Baldwin Investment Management, LLC

CLIMB EVERY MOUNTAIN……

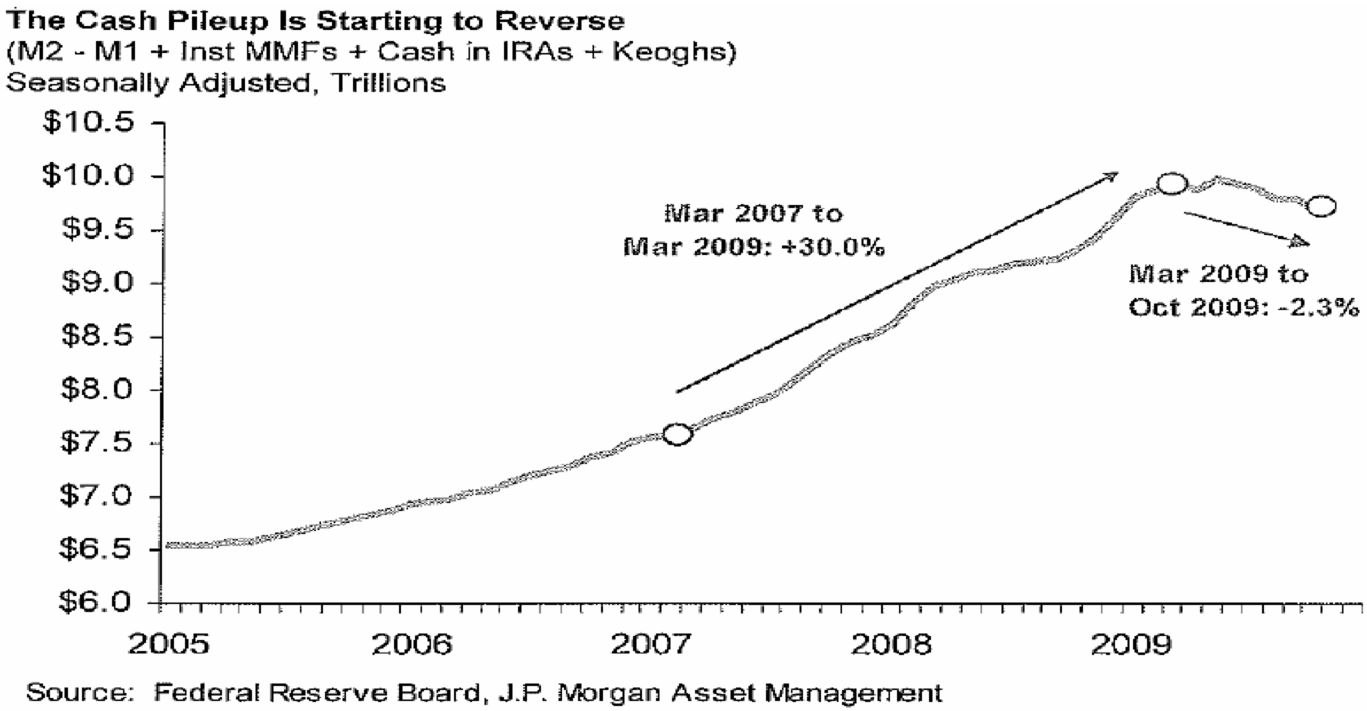
From the Rodgers and Hammerstein hit musical, "Sound of Music", came the above lyrical phrase. The story, as many know, recounted a dark time in European history – a period when life was upended and the future was clouded at best. Coming into 2009, the unease of the world was palpable. Large institutions, like Lehman Brothers and Bear Stearns, heretofore considered "too big to fail" failed and others (think Citigroup and Bank America) looked like they were not far behind. Unemployment has soared to 10% in the U.S. and is much worse elsewhere. National debt loads have climbed without regard to upper limits. Significantly, anger between "classes" is growing. In the first three months of 2009, the downward trend exhibited in most world markets (excepting the U.S. Treasury market) gained speed. Finally, the bottom was reached in March after many markets had been cut in half from their previous peak. To many, in late February, there was no sunshine. The idea of being optimistic seemed "Pollyannish". Whatever threads of positive rationale which could be sewn together seemed unrealistic given the circumstances. Almost shockingly, markets around the world turned and with a vengeance. In fact, 2009 will end having been one of the best years for many markets. It has been a wonderful turnabout – one not expected and one still not believed by most investors. Importantly, in spite of the extremity of the about face and its unbelievability, the markets have behaved quite normally with the benefit of 20/20 hindsight. So have markets "come too far too fast"? Is there any value left? Who will buy after such an incredible run-up?

