



Baldwin Investment Management, LLC

FOLLOW THE CASH

At the beginning of this year, money market fund assets had swelled to nearly \$4 trillion (See Chart #1). As we all know too well, investors had been selling almost any asset, no matter its quality or future prospects, because they were seeking liquidity. There was fear in investor hearts. As Baron Rothschild once quipped, there was “blood in the streets”. Return on investment was not considered important. Rather, return *OF* investment was considered paramount. Volatility as measured by several different markers was setting new and historic highs. Wild swings in asset prices daily were normal rather than unusual. Whole markets were frozen. Prices could not be determined. Traders would not trade. Deals collapsed.

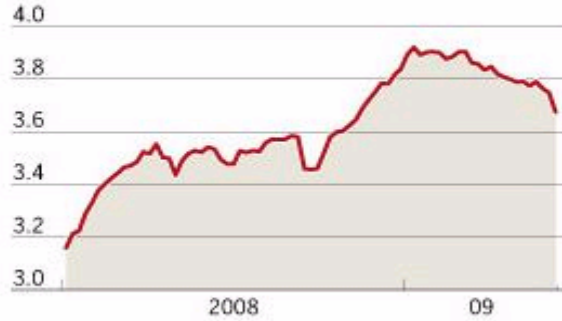
Time has passed and numerous “wounds” have been healed. All is still not right with the world – but substantial improvement has been made. Importantly, most markets around the world are again functioning in a normal fashion. Many emerging markets have registered substantial gains so far in 2009, helping eradicate some of the losses recorded in 2008. In the U.S. the S&P 500 is positive for the year as is the NASDAQ, after both were down quite significantly earlier in 2009. The EAFE markets are also up for the year. Bond markets have rallied around the world and several commodities (like oil, corn and sugar) have scored nice gains during the year to date. Why?

Since last fall, numerous programs have been put in place by the U.S. government and other central governments around the globe to help stabilize markets. These efforts were aided by massive amounts of liquidity supplied by central banks. Combined, these initiatives calmed investor nerves. People began to believe that the financial world was not coming to an end and markets started to function more typically. Volatility indexes declined dramatically. Some sense of calm returned to the marketplace. Improving investor sentiment was a necessary condition but not a sufficient condition to advance market prices. This is where the cash comes in and why it is always important to follow the cash. Just because someone feels better does not necessarily mean that they are going to execute on anything. But once someone “decorates the mahogany” with cold, hard cash to invest in an asset – then times have changed.

CHART #1

Cash in money market funds has peaked...

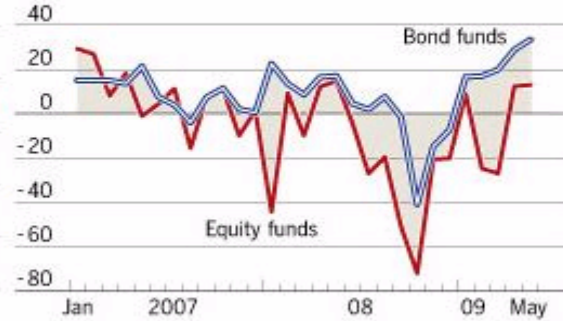
US money market funds
Total net assets \$bn ('000)



Sources: EPFR; Investment Company Institute

...flows into bonds exceed equity inflows...

