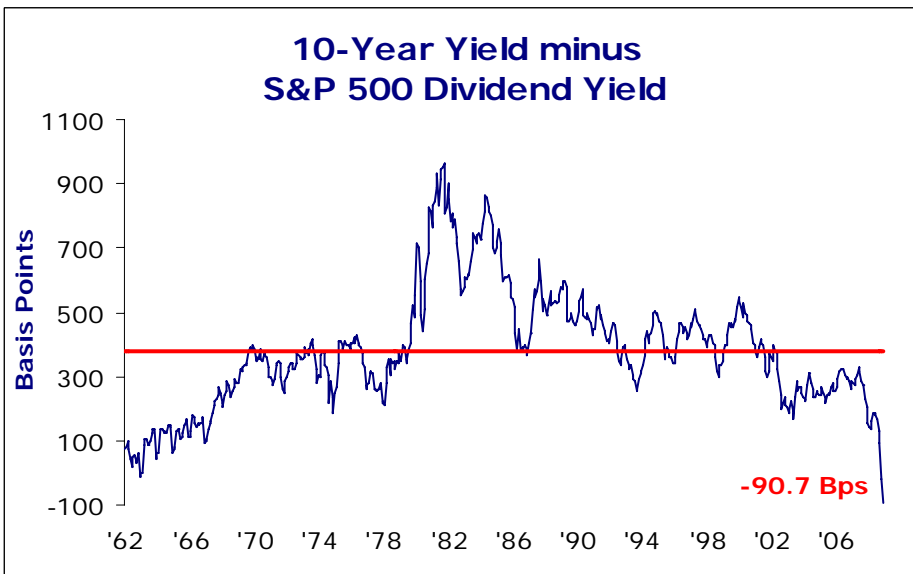
This chart argues against market timing for long-term investors -- the bulk of the market's rebound comes in the months immediately following the low.

NO RUSH TO ABANDON DEFENSIVE POSTURE

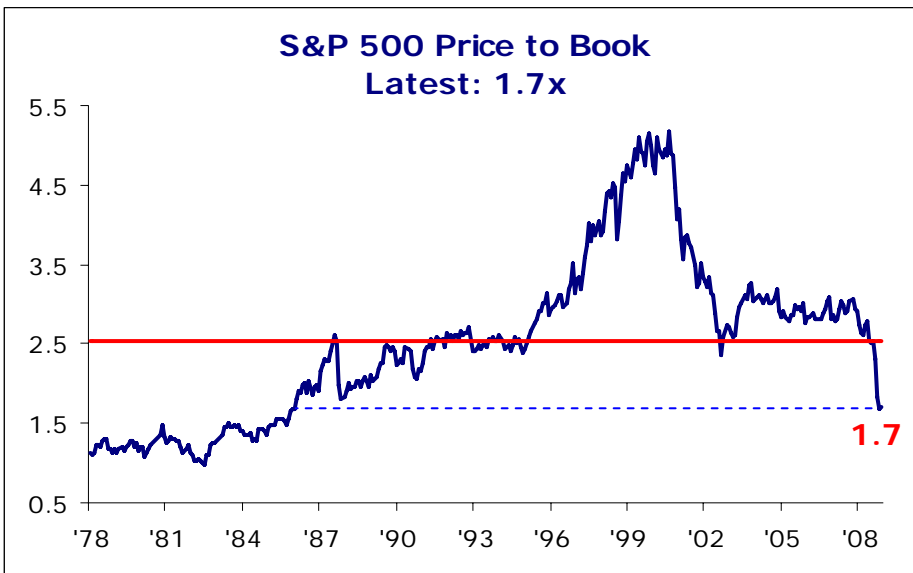
Consumer Staples Continues to Outperform
Broader Market in Months After Recession