The American consumer, a purchasing force with no peer, has been on a "buyer's strike" for some time. Procrastination has been the "watchword" of late around the kitchen table or the board table. Whether it is autos or houses or inventory or capital equipment, purse strings have been tied shut. This represents significant "pent up" demand which will get released. If buyers did nothing more than purchase goods equal to their average over the past ten years, 3.9% would be added to real GDP – a meaningful jolt to the economy.

Furthermore, the stimulus program, some $787 billion worth, has only been spent to the tune of $220 billion, i.e. 28% so far. No doubt deficits are not good in the long run. But in the short run, deficits stimulate the economy. Also, the Federal Reserve has pledged to do "its bit" and keep interest rates low. We think that will be until inflation has started to rise and unemployment has started to come down. With a calendar in hand, we would suggest that late 2010, at the earliest, would be when the Fed turns interest rates upwards. There is only one caveat to this schedule – the dollar. If for international reasons the dollar were to suddenly depress, then the Fed might feel compelled to come to its rescue by raising rates prematurely. We think that the dollar will be allowed to slowly fall and would anticipate such.

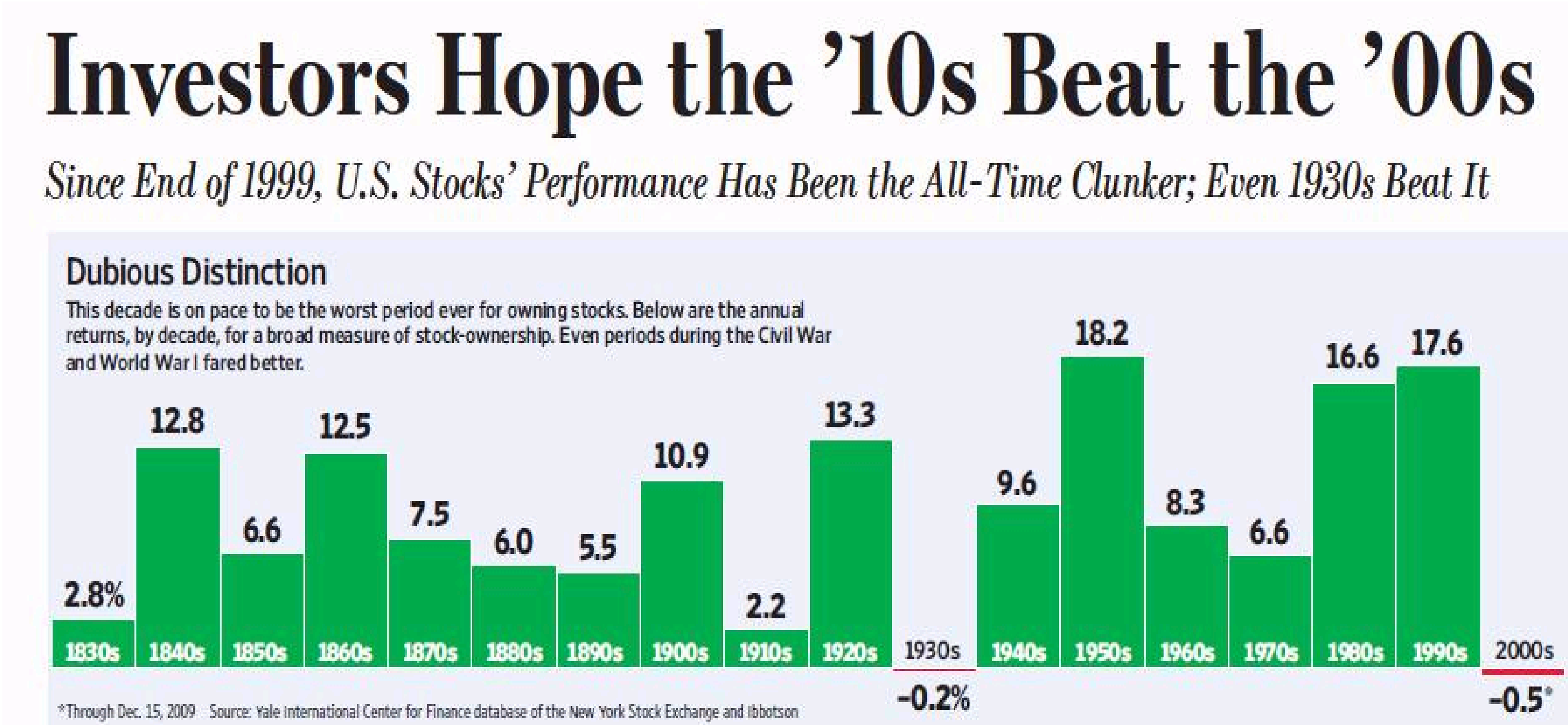
We have said on many occasions that inflation is not nor will be a worry for the central bankers. To date this has been the correct stance. We continue to think so. There is excess capacity in the U.S. and world economies. There are no constraints. Thirty percent of American industrial capacity is idle. Unemployment is at 10%. Both of these factors should keep inflation well under control.

