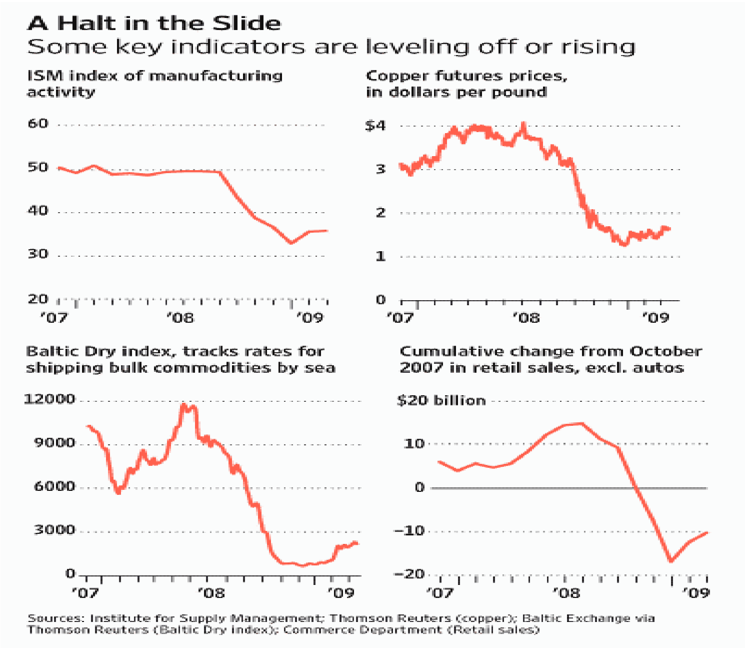
Baldwin Investment Management, LLC

…..NOT SO BAD AS IT WAS…..

The title above is a second derivative thought and we will explain later the notion of "second derivative". But we thought that since the world is drowning in a sea of derivative excess, characterized by none other than Warren Buffet as financial "weapons of mass destruction", we would use a literary derivative to start us off.

Like new plant shoots poking their heads through the soil, scattered signs of economic stability have become evident. We are not declaring an end to the U.S. recession but we are noting some signs "of spring". The rate of deterioration in a number of measures has declined and in fact some indices have even turned positive.

