CYPRESS

ASSET MANAGEMENT, INC.

MARKET COMMENTARY

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A Strong Quarter for Stocks

Despite losing momentum a little more than one month into the second quarter (the S&P 500 rose 14% from April 1 through May 4, but only 1% in the subsequent eight weeks), the S&P 500 still posted a 16% total return, its best performance since the fourth quarter of 1998. The S&P 500 has now managed to move into positive territory for the year, up just over 3%, which seemed almost inconceivable in the gloom of early March. With the benefit of hindsight, we were probably due a significant recovery from the morbid conditions that gripped the world economy during the fourth quarter of 2008 and first quarter 2009. The financial crisis precipitated an economic freefall that led to unprecedented drops in industrial production, employment, and inventories. Global stock markets were early to see signs of economic life and recovery. But like everyone else, the markets are unsure whether to trust the green shoots and recent signs of recovery. Hence the volatility and bipolar swings in investor sentiment and in the market averages over the past two months.

Bipolar Market and Confused Economists

It is also quite reasonable to expect a period of consolidation and digestion after a seven week surge like we saw from mid March through early May. Now that we are past the crisis stage and the patient has been stabilized, economists and the market lack conviction as to the prognosis or future course of our economy. Hope and optimism alternate with fears that recovery may not actually take hold, that any recovery will be subpar, feeble, and attenuated and that we will be overwhelmed by the long term challenges of high consumer debt levels, fiscal budget deficits, and the mounting costs of social security and health care. The bipolar market which moves from sanguine outlook to doubt and pessimism and back again in short order is likely to be with us a while longer. At least until a clearer picture starts to emerge sometime in the second half of this year. The next significant move in the market, which could occur anytime between now and year end, will depend on the strength and vigor of the economic recovery. We are in the camp that believes a global economic recovery has begun to take hold, with the emphasis on the global part of the recovery.

China and the Global Recovery

Why do we see some cause for optimism when many others see little basis for more than a muted recovery with subpar growth for the next few years? Foremost is our view toward China and the other developing countries of the world. China will be one of the engines of the world economy, in essence replacing the American consumer in that role. China can, and indeed is, stimulating their own economy. They have reserves and savings. They have a trade surplus. The results are in and China's stimulus is a success and already having an enormous impact on both their economy and the rest of the world. China just reported better than expected growth of 7.9% in its GDP for the second quarter of 2009, and that is forecast to rise to 10% by year end. The engine is revved and running with real power.

India and Brazil are also poised to be forces of growth as the world emerges from the economic crisis. The center of gravity for economic growth has shifted away from the industrialized nations (Europe, Japan, and to a lesser extent even the U.S.) to China, India, Brazil and other developing countries of the world. These new found sources of growth make the world a far different place than it was when the U.S. and European economies broke down in the 1970's. We believe it is important to emphasize a simple but telling fact: China itself has a population greater than that of the U.S., Europe, and Japan combined and it has a large and growing middle class. In fact, we are likely witnessing in China today the same economic miracle that occurred in Japan in the 1960's and 1970's and South Korea in the 1980's and 1990's. India and Brazil are also rapidly industrializing, and benefit from their own significant natural resources, strong financial status, as well as relative political stability.

Investment Implications

Despite the current uncertainty, we believe the global economy and growth from the newly industrializing and developing countries provide good opportunities for investment. U.S. companies that are global leaders and serve the rapidly growing international markets all stand to benefit significantly. The list ranges from Intel to Procter & Gamble to Exxon Mobil, Pepsi and Emerson Electric to cite a few leading examples. The recovery in China and its industrialized brethren has already started to revive the resource and commodity markets, and we continue to believe these sectors will be long term outperformers. Our portfolio strategy remains that of investing in those sectors and companies that are best positioned to thrive in today's global economy, and who stand to benefit most from the growing importance of China and other developing countries.

The U.S. Economy: A More Difficult Case

China's domestic stimulus and growth will also aid the U.S. economy. China is already our second largest trade partner. A domestic recovery is taking hold, and in many ways the U.S. economy has already shown considerable resilience given the unprecedented drop in economic activity in late 2008 and early 2009. Housing starts and auto sales are both at multi decade lows (going back to 1950's for housing and early 1980's for auto), employment and industrial production both experienced record declines, and inventories were reduced at the sharpest rate in history. But monetary and fiscal stimulus is starting to work, as the inventory cycle has begun to turn and industrial production has picked up (rapidly in China and developing economies but also here in the U.S.). In fact, the very sharpness of the downturn provides some basis for a potential "V" recovery. Growth of 2%-3% in the second half, followed by faster growth in 2010, is not out of the question.

The American consumer is burdened with too much debt and as a consequence consumer spending may be subdued for the next few years. Our fiscal and trade deficits present a challenge, and we must still pay for our stimulus, our retirement benefits, and our health care. These are all significant headwinds to growth. But the American economy possesses many competitive strengths. We are the leader in many vital industries from computing and digital technology to medicine, medical technology and equipment, to oil services and production technology, to defense and aerospace. The U.S. also has the world's third largest population (after China and India), and unlike our friends in Europe and Japan it is growing. Trade and exports are also rising longer term and benefiting from global growth. If our economic patient gets his sea legs back, the global economy is set to provide a boost that could make the doomsayers and pessimists look very foolish.