HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKETS

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The stock market was upbeat for much of the second quarter and the industry buzz was all about the "green shoots" of potential economic recovery. That tone and happy talk ended in mid June and the rally fizzled. Economic reports indicated that perhaps the market had gotten ahead of itself with all the green shoots stuff. The noted economist Nouriel Roubini had a good sound bite with his comment that "yellow weeds" seemed as much in evidence as any positive economic signs.

Indeed, the latest reports on joblessness, housing prices, and consumer confidence suggest that economic turnaround is on a slow and halting pace. For the market rally to resume in any sustained way, investors will need firmer evidence – not just that economic decline is abating – but that activity will actually turn higher by year-end. Instead, at the moment, the landscape is definitely a mixed array of shoots and weeds.

At Hudson Advisors, we have studied the history of market cycles. That history tells us that the current secular bear market will end and that eventually a new cyclical bull market will emerge. Indeed, we are fairly confident that the worst of the market declines are behind us. But, given that uncertain economic landscape, we do not honestly know when the bulls will be running free again. To use the professional term, we expect the market to be "range bound" for the rest of the year – meaning that it will churn around and move basically sideways.

For client portfolios, our asset allocation model remains conservative by the historic standards of this firm. We are still in defensive mode, and our priority is to protect assets and provide the most respectable returns possible in this market. At the same time, we are thinking long-term and seeking opportunities that will emerge strongly once the cyclical bull market does get underway.

MARKET TRENDS

The accompanying chart summarizes stock and bond market results for the second quarter of 2009. Interestingly, the equity markets were surprisingly positive, ending six consecutive quarters of decline, and posting their best results since 2003. That rally ended in mid June. Meanwhile, the fixed income markets behaved somewhat curiously with Treasury bonds showing steep price declines, while corporate bonds and asset-backed securities, generally considered more risky, rallied to levels not seen since the financial panics last fall.

Equity Markets: The first 10 weeks of the quarter were markedly positive. Investors were cheered by the stabilization of the financial industry and increased business investment in some industry sectors. The major indexes moved steadily upward. The benchmark S&P 500 index rose 15% for the quarter and was up 1.8% for the year. The Dow Jones 30 was up 11.0% for the quarter – although still off 3.8% for the year. The Russell 2000 index of small cap stocks was up 20.2% for the quarter and 1.8% for the year. The star performer of the 2009 year has been the Nasdaq Composite – up 20.0% for the quarter and 16.4% for the year, reflecting the relatively stronger balance sheets of technology companies.

The trend changed in the second half of June and the early weeks of July. Faced with those signs of "yellow weeds", investors pulled back and every index lost ground in the last month. At mid-July, the S&P 500, the Dow Jones 30, and the Russell 2000 were clearly negative for the year. The Nasdaq Composite had given up nearly half its second quarter advance.

Fixed Income Markets: The bond markets were a bit of a paradox in the second quarter. Despite the economic slump, concern about future year inflation is hitting hard at the long-term Treasury prices. The 10-year instrument lost over 6.0% of price value in the quarter. The yield on the benchmark 10-year Treasury note, which moves opposite prices, was 3.5% at quarter-end versus 2.7% three months earlier and 2.3% six months ago. The concern is rooted in the long-term impact of the Government's massive issuance of debt and the future consequences for inflation.

Meanwhile, fixed income investors were drawn to the returns available from corporate bonds. Investment-grade corporate bonds offered returns of nearly 11% in the quarter. The riskier high-yield corporate bonds were offering about 23%. Obviously, investors were willing to compromise concerns about quality in the quest for investment earnings. Significantly, however, just like the drawback from equities, this trend has slowed in recent weeks and more traditional attitudes about risk aversion are more evident.

MAJOR MARKET INDEXES

	2 Q Total Return*
Dow Jones Industrials	-2.01%
S&P 500 Index	3.16%
Russell 2000 Index	2.64%
NASDAQ Index	16.36%
Barcap Intermediate Govt/Credit	1.62%

*Total Return Includes Reinvested Dividends.

THE OUTLOOK

The Economy: As indicated above, investors will be watching and analyzing key indicators to gauge the trends in the economy. At Hudson Advisors, our eyes will be focused on some important areas in the months ahead:

Consumer spending: U.S. consumers drive the economy. The most recent survey shows confidence slipping once again. Jobs are still being cut. Homes are difficult to sell. Instead of spending, consumers are saving -- with the national savings rate now over 6% -- as opposed to negative in recent years. Weak consumer spending hurts such key sectors as retail, hospitality, autos, and capital goods.

Credit availability: The Fed is keeping interest rates low. Nonetheless, credit remains tight for both businesses and consumers. Even where borrower demand does exist, loan approval can be difficult.

Energy prices: Energy prices are fluctuating, but remain modest compared to some periods in recent years. This trend must continue for the economy to rebound. A new round of spiking prices would be harmful.

Taxation: Although somewhat slow in its implementation, the Federal stimulus package is helpful. However, its impact could be mitigated by new federal tax hikes on the affluent, such as to finance health coverage, or state and local increases needed to close budget deficits.

Trade balances: The onset of worldwide recession confirms the interconnectedness of the new global economy. To some extent, U.S. economic recovery depends upon capability of the big emerging economies, especially in Asia, to stimulate their own domestic demand and invest in infrastructure.

On balance we are hopeful, but not confident of the U.S. recession ending in 2009. We could see flat to positive GDP growth prior to end of year.

The Market: Given this economic view, our forecast for the equity market indexes is to end 2009 at approximately their current levels. We do not see any significant new decline. Nor do we see much prospect for renewed advance this year. After the spring rally, the S&P 500 is now trading at a price-to-earnings multiple of about 16, close to its historic levels. We see little incentive for sustained market gains until the economy is in clear recovery and corporate earnings are growing accordingly. We expect the S&P 500 index to bounce around in the 850 to 1000 range for the remainder of 2009.

OUR STRATEGIES

Because of the economic and market outlook just expressed, our current investments strategies are tactical for the period immediately ahead – but seeking advantages for long-term gain.

Asset Allocation: For clients investing new money, our asset allocation remains conservative by our usual standard. As explained last quarter, we recommend 50% allocation to equities, 40% to fixed income/cash, and 10% to alternative investments.

Preferred Equities: Our main focus is to find stocks that will perform well when the market does reemerge into the next bull period. We are looking to invest in undervalued, large cap companies with strong balance sheets, sustainable cash flows, and credible business models. For the immediate term, we also like companies that pay attractive dividends. Our sector preferences include:

INDUSTRIALS/TECHNOLOGY: The Federal stimulus package emphasizes infrastructure investment – which creates opportunity for certain technology and industrial companies – such as those that enhance productivity and power management. Many technology companies also have next generation products in development.

ENERGY: Despite recent price moderation, the long-term imbalance between supply and demand creates profit benefit in production and exploration companies. Natural gas is also attractive.

MATERIALS: This sector is well priced, and also will benefit from the Federal stimulus package. In addition, the prospect of infrastructure investment in the emerging nations is attractive for this sector.

CONSUMER STAPLES: Companies that provide the necessities of life are good dividend payers in the current market – and will gain value when the market picks up. We especially like international companies such as General Mills that benefit from the growing middle class in emerging countries.

Fixed Income: The specter of future inflation makes us extremely cautious on long-term bonds. Treasuries are especially vulnerable. We also think the investor appetite for corporate bonds this past spring was short-sighted. Right now we are staying with maturities under 5 years and using bond funds such as those which invest in Ginnie Mae securities and high grade short-term tax exempts.

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