Baldwin Investment Management, LLC

UNBEARABLE JEOPARDY

OR

BEHAVIOR IN A BUNKER

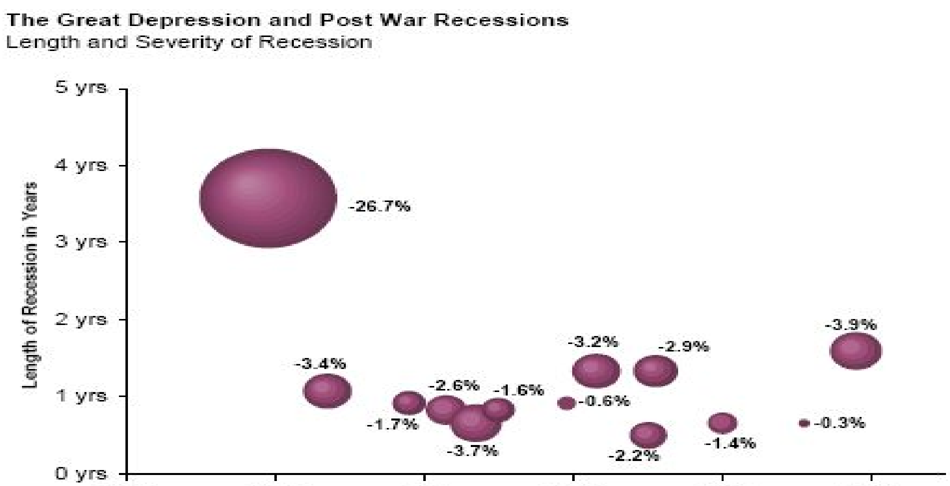
Daniel Kahneman and Amos Tversky outlined some basic precepts of behavioral finance in the early 1980's, (work that won Kahneman a Nobel Memorial Prize in Economics in 2002), that people fear loss more than they treasure gain. In the discipline of behavioral finance, the phenomenon is called "risk intolerance."

Recently, two professors from the Wharton School of the University of Pennsylvania, (Devin G. Pope and Maurice I. Schweitzer), published a paper entitled, Is Tiger Woods Loss Averse? Persistent Bias in the Face of Experience, Competition, and High Stakes, which supports the Kahneman/Tversky proposition not from studying the denizens of Wall Street but examining some of the best golfers on the professional tour. Approximately *1.6 million* putts attempted by 200 golfers between 2004 and 2008 were studied by them. The distance of each putt was analyzed using laser precise measurement. The result was that from an *equal distance*, birdie putts were made 3% less frequently than par putts. This bias to sink the par putt more often than the birdie cost the best golfers approximately $1.2 million in tournament winnings per year, according to Pope/Schweitzer. *OUCH!* Golfers exhibit a measurable and costly bias known as loss aversion. The fear of making a bogey is scarier than the potential exhilaration of making a birdie. If one misses a birdie, it is acceptable to make par. Missing par and making a bogey is not acceptable and thus golfers feel a greater sense of urgency not to drop a shot, be more aggressive and make par. Strong evidence of an economically significant omission bias: players incur substantial losses by playing too conservatively.

In another field of endeavor, blackjack players exhibited similar behavior. In a study entitled Fear and Loathing in Las Vegas: Evidence from Blackjack Tables published this summer, Professor Bruce I. Carlin from UCLA and Professor David T. Robinson from Duke University, showed that players fail to act when they should. The professors, with the help of tiny embedded RFID chips, studied 4,300 hands played during 1,300 rounds of blackjack in a Las Vegas casino. Gamblers generally make two kinds of mistakes – inaction and unnecessary action. However, in the study, the errors of inaction were four times more often than the errors of unnecessary action. In short, most people persist in being too conservative – failing to take a card when it would be best to do so. The economic cost of such mistakes was significant. Winning hand players who acted won approximately 20 times more than those who did not. *UGH!* People experience more regret from actions they have taken than from inaction. Further, gamblers are by nature risk-takers, which surprisingly, serves to magnify the inaction bias. Even those who love risk err far more often by failing to act.