Finally, the emotional trauma of this last year filled with "asset bubbles" and disappointment has prompted an unreasonable dislike for equities and an equally unreasonable love for Treasuries and cash. Investors have opted to "be safe rather than sorry". Some would read what was just written and say that we must be wrong. The equity markets have rallied strongly – not only here but abroad. Junk bonds (i.e. high yield paper issued by less credit worthy entities) have skyrocketed in price. People seem to love risk. What are we talking about? While stock prices are certainly higher than they were in March 2009 and December 2008, they are still down significantly from their peak in 2007. So too are high yield bond prices. The S&P 500 has recouped approximately half of its "bear market" losses. On the other hand, Treasury bond prices are near or at historic peaks. We think it not too "heroic" to believe that corporate earnings will eclipse their old cyclical peak of $24.06 set back in Q2 of 2007 in the foreseeable future on the back of a growing economy characterized by high productivity growth and low wage growth. At current inflation rates, an appropriate P/E multiple would be 17. With annual S&P earnings of $80/share, this would translate to a market valuation of 1360 vs. 1102 (as of 12/19/09, i.e. 23% potential upside, but still well below the all time high of 1565). So there is still value to be had. But has the money been spent in the market run-up? NO!



As can be seen from the above chart, there still is a "sea of cash" available for investment.

A decade ago, there was widespread optimism as the world stood on the "brink of a new decade". Ten years later, the sentiment is exactly the opposite. The last ten years have been a disaster for investors in equities. The last time things were so bad for stock investors was the 1930's and we all know what happened then. Since the 30's, there were six decades of advancing stock prices and no ten year period registered a decline until we got to the last ten years.