US mutual funds
Monthly net cash flows, \$bn



...EM equities and bond funds the winners

Global fund flows
Cumulative year-to-date, \$bn

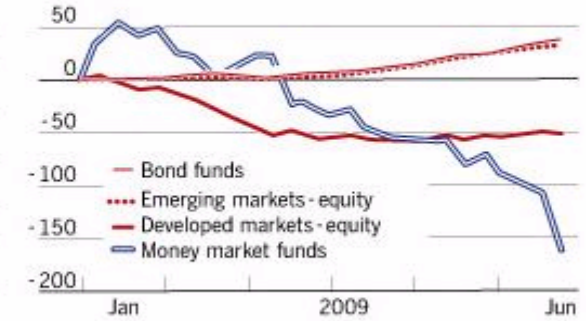
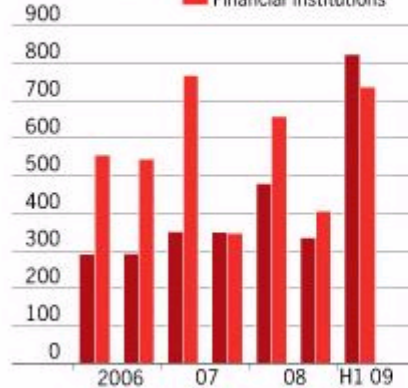


CHART #2

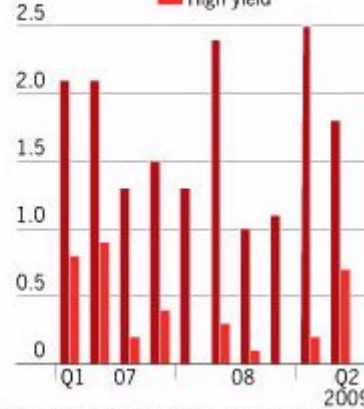
Global corporate and financial bond issuance*

Deal value (\$bn) ■ Corporate ■ Financial institutions



Global corporate bond revenues

Value (\$bn) ■ Investment grade ■ High yield



Source: Dealogic *Investment grade only **Including IPO's, follow-ons and other equity capital raisings

Once return on investment became dominant over return of investment, capital started to flow to riskier assets than cash (see Chart #1 above). Bonds have been the asset class which has to date received the most investment. Investors, deciding to “dip their toes” in the investment “pool” have started at the top of the capital structure. They were willing to take some risk – but not to be aggressive about it. American corporate and municipal bonds rallied first as they were cheap to the ultra-safe U.S. Treasuries. In Europe, high grade corporate issuance stands at \$345.1 billion, already outstripping the record for any previous year. Then high yield bonds (also known as “junk” bonds) joined the party. Global high yield issuance reached \$59.4 billion in the first half of 2009, with most of that in the second quarter (see Chart #2 above). Furthermore, in spite of all the money that has been raised, investor appetite for more seems unslaked. Recent deals have been priced at lower coupon levels than expected and deal books have been many times oversubscribed. As mentioned earlier, emerging markets have rallied strongly in 2009. Once again, there are discussions of market “decoupling” (i.e. markets not being highly correlated and going different ways) amongst pundits – a thought with which we agree. Equity financings have had a slow start to the year. But speed is picking up and bankers are predicting a return of initial public offerings later this year.

Cash is now seeking higher returns. Investors are willing to take on more risk. Importantly, there remains an abundance of investment money still to be deployed – in excess of \$3.6 trillion according to Chart #1. The U.S. stimulus cash has not yet been spent to any large degree – less than \$50 billion so far. Thus, the American economy can look forward to increasing growth in the second half of 2009 and into 2010. Parenthetically, this should help many foreign economies as America remains a big consumer of foreign goods and services. Corporate earnings should begin to turn for the better and by Q4 2009 should begin to register positive growth comparisons with fourth quarter 2008 results. Interest rates around the world are historically low and inflation is quiescent. Thus, no central banker anticipates raising interest rates any time soon. At these interest rate levels, stocks, while no longer “dirt cheap” are still inexpensive – especially in terms of expected higher earnings in the near future.

PREDICTIONS FOR 2009

COMMENTS

- | | |
|---|---|
| 1) Stock markets around the world will do better in 2009 than in 2008 | Yes, markets strong across the board |
| 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 – numerous hedge fund bankruptcies |
| 10) Russia will continue on its path of becoming more insular | Yes, as a result of their economic implosion |

A FINAL THOUGHT



modern
“Look closely, Ms. Fleere—do
you see the man who managed
your hedge fund?”

A FINAL, FINAL THOUGHT



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The reported numbers enclosed are derived from sources believed to be reliable. However, we cannot guarantee their accuracy. Past performance does not guarantee future results.

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

06/30/09