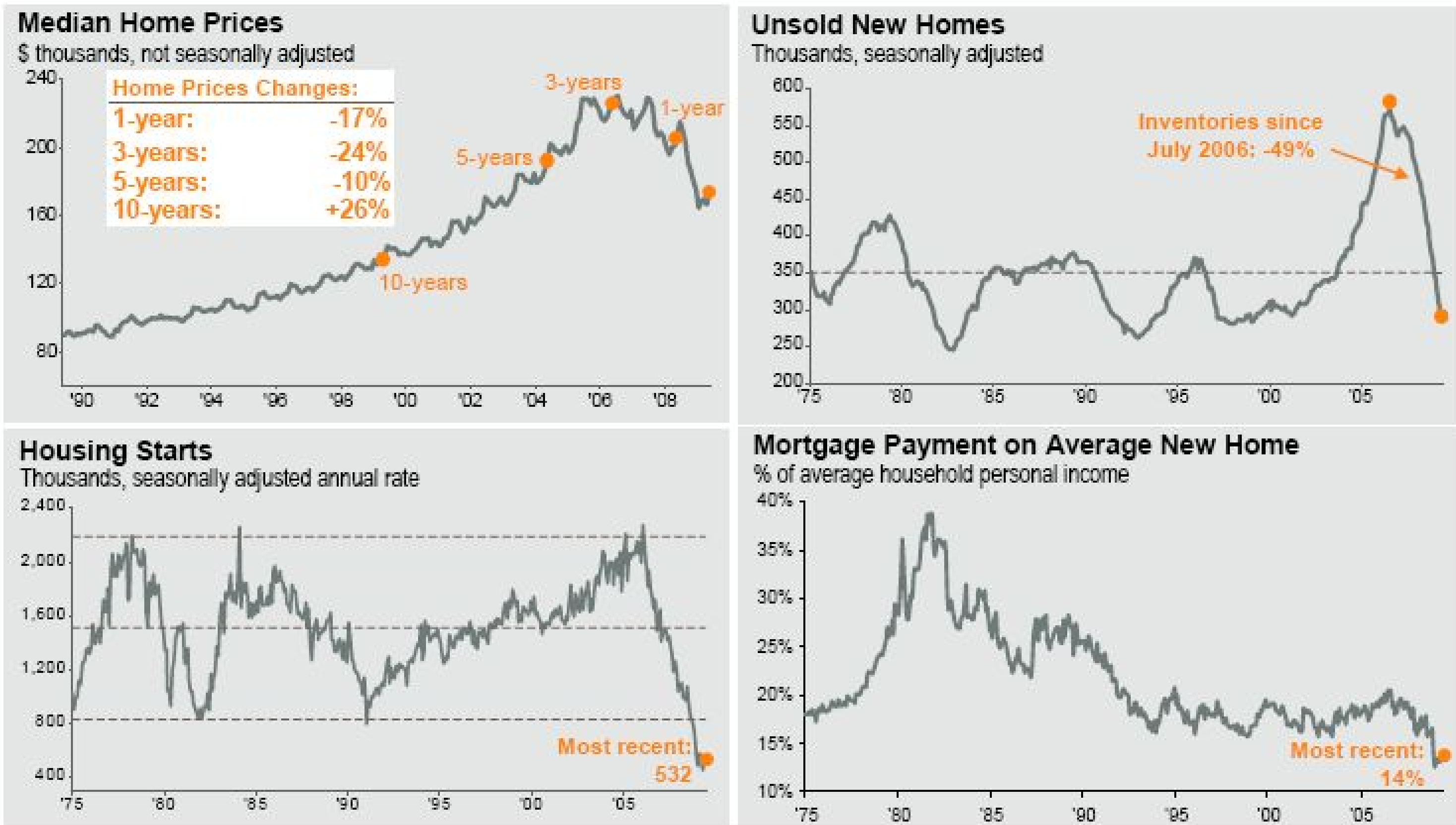
So what does all this mean for investors? Well, investors are human and are subject to the same emotional constraints which afflict golfers and blackjack players. Most people fear losing more than they treasure winning. I must sink the par putt – but I do not have to sink the birdie. Losing $100,000 is more painful than earning $1,000,000 is joyful. This will typically lead to much too conservative asset allocations and investment selections. Also, when people make mistakes, it is more than likely because they failed to act (i.e. sticking to a discipline, rebalancing a portfolio) rather than actually doing something when something is called for. Markets around the world, no matter the asset class, have put investors through a "hair-raising" time over the past 12 months. To be a successful investor, like a successful golfer or gambler, emotions must be kept in check. Otherwise, risk intolerance will lead to too many mistakes – hazardous to one's financial health.

