CYPRESS
ASSET MANAGEMENT, INC.

MARKET COMMENTARY **April, 2010**

The first quarter of 2010 was a good quarter for stocks. The S&P 500 and the Dow Jones Industrials posted total returns of 5.4% and 4.8%, respectively. As we write, in April 2010, the Dow is flirting with the 11,000 level for the first time since October 2008, after having visited the harrowing low of 6,500 in March of last year. With the market recovery from historically significant lows, we thought it might be valuable to briefly revisit our thoughts on the market and the sustainability of the current global economic recovery.

Overview: The Global Recovery Picks Up Steam

As we have discussed, over the past decade U.S. public companies have come to recognize that the domestic economy is a shrinking portion of their revenue and profits, and most of the companies in your portfolio make far more overseas than they do at home. These global companies (aka "multinational corporations") increasingly look to China and to other developing markets like Brazil, India, much of East Asia, and even the Gulf states of the Middle East for future growth and profits. During the post war period spanning the early 1950's through the 1970's, U.S. corporations expanded into Europe and to a lesser extent Japan. But the industrial economies of Western Europe and Japan have been mature markets for most American firms for many years now. Over the past decade, American corporations have moved rapidly into the developing economies of the world, and increasingly look to China and the emerging markets for growth.

The great financial crisis and unprecedented sell-off in global equities that occurred between September 2008 and March 2009 will be remembered and studied for years to come. But in the broadest sense, it also marks a historical tipping point where the engine of global economic activity and future growth shifted from the industrialized nations to China and the emerging market economies. Ironically, while understandably unprepared for the suddeness of the financial crisis and resulting global downturn, U.S. industrials were fully ready for the shift to the new global economy focused on growth in China and the emerging markets. Corporate profits have come to be increasingly detached from their national economies, and more tied to an interlinked global economic system and market. Companies can and do go wherever the growth is, and source and produce where the cost is lowest and productivity is highest. The result is lean levels of inventory, jobs moving overseas, strong gains in productivity and efficiency, and surging profits even while domestic economies struggle to regain their footing.

How else can it be explained that U.S. corporate profits are projected to make a new all time high of about $1.75 trillion in the second quarter of this year according to the ISI Group. This would eclipse the 2006 peak of $1.66 trillion. Of note, in the 1930's depression era it took 12 years to reach a new high in corporate profits (1929-1941). In Japan's "lost decades", it took 16 years (1989 to 2004). U.S. profits are poised to make a new high only 4 years after they peaked in 2006.

In short, none of the primary reasons for the market recovery or for why markets should continue to move higher over time depend on a robust U.S. or European economy. Corporate profits are tied to global growth which, as discussed, increasingly revolves around China and other burgeoning emerging markets like Brazil and India, but also includes other economies tightly linked with them such as Canada and Australia (so called "resource economies"). Many U.S. corporations, including those in your portfolio, are thriving in this new global growth economy. We believe the global economic recovery is sustainable and not likely to end any time soon. We also believe in the vast longer term potential of the global growth story.

Sentiment & Valuation: Still Supportive For Equities

Individual investors remain notably absent from the stock market rally, and have continued to pour money into bond funds while largely shunning stocks. For the last three years there has been a migration of mutual fund flows into bond funds, and the retail investor has yet to return to equities. Money market funds still have almost $3 trillion, although outflows have been picking up in recent months from the record high cash levels of second half 2009.

Investors remain skeptical of stocks, mistrustful of the market and the economic recovery, and typically hold a pessimistic, or at best uncertain, view of the future. In a sense, it is hard to blame them. Our domestic economy is mired in a quandary: when are we going to transition from an environment where things are "getting less bad" to an environment where things are "definitely getting better." But this quandary does not exist for the emerging global markets. There, things are good and getting better. It is difficult for the domestic investor to see the trees from the woods. So, despite the historic market rally, the average domestic investor remains far from bullish.

In contrast, U.S. corporate balance sheets are in solid shape and equity valutions reasonable at 14.5 times estimated 2010 operating earnings for the S&P 500. This provides a relatively strong underpinning for stocks, at least in the near term. The S&P 500 is still 25% below its all time high posted in October 2007, while corporate profits are poised to make a new all time high this year (see above).

Corporate balance sheets also provide a welcome contrast to the high levels of government and consumer debt. According to the Wall Street Journal, U.S. companies have close to $2 trillion in cash, generated a record level of retained free cash flow in 2009, and by most measures non-financial corporations have historically low levels of debt. Companies have been extremely cautious and conservative in the wake of the global financial crisis. We expect to see a significant pickup in business investment, dividends, and in mergers and acquisitions in the future. This should provide support for stocks.

As a leading indicator of these trends, semiconductor giant Intel Corporation just reported record first quarter revenues and profits, and did so by a wide margin. Interestingly, Intel trades at only thirteen times current earnings, is still 70% below its 2000 bubble high, 35% below where it was in early 2004, and has about $10 billion in cash on the balance sheet net of all debt.

Interest Rates, Profits & The Markets: Higher Across The Board

Rising interest rates are inevitable given the global economic recovery and surging profits. To some extent stocks could find themselves in a tug of war later this year between rising rates and rising earnings. India and Australia have already raised rates, and Brazil and China are also seen as likely to tighten soon – albeit adopting a "go slow" approach to raising rates. We also expect the Fed to raise rates in the U.S. later in the second half of the year. But, as Fed Chairman Bernanke has often stated, short rates are likely to remain at historically low levels for some time; or at least, until the strength and sustainability of the global recovery has become undeniable even to Nouriel Roubini.

