

Institutional Appreciation Strategy

4Q09

Market Review

A year – no, make that two years – to remember.

We will gladly accept the recovery in the stock market since March of this past year. We also express our appreciation to Ben Bernanke and his partners at the Federal Reserve, who understood the risk to the entire financial system in late 2008 and early 2009, and acted to prevent a worldwide calamity by flooding the financial system with money. But forgive us for continuing to believe that Wall Street's recovery and optimism is neither felt nor shared by Main Street. It seems to us that the outlook for 2010 depends on whether the domestic economy can at least partially fulfill the hopes that the stock market anticipates.

The government's massive money printing and deficit spending apparently have stopped the economic free-fall. Certain industrial production statistics and leading indicators suggest that the worst of the "Great Recession" is behind us. We wonder, though, what the underlying economic vitality will be when government stimulus is removed. We suspect that the Federal Reserve feels similarly, as each month, in speech after speech, representatives of the Fed talk about keeping short-term interest rates at very low (near zero) levels for an extended period of time. In our opinion, housing remains weak, supported by extraordinary tax credits to buyers and by the sale of distressed properties. The U.S. consumer remains under the strain of credit card and past mortgage debts; retail sales reflect the lack of wherewithal to spend as in the past.

We have written in recent letters about the likelihood of permanent changes in consumer behavior and that has shown up in the return of the U.S. savings rate from zero levels. Cash for clunkers and cash for caulkers might make sense as part of a recovery effort. The ranks of the unemployed and underemployed, however, cast a long shadow over an economy that struggles despite policy measures never dreamed of in our lifetimes.

“The ranks of the unemployed and underemployed, however, cast a long shadow over an economy that struggles despite policy measures never dreamed of in our lifetimes.”

sector. Leading detractors from performance for the period included NRG Energy Inc. in the Utilities sector, Bank of America Corp. and Forest City Enterprises Inc. in the Financials sector, Weatherford International Ltd. in the Energy sector and General Electric Co. in the Industrials sector.

Market Outlook

In our opinion, the financial infusions into banks, insurers and other agencies, while helping to avoid a meltdown, will leave enduring marks on our society. The public is angry – about employment loss and job insecurity, about declining real estate

Scott Glasser

Managing Director, Senior Portfolio Manager

- 18 years of investment industry experience
- MBA from Pennsylvania State University
- BA from Middlebury College

Michael Kagan

Managing Director, Senior Portfolio Manager

- 24 years of investment industry experience
- BA in Economics from Harvard College
- Attended Massachusetts Institute of Technology Sloan School of Management

PORTFOLIO MANAGER COMMENTARY



values and foreclosures, about loss of confidence in significant public and private institutions, about perceived favoritism for selected financial firms and compensation structures, and about the ineptitude of elected officials to effect meaningful change.

The reckless use of financial leverage by some banks and life insurance companies was intricately intertwined and causative in the collapse or near-collapse of those entities. With the use of effectively free money from the Fed, profitability in financial institutions has been restored and depositor interests have been protected. Failures were socialized, however, meaning taxpayers are footing the bill for some failed banks as well as industrial concerns (i.e., the auto industry). In the future, assistance that may be necessary might not be as easily accomplished given outrage over the lack of regulatory oversight or penalties for the managements responsible for some elements of the crisis.

ClearBridge Advisors

www.clearbridgeadvisors.com

800-691-6960

info@clearbridgeadvisors.com

Lest we be accused of “populism”, let’s be clear that there is enough blame to go around for other contributors to the “Great Recession.” These include politicians who aided and encouraged lax lending standards, regulators who stood by and watched while so many abuses took place and social policies that encouraged borrowing rather than savings, creating a nation of debtors.

“We are major believers in sticking with high quality assets, especially given the fragility of the recovery.”

The biggest losers, tragically, are the people who have done everything right. They saved, paid their mortgages, and lived within their means. Now, with short-term interest rates at temporarily low levels, they struggle to live on their retirement incomes. We are frequently asked about how to get higher yield with no risk -- which is an impossible task. The Fed is forcing savers and investors to take some risk to get the returns they want. It is difficult to see how the serious social and economic cross-currents described play out smoothly. We don’t claim to have a perfect solution, but given that scenario, we are major believers in sticking with high quality assets, especially given the fragility of the recovery.

If we made a “mistake” this year it was sticking with higher rather than lower quality issuers. We prefer stocks with solid dividends over bonds with miniscule yields as the dividends can rise over time. We have always emphasized quality stocks with better balance sheets, sustainable business models, high free cash flow yields, and proven managements. We will continue with the strategy and philosophy.

It is hard to imagine that 2010 could be as exciting as this past year. That is not a bad thing. Given the incredible swings of the past two years, we are extremely grateful for your continued belief in our determined efforts to help protect your financial well-being.

Past performance is no guarantee of future results.

Copyright © 2009 ClearBridge Advisors

ClearBridge Advisors consists of ClearBridge Advisors, LLC and ClearBridge Asset Management Inc.

All opinions and data included in this commentary are as of December 31, 2009 and are subject to change. The opinions and views expressed herein are of the ClearBridge Advisors, LLC Appreciation portfolio management team and may differ from other managers, or the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results or investment advice. The statistics have been obtained from sources believed to be reliable, but the accuracy and completeness of this information cannot be guaranteed. Neither ClearBridge Advisors, LLC nor its information providers are responsible for any damages or losses arising from any use of this information.