Some Interesting Pictures……



Source: NBER, BEA, J.P. Morgan Asset Management.
Bubble size reflects the severity of the recession, which is calculated as the decline in real GDP from the peak quarter to the trough quarter except in the case of the Great Depression where it is calculated from the peak year (1929) to the trough year (1933), due to a lack of available quarterly data.
Data are as of 07/31/09.

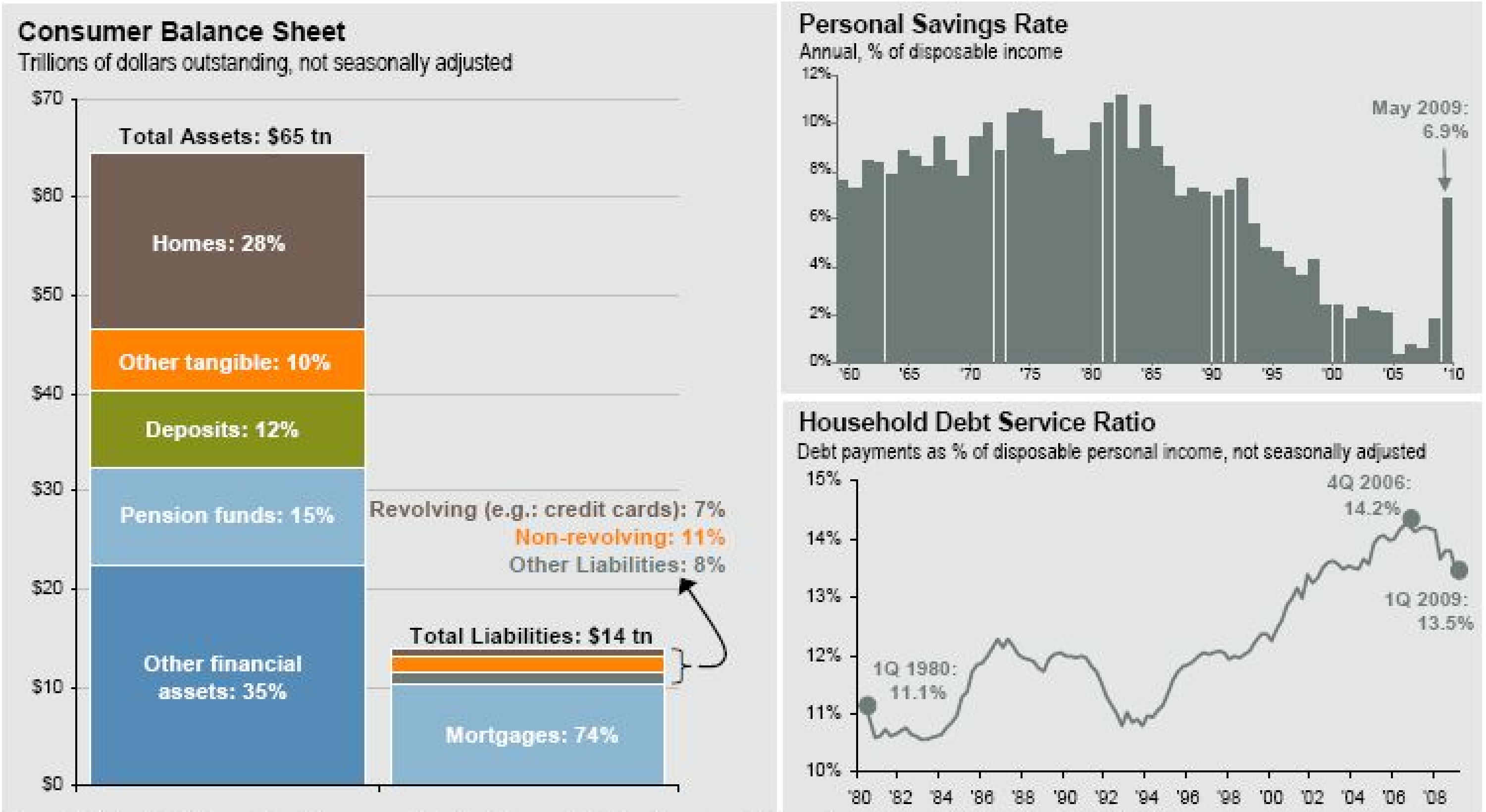
A bad recession – but certainly no Great Depression II and about on par with at least 3 others