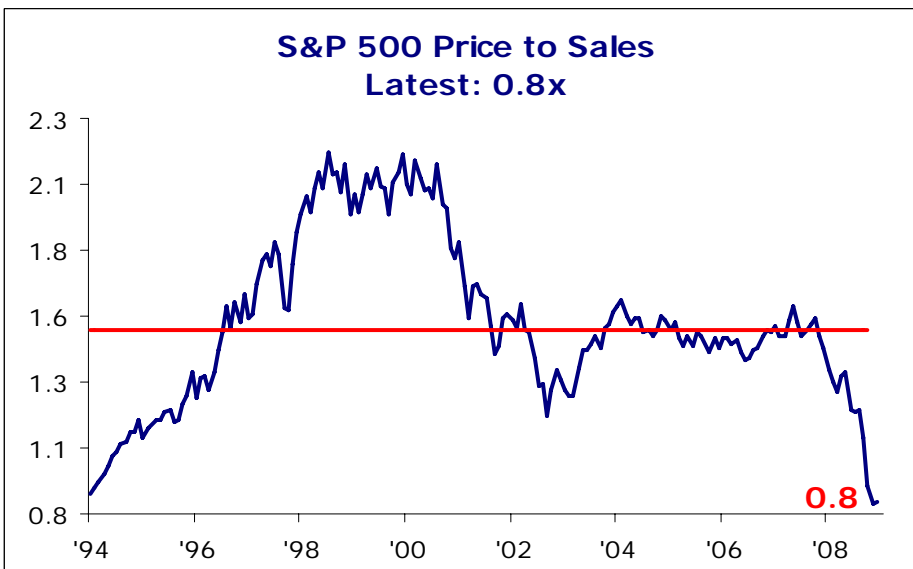
VALUATIONS APPROACHING EXTREMES



The market's dividend yield is now nearly 100 basis points greater than 10-Year Treasuries.



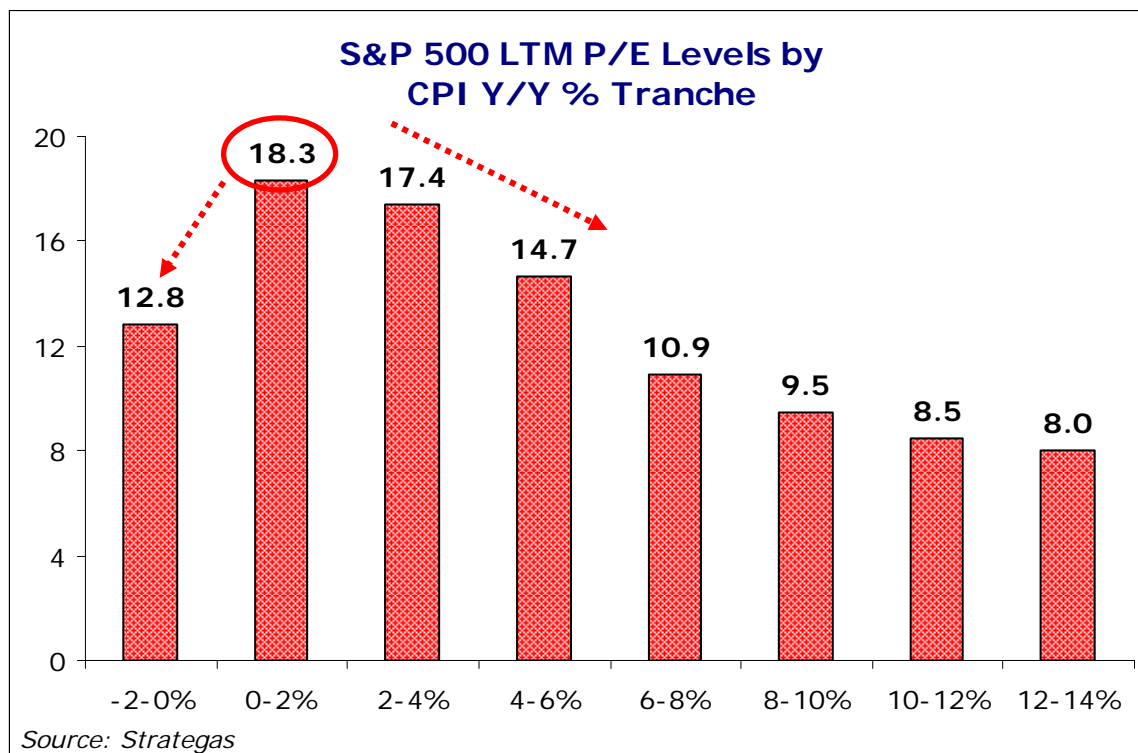
The market's current Price-to-Book is now lower than it has been at any time since roughly 1986.