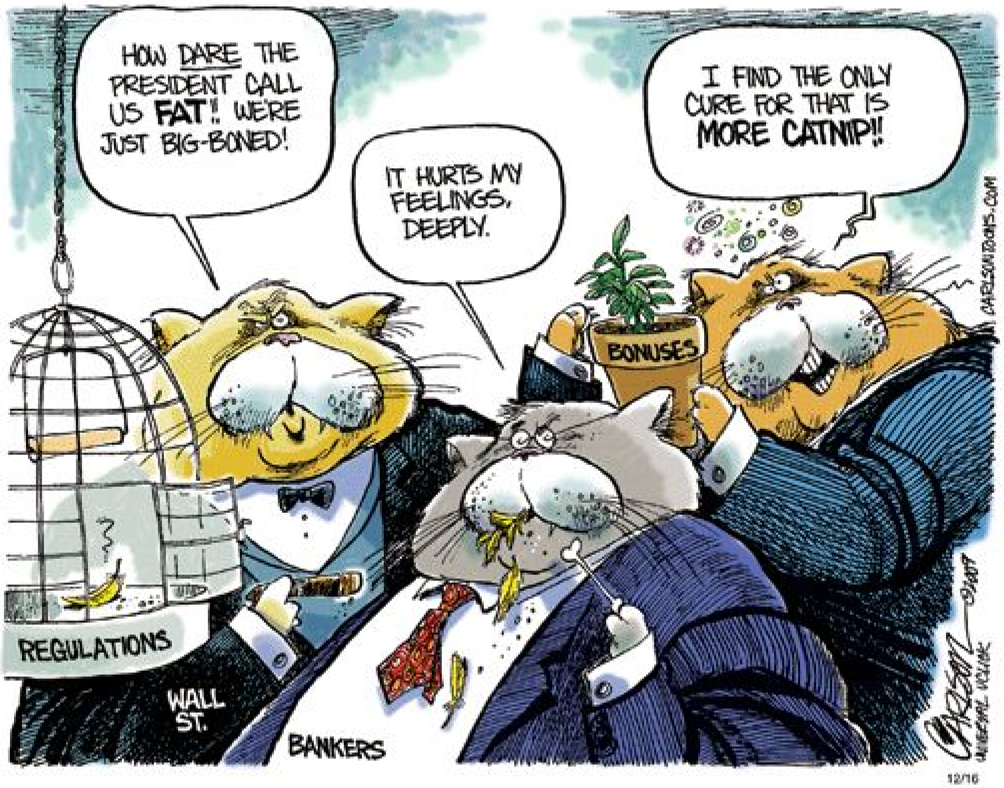
We think 2010 will start a "new run" of higher stock prices. Interest rates are low and are forecast to be so for some time. Inflation is nonexistent. Corporate earnings are on the upswing. Dividends are being raised by boards. Economic expansion is taking hold in America and elsewhere in the world. Equity valuations are not unreasonable, especially after considering interest rate levels. Safety (i.e. treasuries) is expensive and risk (i.e. equity) is cheap. Risk is perhaps not as cheap as it once was – but we still like the odds of owning risk and climbing the mountain.

PREDICTIONS FOR 2009 –HOW DID WE DO?	COMMENTS
1) Stock markets around the world will do better in 2009 than in 2008	Yes – an amazing year around the world
2) Oil prices will rise	Yes – in the 70s and looking higher
3) Housing will stabilize in 2009	Yes – sales picking up, prices stabilizing in numerous markets
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 has improved with more to come
7) Inflation will not be an issue in 2009 – but will look like it will become an issue for 2010	Yes – it may become an issue in late 2010 - more likely 2011
8) China will assume a more important geopolitical/economic role	Yes – acknowledged by just about everyone in 2009
9) Alternative investment vehicles (i.e. private equity, hedge funds) will lose investors to mainstream investments	Yes – mainstream investing has become more popular as investors seek to simplify their investing lives
10) Russia will continue on its path of becoming more insular	Yes – the Russians "backed more into their cave" during 2009

PREDICTIONS FOR 2010

1) The world will grow with China leading the way
2) Global inflation will still not be a problem
3) The dollar will have bouts of strength – but will still melt during the year
4) The Euro will lose strength versus the dollar
5) The Chinese renminbi will appreciate in value
6) Commodity prices will go up across the board
7) U.S. Treasury prices will decline
8) There will be more merger & acquisition activity
9) U.S. equity prices will advance
10) Foreign markets (especially Emerging markets) will rise

A FINAL THOUGHT



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

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