Sources: (left chart) Census Bureau, FactSet, EcoWin, J.P. Morgan Asset Management. (Top right chart) Census Bureau, FactSet, EcoWin. J.P. Morgan Asset Management. (Bottom right chart) Census Bureau, Federal Reserve Board, BEA. Data reflects most recently available as of 06/30/09.

Home price based on median sales price of existing homes and are cumulative, not annualized. Existing-home sales include single-family, townhomes, condominiums and co-ops. Note: Calculation for bottom right chart assumes a 20% down payment, a 30-year fixed rate mortgage, excludes property tax and homeowners' insurance and is expressed as a percent of pre-tax income.

Where It all started: Inventories clearing + little new supply + affordability up substantially = House Prices up in the future.

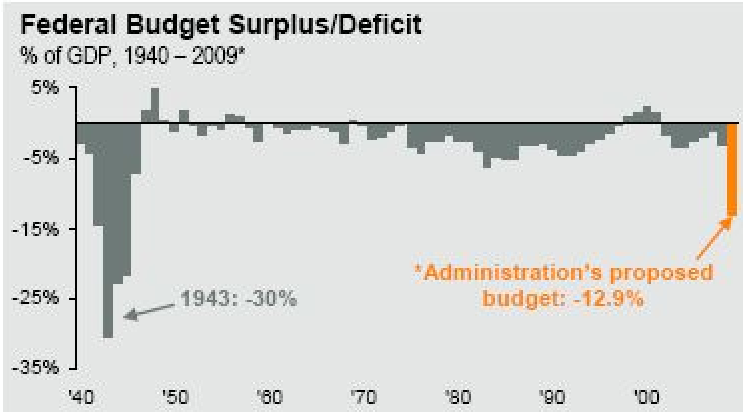


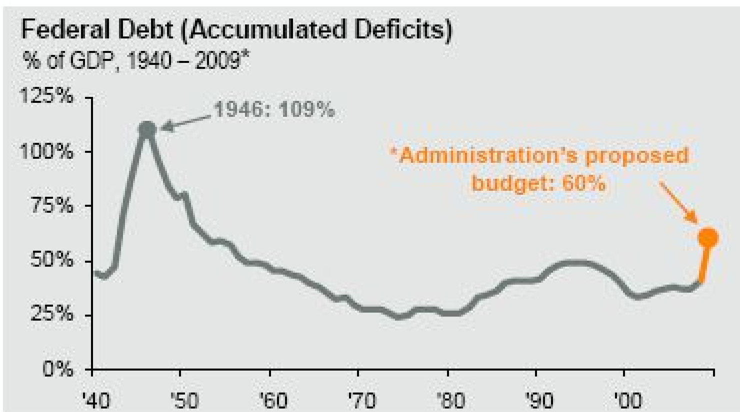
Source: (left chart) J.P. Morgan Asset Management, Federal Reserve. Data includes households and nonprofit organizations. (Right charts) J.P. Morgan Asset Management, BEA, Federal Reserve.