The S&P's price to sales multiple is now 0.8x, lower than at any time we have available data (unfortunately only to 1994).

INFLATION AND EARNINGS MULTIPLES

The sweet spot for multiples is in the 0-4% inflation range, with statistical breaks both below 0% and above 4%. The fair value table below is a Rorsharch test of sorts but we believe current market levels are pricing in a lot of bad news.



Historical Market Bottoms: Multiples, Treasuries, Inflation, & Taxes

S&P 500 Trough	Level	Trailing P/E	10-Year Yield	Inflation	Top Marginal Tax Rate
10/22/57	38.98	12.2x	4.0%	2.9%	91.0%
6/27/62	52.32	16.1x	3.9%	1.2%	91.0%
10/7/66	73.20	14.8x	5.0%	3.8%	70.0%
5/26/70	69.29	14.0x	7.9%	6.0%	71.8%
10/3/74	62.28	8.3x	7.9%	11.8%	70.0%
8/12/82	102.42	8.8x	13.1%	6.0%	50.0%
12/4/87	223.92	12.6x	9.0%	4.3%	38.5%
10/11/90	295.46	13.1x	8.7%	6.4%	31.0%
10/9/02	776.76	19.8x	3.9%	2.0%	38.6%
Average		13.3x	7.0%	5.0%	61.3%
11/20/08 Low		11.4x	3.0%	3.7%	35.0%

CONTRARIANS NOTE: U.S. LARGE-CAP GROWTH THE DECADE'S WORST

By Asset Class,

	1970s	1980s	1990s	2000s
Small-Cap Stocks	11.5%	15.8%	15.1%	10.8%
Long-Term Government	5.5	12.6	8.8	8.8
Long-Term Corporate	6.2	13.0	8.4	8.1
Intermediate-Term Government	7.0	11.9	7.2	6.4
Treasury Bills	6.3	8.9	4.9	3.2
Inflation	7.4	5.1	2.9	2.8
Large-Cap Stocks	5.9	17.5	18.2	1.7

Style,

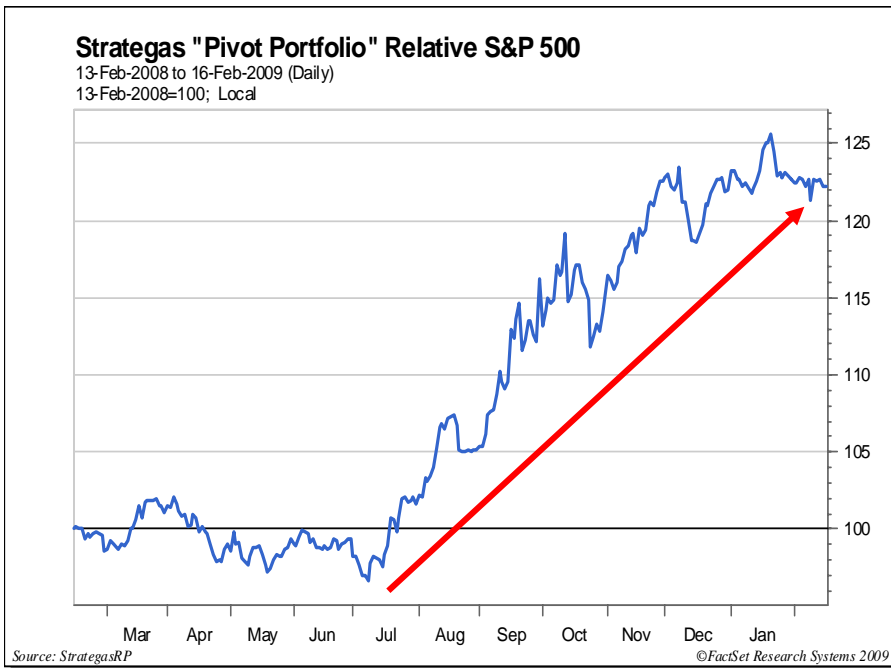
	1970s	1980s	1990s	2000s
Small-Cap Value	14.9%	20.3%	14.5%	13.6%
Mid-Cap Value	12.5	19.0	14.2	12.4
All Value	8.8	18.4	15.6	5.7
Large-Cap Value	7.7	18.1	15.8	4.2
Mid-Cap Growth	5.7	15.4	16.7	3.0
Small-Cap Growth	8.6	14.4	13.1	2.6
All Growth	3.3	15.4	20.0	-1.8
Large-Cap Growth	2.4	15.6	21.4	-2.8