Ironically, the combination of strong global growth and corporate profits, with a U.S. domestic economy where a full recovery appears "a long way off", is bullish for stocks. A slow and tenuous U.S. recovery will likely cause short rates to remain very low for a longer time, thereby supporting corporate profit growth, overseas investment, and not least, equity valuations. U.S. global companies get the benefits of low interest rates (essentially the lowest rates in the global economy) from a relatively weak domestic economy that is forecast to grow below its potential for an extended period of time, as they increasingly focus on growth and investment abroad. This is a powerful combination providing the best U.S. companies a competitive advantage in a sense similar to what an undervalued currency has provided to Chinese firms.

In closing, we think it is important to quote again from our last year end 2009 commentary:

> But as noted, we would be remiss if we didn't stress clearly that when we look at the prospects of this massive global economy, we see opportunities – real opportunities, mind you – that are, simply put, far bigger than anything we have witnessed in our lifetime as investors. Despite the imbalances, the pessimism, the uncertainties, the risks, we think there remain great opportunities for the long term equity investor.

CURRENT ECONOMIC OUTLOOK:

You Are Never as Good as You Think, Nor as Bad as They Say You Are

Good News

US Economic Statistics Improving

- **US Unemployment claims decline from high of 700,000 to 454,000 in 3/20/10**
- **US productivity +5.8% year over year, 4Q 2009**
- **US Manufacturers Index (PMI) rose to 59.6 in March, highest level since mid 2004**
- **US Manufacturers PMI Employment component strengthens to 55.1**

US Consumer Improving Off Low Base

- **US Consumer net worth up 14% ($7 trillion) year over year to $55 trillion 1Q2010e (ISI Group)**
- **US Consumer spending up 2% annualized rate, 2/10**

Emerging Nations Have Clean Balance Sheets

Debt/GDP
Hong Kong: 0%
China: 20%
Thailand: 30%
Malaysia: 50%
India: 80%

Bad News

US & Developed Economies Unemployment

- **US Unemployment Ratio: 9.7% in 3/10**
- **Japan Unemployment Ratio: 4.9% in 2/10**
- **German Unemployment Ratio: 8.0% in 3/10**

Weak US Consumer Balance Sheet and Income

- **Household Debt Service Burden (pmts/income):**12.6%
- **Total Consumer & Mortgage Debt/Income:** 1.4x
- **US Real Disposable Income Personal Income** Ex Transfer Payments **recovery weakest on record**

Developed Nations Debt Burden

Debt/GDP:
Japan: 227%
Greece: 125% e
Italy: 115% e
Portugal: 85%
US: 85% e
UK: 75% e

Good News (cont.)

International Business Segment Strong

- **Emerging market vehicle sales at all time high**
- **Global vehicle sales (includes developed nations) at all time high at 47 million units**
- **China car sales surpass US, climb 56% year over year to 1.7 million units in 3/10**
- **US real exports rise to $89.5 billion in 1/10**
- **Real global exports surge 28% annualized rate**
- **US rail car loadings increase 19.4%, 37 week annualized rate**
- **Australia leads developed nations in jobs growth, raises interest rates 5th time in 7 months**
- **Emerging markets projected to grow 7% in 2nd half, 2010, same as first half, 2010**
- **Canadian economy booming. Canada creates more jobs than expected in February, 2010 and the jobless rate fell to a 10 month low Source: Bloomberg**
- **South Korean unemployment rate declined from 4.4% to 3.8% in** one month**, March 2010 Source: Bloomberg**

US Corporate Condition Strong

- **US Corporate Profits increased 30% year over year in 4Q 2009**
- **US Corporate Profits projected to grow 44% to record levels by 2Q 2010 (ISI Group)**
- **Treasury makes $10 billion on equity investments that accompany TARP bank loans**

Mergers and Acquisitions Pick Up

- **Exxon and XTO**
- **Schlumberger and Smith**
- **AIG sells Asian units to Prudential (Britain) and Metlife**
- **Berkshire Hathaway buys Burlington Northern Santa Fe**
- **Kraft purchases Cadbury**
- **Conoco agrees to sell stake in Syncrude to Sinopec**
- **US Air and United Air in talks**
- **Mirant and RRI agree to merge in Utility Industry**

Bad News (cont.)

Sovereign Debt Crisis

- **Greece budget deficit reaches 12.7% of GDP in 2009, struggles to rollover $28 billion in debt in April and May, 2010 and yields on Greek sovereign debt skyrocket. Source: Economist**

US State and Local Debt Problems

- **California state and localities suffer from significant total debt if underfunded public pension funds are included. Los Angeles struggles to maintain solvency. Source: NY Times**
- **New Jersey: in last 15 years, state debt has increased 4x to $35 billion Source: NY Times**
- **50 states' pension fund obligations estimated to be $5.17 trillion Source: NY Times**

Banking System: Banks Investing, Not Lending

- **Banking assets declined 5.8% from 2008 to 2009**
- **As of 3/31/10, industry wide, commercial and industrial loans declined $26 billion, real estate loans at larger commercial banks declined $32 billon.** Overall lending flat**. Source: Beforeitsnews.com**

US Taxes Are Increasing / Tax Burden Increasingly Disproportionate

- **Capital Gains and Dividend taxes will increase at start 2011 to 20% from 15%; then increase again to 23.8% in 2013 as a result of new Medicare tax**
- **Government wants highest marginal rates to revert to pre-Bush rates, 36% and 39.6% in 2011**
- **48% of US citizens don't pay federal income taxes**

Real Estate and Mortgage "Over Capacity" Still a Drag on US Economy

- **Real construction spending fell 1.2% month over month in February, down a whopping 32% from roughly $1trillion to $678.9 billion**
- **Bankruptcies back to Pre 2005 levels, over 42,000**