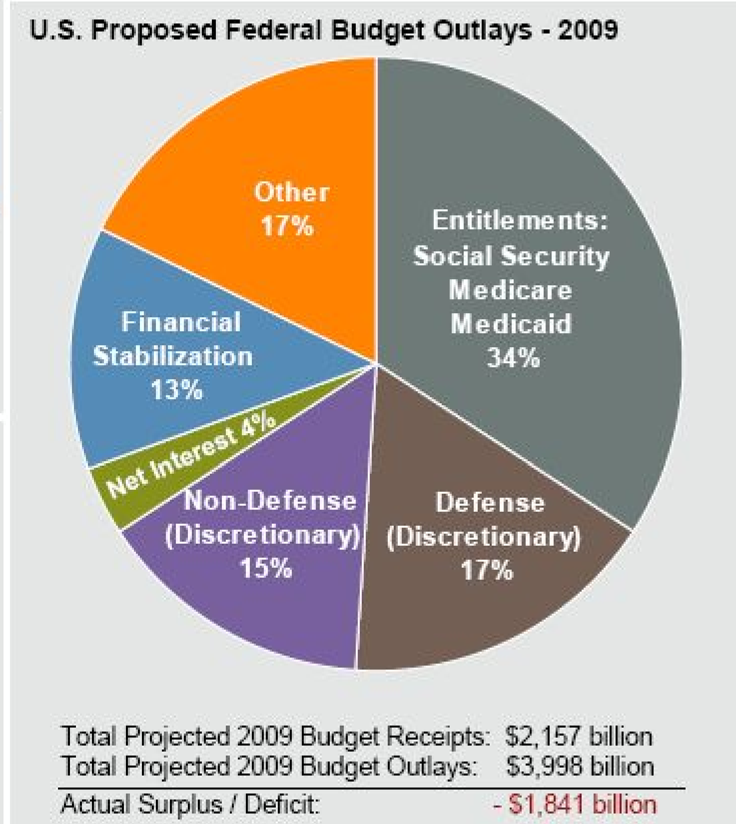
Personal savings rate is calculated as personal savings (after-tax income – personal outlays) divided by after-tax income. Employer and employee contributions to retirement funds are included in after-tax income but not in personal outlays, and thus are implicitly included in personal savings.

Data are as of 1Q09, except the savings rate, which is shown through May 2009.

Consumer NOT highly leveraged – Debt Service Ratio down, Personal savings up strongly – not a bad picture at all!





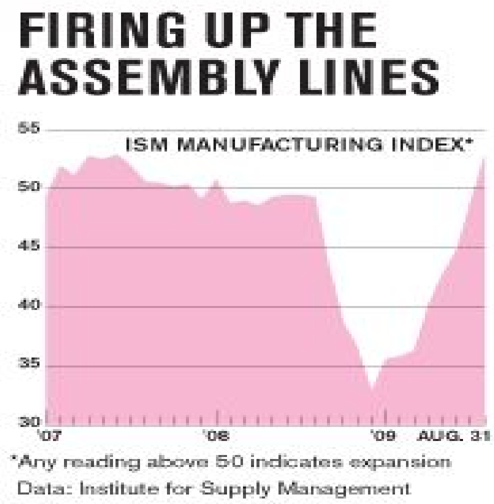


Source: Congressional Budget Office, St. Louis Fed, Bureau of Economic Analysis, J.P. Morgan Asset Management. Data reflects most recently available as of 06/30/09.

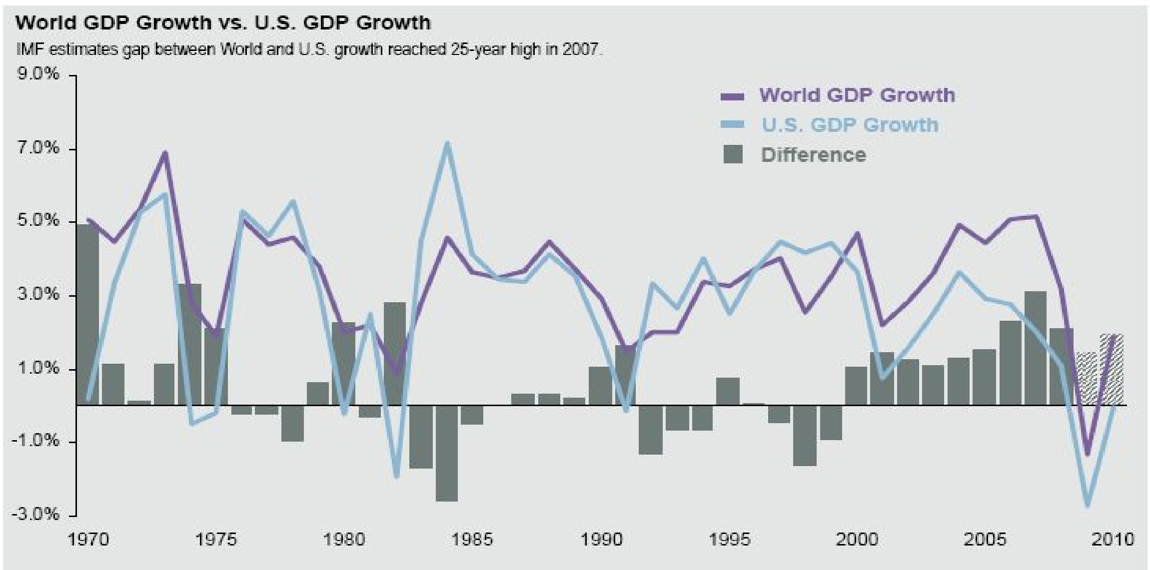
Note: years shown are fiscal years (Oct. 1 through Sep. 30). Bottom left chart displays federal debt in the hands of the public.