And Region

	1970s	1980s	1990s	2000s
Canada	11.0%	11.6%	9.9%	13.5%
Europe	8.6	18.5	14.5	7.1
EAFE (Europe, Australia, Far East)	10.1	22.8	7.3	5.6
World	7.0	19.9	12.0	3.4
Pacific	14.8	26.4	0.5	2.6
United States	5.9	17.5	18.2	1.7

COST OF DEBT CAPITAL TO REMAIN IMPORTANT FACTOR; “PIVOT” STOCKS CONTINUE TO OUTPERFORM

In a deleveraged world in which the structured finance market has been forever changed, we believe that access to and cost of debt capital may be one the most important factors in determining earnings growth and performance as the economy slowly starts to recover. With credit semi-permanently impaired, we believe investors should now be buying companies just strong enough to access the credit markets, but not so strong as to provide little operating leverage – a so-called “pivot” portfolio. This “worst of the best” strategy would be a significant departure from what worked in the past, in which the most highly leveraged – “the worst of worst” – were able to most greatly take advantage of low interest rates and easy access to capital to outperform.



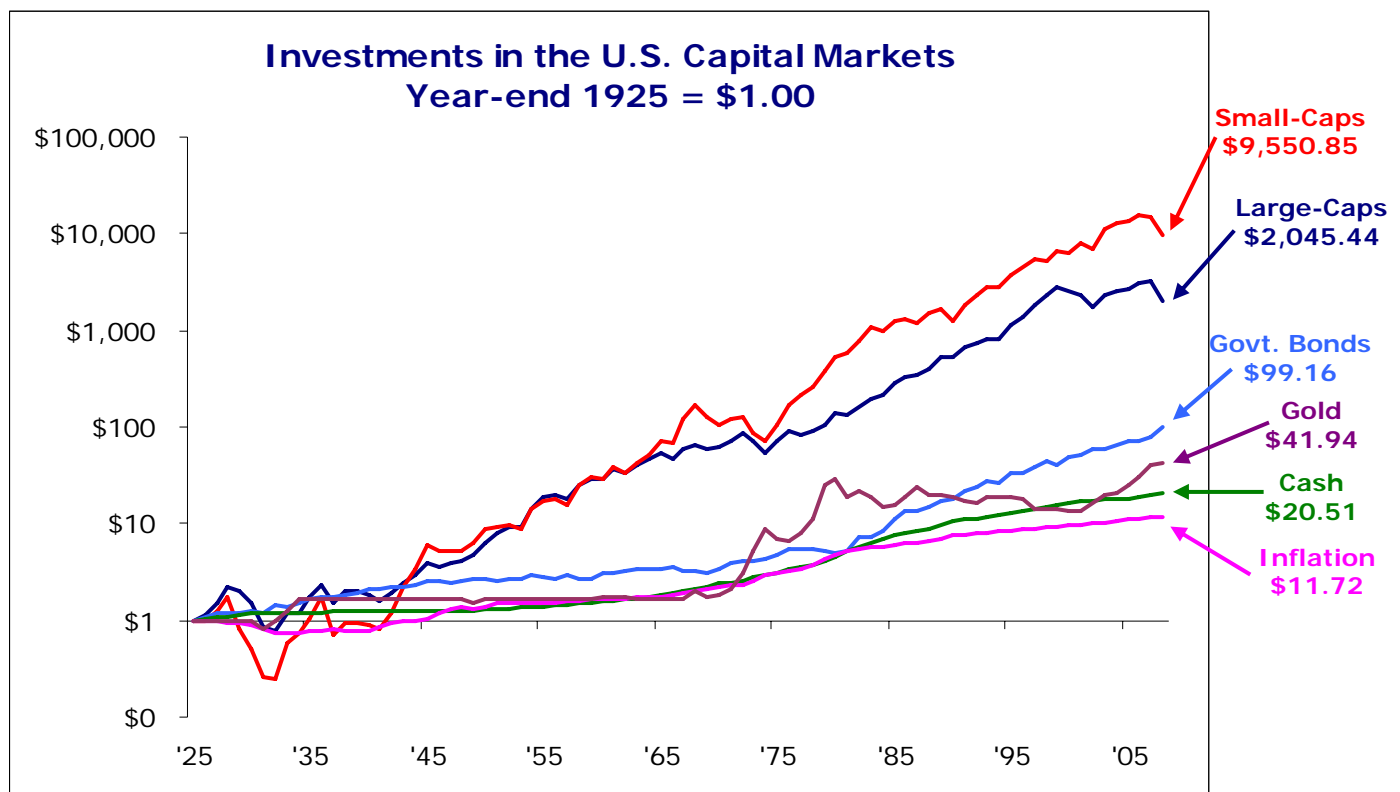
“Pivot Portfolio”