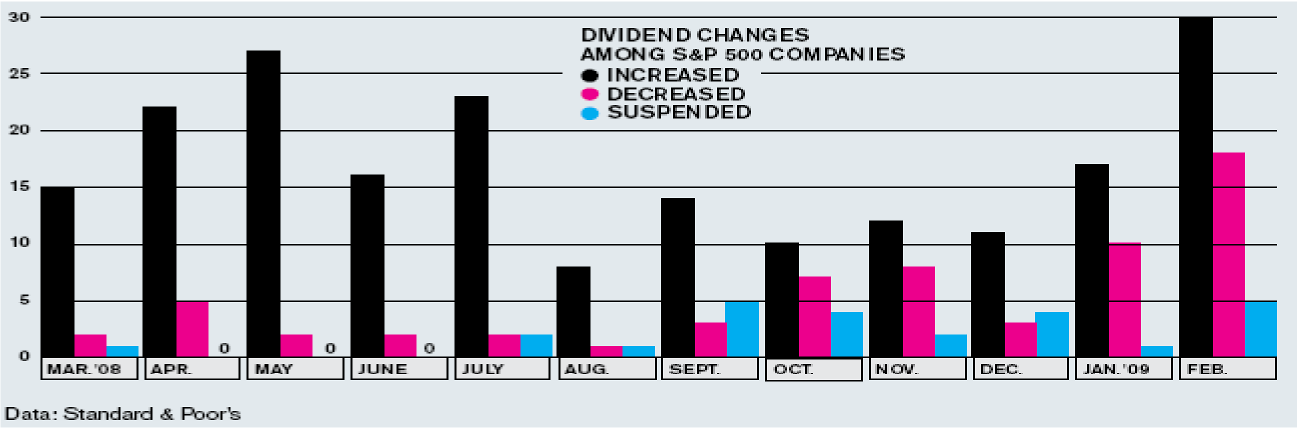


First, the ISM index for manufacturing has turned up. This is a very broad measure of manufacturing activity in America. A score below 50 means that manufacturing is shrinking. As the reader will note, the Index is well below 50 – but has turned up. So things are "not so bad as it was", a second derivative description of the state of U.S. manufacturing. The price of copper futures may have bottomed and turned northward. Copper is used in a multitude of applications in many industries so increased prices are indicative of some economic stirrings. The Baltic Dry Index, one of our favorites, has taken a decided turn for the better. This index, perhaps better than almost any index, captures the state of health of world trade. If the index is going up, shippers are increasingly chartering ships to move goods around the world and that means business is being done. Everyone should watch this indicator! Lastly, it looks like retail sales (ex. autos) have started a push forward. As one can see, retail sales "fell off a cliff" towards the end of last year. It would appear that "cupboards are bare" and consumers need to restock. One can only stop refilling the cupboards for some period of time – not forever. These indicators are not "thin reeds" on which we are building our case that things are "not so bad"; there are others. For example, the stock market has rebounded smartly from a recent intraday low of 666 on the S&P 500 and the yield curve (a chart of interest rates at various maturities) is steeply sloped, signifying importantly that the bond market, like the stock market, seems to think that things are getting better.

We have written that two important changes need to be made to our regulatory system to help the mending: first, the uptick rule needs to be reinstated; second, mark-to-market accounting rules need to be reformed; not to do away with the concept, but to have the rules work better in "the real world" not a theoretical world. Happily, it seems that there is a strong movement afoot to accomplish both. This will relieve some important pressures in our markets. Representative Barney Frank has publicly stated that he expects the SEC to reintroduce the uptick rule in about a month's time. There is also a growing chorus in Congress to edit the mark-to-market regulation and change is supported by Warren Buffet, who believes the rules as presently written do not add clarity to financial reporting, but rather cloud issues. So, presuming (which can be dangerous!) that both regulations are changed as currently outlined, the stock market should react positively. This is important progress!

Economic stimulus is coming from our government and an even bigger stimulus package is already in the works. The government's jolt to the system (totaling almost $800 billion) will start flowing later this year. The one already working is potentially much larger – approximately $1.7 trillion at current estimates, representing 2.7% of world GDP. This is more than three times larger than any stimulus in any other recession. About what are we speaking? At current oil prices, consumers in the United States, France, Germany, Japan, China, Spain, Italy, etc. will pay a fraction for energy this year as compared to last. This savings "drops to the bottom line" in a very stimulative fashion, putting a lot of money in people's pockets.

The headlines have focused on unemployment, Citigroup, AIG, Wall Street bonuses/compensation, office redecorations, Bernie Madoff, stock market tumbles, and real estate debacles. It has been nothing but a litany of woes, very depressing stuff. We do not suggest for a moment that all the aforementioned has not happened or that it is not serious. BUT what we are suggesting is that not everything is awful. This reflects our second derivative view of the world. While not everything is positive, we do not predict that things will become as negative as rapidly as they were in Q4 of 2008 – hence the second derivative characterization of "…not as bad as it was…" Not everyone is firing people. Jobs are being added in education and health care. Discount retailers, like Family Dollar Stores are adding some staff. Nuclear engineers are being hired at Westinghouse Electric and GE Hitachi Nuclear Energy. Companies are under leveraged with a great deal of cash (the non-financial firms of the S&P 500 have $811 billion of cash and marketable securities on their books). In spite of the headlines indicating otherwise, more corporations are raising dividends than are lowering them.



Source: Business Week, 3/16/2009

Houses are being sold. Recent statistics out of California, considered by some to be the epicenter of the housing crisis, clearly demonstrates that housing inventory is being cleared as prices have come down and affordability has gone up. The market is working.

We have written in the past about various market measures and about how cheap we believe the markets are – here in the U.S. or elsewhere around the world. We will repeat ourselves to say that we still believe that markets are cheap. When they will get more expensive has much to do with when investor sentiment will improve.

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PREDICTIONS FOR 2009	**COMMENTS**
1) Stock markets around the world will do better in 2009 than in 2008	So far, very wrong
2) Oil prices will rise	Yes
3) Housing will stabilize in 2009	Some encouraging signs in California, Florida, Las Vegas & Arizona
4) The U.S. Treasury market will decline in price	Yes, investors are regaining a risk appetite
5) Corporate and municipal bond prices will go up	Yes, investors are regaining a risk appetite
6) The Baltic Dryship Index will go up, reflecting world growth	Yes, world trade is "up off the floor"
7) Inflation will not be an issue in 2009 – but will look like it will become an issue for 2010	Yes
8) China will assume a more important geopolitical/economic role	Yes, as an important investor, China's sway grows
9) Alternative investment vehicles (i.e. private equity, hedge funds) will lose investors to mainstream investments	Yes, funds are expecting more liquidations this year
10) Russia will continue on its path of becoming more insular	Yes, as a result of their economic implosion

A FINAL THOUGHT

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A list of our Proxy voting procedures is available upon request.

A current copy of our ADV Part II & Privacy Policy is available upon request or at www.baldwinim.com/disclosure.htm

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