Source: Office of Management and Budget, J.P. Morgan Asset Management.

None of this is pretty – BUT it has been MUCH worse (See 1940s).



Factories are revving up!



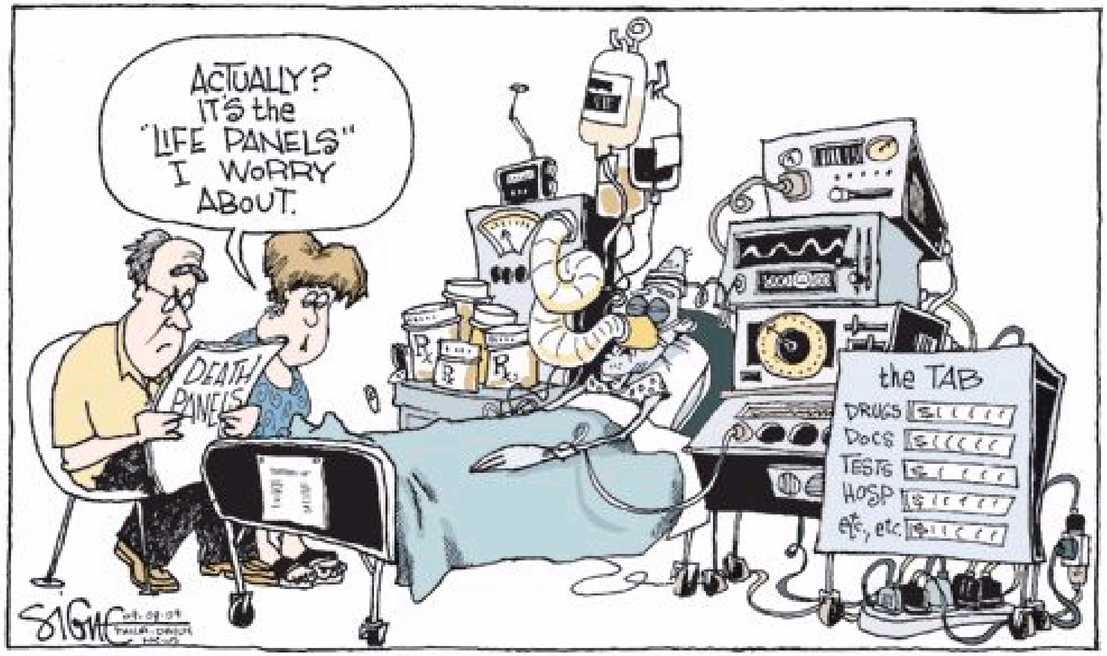
Source: J.P. Morgan Asset Management, IMF.

Data are as of April 2009 and are provided by the International Monetary Fund. 2009 and 2010 data are estimates as provided by the IMF.

Since 2000, the world has grown faster than the U.S. We believe this will continue for years.

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



The opinions expressed in this Commentary are those of Baldwin Investment Management, LLC. These views are subject to change at any time based on market and other conditions, and no forecasts can be guaranteed.

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

09/30/09