HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKETS

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As indicated above, this is the 38th time we have written our quarterly commentary – a tradition of nearly one decade. Not surprising, unless you were isolated somewhere on a desert island in recent months, number 38 is proving to be the most difficult to compose. It is hard to describe all that has occurred with the economy and financial markets, or to speak with good confidence about what might happen next.

We are not alone in our quandary. Part of the fascination in the current environment is to watch and listen as all the professional commentators struggle to find the right choice of words. How do you convey that something unprecedented is going on? How do you appear alarmed but not panicked? Amidst the torrent of commentary, we did hear a description that seemed about right: "The Great Recession."

We like that term for its sense of balance. At Hudson Advisors, we do not believe the economic and financial system is headed for the abyss. We are not facing a 1930's level depression. While permanently transformed, the financial system will hold together and start to function more productively. Nonetheless, we are in the worst economic mess of our lifetime – and so the term "Great Recession" captures the gravity of the challenge.

At Hudson Advisers, we regard ourselves as strategic investment managers. But our first mission is always to safeguard client assets. To be strategic requires having reasonable confidence in the outlook for the market environment. At the moment, the uncertainties are so extensive, and the predictabilities so tenuous, that we are in high alert, defensive mode. Our management of client assets is tactical – with a focus on safety and protection. We will stick with tactical management until the big picture starts to assume more clarity. Nonetheless, as explained below, we believe that we can navigate client portfolios constructively through what promises to be tough terrain for most of 2009.

MARKET TRENDS

The accompanying chart summarizes stock and bond market results for the fourth quarter and full year of 2008. For those of you not trapped on a desert island, you already know the equity markets suffered one of their worst years in history. Meanwhile, the bond market was a mixed story reflecting the chaos in the credit system.

Equity Markets: The statistics are overwhelming. The Dow Jones had its third worst year on record – down 31.9%. The S&P 500 also saw the third worst year in its history – down 37.0%. The Nasdaq Composite had its worst year ever – down 40.5%. Most of the damage occurred during the month of October as the banking system seemed perilously close to collapse – and a state of near panic gripped the market. Following the Government intervention, and the Presidential election, the market stabilized and even managed something of a late year recovery. Nonetheless, the devastation done in a period of several weeks was an event that market historians will study and analyze for years to come.

Fixed Income Markets: The multiple concerns over credit quality and economic slowdown hit hard at the value of many fixed income assets. Like equities, corporate debt and mortgage-backed securities suffered historic declines. The so-called "high yield" corporate – or junk bond market – fell an estimated 26%, its worst ever decline. Securities backed by sub-prime mortgages, auto loans, and credit card receivables fell 21%. Even municipal bonds – usually considered a safe credit –were caught up in the uncertain ability of the bond insurers to meet their credit obligations. Amidst the turmoil, Treasury securities became the haven of safety. The yield on the benchmark 10-year Treasury note, which moves opposite prices, was 2.3% at year-end versus 4.0% a year ago. Some investors bought short-term Treasuries at almost 0% yield just for the assurance of getting their money back.

THE OUTLOOK

The Economy: As suggested by the term "Great Recession," this economic downturn is unparalleled in recent times. The data now confirms the economy was in recession for most of 2008. That situation is likely to persist for most of 2009.

The confluence of negative forces is powerful. The housing market – where much of the current problems originated – remains distressed. An estimated 20% of U.S. homeowners owe more than the market value of their property.

Foreclosure rates are at record levels. Thus, the pressure on the banking system is intense – and could grow worse in the months ahead. The normal credit function of the financial system is not working properly. As a result, both consumer and business spending is curtailed. Unemployment is growing and, by some estimates, could reach close to 10% later in 2009.

Interestingly, conventional ideological debate is almost muted. Few observers dispute that only the Federal Government has the capability to provide the stimulus necessary to spark

MAJOR MARKET INDEXES

	4 Q Return	2008 Total Return*
Dow Jones Industrials	-19.1	-31.93
S&P 500 Index	-22.6	-37.00
Russell 2000 Index	-25.5	-33.79
NASDAQ Index	-24.6	-40.54
LB Intermediate Govt/Credit	4.84	5.12

*Total Return Includes Reinvested Dividends.

economic recovery. The Government has already taken extraordinary action to rescue the banking system – and policies in this arena are still evolving. The Federal Reserve has reduced short-term interest rates to effectively zero. The new President and Congress are moving forward quickly on a massive fiscal stimulus package.

At Hudson Advisors, we accept the general consensus viewpoint of the moment – which is cautiously positive. With the right Government actions, the seeds of recovery can take hold. Most of 2009 will be difficult – and joblessness will even increase. By the end of the year, however, and certainly in the first half of 2010, we will see the return of modest economic growth. The source of this recovery will be the massive federal spending and the slow repair of the credit system for businesses and households.

The Market: The equity markets will remain volatile and nervous until the economy shows some signals of recovery. In the early weeks of January, as the bad economic news flowed, the market lost some of the ground it had regained in December. Nonetheless, at Hudson Advisors we are willing to venture out on this forecast limb: the market may well have reached its bottom in November. Barring some new event, such as an international crisis, we do not anticipate the market to keep declining as we move into 2009. We expect the market to trade within its current range during the first half of the year – even though there will be days of volatility.

Moving into the second half, we are modestly hopeful to see the market indexes demonstrate some gradual., sustained increases. This prediction is based upon the market's capacity to anticipate slow economic recovery in 2010.

OUR STRATEGIES

As suggested, because of the extensive uncertainties, our current investments strategies are tactical and designed to safeguard client assets in the year ahead.

Asset Allocation: For clients investing new money, our asset allocation is quite conservative by our usual standard. We recommend 50% allocation to equities and 50% to fixed income/cash. On the equity portion, we will invest the money gradually during the course of 2009 based upon "way points" tied to market performance.

Preferred Equities: For the equity component, we like the current sectors:

INDUSTRIALS/TECHNOLOGY: The Federal stimulus package will emphasize infrastructure investment – which should create opportunity for certain technology and industrial companies – such as those that enhance productivity and power management.

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

MATERIALS: After the sell-off in 2008, this sector is well priced, and also will benefit from the Federal stimulus package.

CONSUMER DISCRETIONARY: Because they fall first in a bear market, consumer stocks often take the lead when the market recovers. They will be assisted by Federal tax cuts and lower energy prices.

Exchange-Traded Funds: Like mutual funds, these instruments offer a diversified way to invest in an industry or asset class – but at a lower price. We are using them tactically to invest in a diversified basket of financial institutions through the preferred stock ETF. Despite its troubles, the financial industry will have value when it ultimately recovers. In the meantime, this instrument pays a current yield around 9.5% -- an attractive return while we wait for the industry to rebound.

Covered Call Writing: As explained previously, we actively engage in writing covered calls in portfolios. This strategy allows an investor to enhance return on a stock position in a flat to falling market. If you own stock, you can sell someone else the right to buy it at a higher price. If the stock is likely to stay below the agreed selling price, you keep the premium paid to you without having to sell the stock. This collected premium acts like an extra dividend payment on the stock – and can generate an extra yield of 4 to 10%.

Municipal Bonds: For clients wanting fixed income investments, tax-exempt municipal bonds are quite attractive right now. Governments need to borrow despite cautious demand and, thus, yields relative to taxable bonds are at record levels. Investors in the highest tax brackets are receiving tax equivalent yields in the 8% range.

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