Wal-Mart (WMT), Home Depot (HD), Automatic Data Processing (ADP), Stryker (SYK), Sysco (SYY), Northrop Grumman (NOC), C.R. Bard (BCR), Expeditors International (EXPD), Sherwin-Williams (SHW), VF (VFC), Sigma-Aldrich (SIAL), Fastenal (FAST), Brown-Forman (BF.B), Church & Dwight (CHD), SEI Investments (SEIC), Aqua America (WTR), CenturyTel (CTL), Donaldson (DCI), Lincoln Electric (LECO), Gannett (GCI), BancorpSouth (BXS), Rollins (ROL), Jack Henry (JKHY), Fulton Financial (FULT)

Pivot Portfolio Criteria: 1) Market Cap > \$1.5 Billion; 2) 2008 Capital Spending < 3-Year Average; 3) Cash > 3-Year Average; 4) Debt to Equity < Sector Average; S&P Debt Rating Better than Index Average

STOCKS FOR THE LONG-RUN

To a remarkable degree, a number of our clients are asking us to provide charts and data to ask a simple question they are receiving from their clients across the investment sophistication spectrum – “why equities?” It is no surprise to anyone at this point that both sentiment and valuation are depressed, but the long-term charts on the following pages may provide investors with solace that we are, at least at the moment, a long way away from repeating the mistakes that led to the two most modern bouts with deflation – the U.S. in the 1930s and Japan in the 1990s. (It has only been recently that many of our clients have started to believe that the Japan scenario could be the *good* outcome.) At the moment, it appears unlikely that we will repeat the mistakes of the 1930s in the U.S. when a combination of a one-third decline in the money supply, protective tariffs, and increases in marginal tax rates compounded our economic problems for a decade. Japan a decade ago may be more relevant to our own experience now, but here again it appears that there is a far greater sense of urgency in recapitalizing the banks and reliquifying consumers. If one believes, as we do, that the unprecedented extent of fiscal and monetary stimulus will lead to eventual **reflation**, stocks should also act as a decent hedge against potential government induced inflation in the future. It’s almost become cliché, but stocks have provided the best returns among all asset classes in both clear skies and stormy weather.



ASSET CLASS VALUATION – STOCKS, BONDS, & HOUSING

