CYPRESS

ASSET MANAGEMENT, INC.

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2009: A Decade Of Disappointment Ends On A Positive Note

U.S. and global equity markets rebounded strongly from their lows in 2009, bringing a positive conclusion and at least some measure of recovery to a decade of stock market disappointments. The year began in deep and near pervasive pessimism, but from the dismal bottom levels reached late in the first quarter 2009, stocks, global economic activity, and corporate profits unexpectedly all began to recover. Despite the dire predictions of negative pundits and the relentless fear mongering of the media and its talking heads, the global economy survived its historic financial crisis and investors slowly crawled out from their bunkers. The banking system recapitalized (U.S. tier one banks repaid TARP funds far faster than even the most wildly optimistic forecasts, capped off when Citigroup, Bank of America and Wells Fargo successfully raised $21 billion, $19 billion, and $12 billion, respectively in the fourth quarter of 2009 to repay the government) and credit markets returned to normal. The U.S. economy is growing again, aided by a burgeoning global industrial revival. This is inherently a global economic recovery, with the resumption in global demand led by China and emerging markets. For the year, the S&P 500 rose 24%, the second best market performance of the decade, as the global economy began to transition from green shoots and a liquidity driven recovery to a demand driven recovery and real growth. Even after the market rebound, stocks remain quite reasonably valued, with the S&P 500 priced at roughly 15 times 2010 consensus estimates for operating earnings. Attractive valuations reflect considerably lowered expectations for equity returns after a miserable decade for stock investors.

As we enter a new decade, and reflect not only on 2009 but on the first decade of the new millennium, the change in sentiment between year-end 1999 and 2009 is remarkable. In 2000, investors confidently began the new decade with a belief that equities were sound investments that should provide superior long term returns. Equities were a favored asset class and stock market optimism was abundant. Pessimism and caution were in short supply. Unfortunately, U.S. equities suffered through two historic bear markets and produced negative returns over the ten year period from year end 1999 through 2009. The S&P 500 remains roughly 25% below where it was ten years ago. This is a rare event in the history of equity markets worldwide.

In contrast, we begin a new decade with chronic and widespread pessimism. There is little conviction in stocks as long term investments, investors are generally fearful of stocks and of volatile markets. Similarly, as a nation we are less confident in our security and in our economic future than we were just ten years ago when the U.S. was the world's only economic and military super power. Whether we describe today's viewpoint as pessimistic or simply reflecting a healthy dose of reality, the result is a diminished appetite for stocks, resulting in much better valuations for those willing to invest. As renowned long time investor Bill Miller of Legg Mason recently commented, one doesn't have to look very far or dig very deep today to find value and quality in the current stock market.

Good values can be found broadly across the market and across industry sectors. We would highlight blue chip stocks such as Pepsi, Johnson and Johnson, Chevron, BP, JP Morgan, General Electric, Intel, Cisco, BHP Billiton, McDonalds, and Honeywell to name a few. As we enter a new decade, reduced investor expectations and widespread pessimism together with attractive valuations are a recipe for better future equity returns.

Not A Lost Decade For U.S. Industrials

While the past decade was one of great stock market disappointment, it was a decade of solid accomplishment for most non-financial S&P 500 companies. U.S. industrials strengthened their balance sheets, improved their operating efficiency and asset utilization, and most importantly successfully expanded overseas. We believe globally oriented U.S. corporations are poised to deliver strong earnings growth in 2010 and 2011, and should excel in an environment of healthy global economic growth led by emerging economies.

Like their British counterparts earlier in the twentieth century, today's U.S. industrials increasingly have moved overseas where their operations and profits are growing rapidly and in many instances now far exceed domestic operations.

So while the outlook for the U.S. economy is less than certain and we face significant longer term headwinds (rising health care and retirement costs, record budget deficits at federal and state levels, relatively high levels of consumer debt), we believe the domestic recovery will continue and pick up steam in 2010. But it is a mistake for investors to focus too much, and to focus in isolation, on the domestic economic outlook and its uncertainties.

It is the global outlook that is most critical to the profit growth and performance of the S&P 500 and the Cypress portfolio. And the outlook for the global economy has perhaps never been brighter and more full of potential. Geopolitical risks and dangers are as present as ever in today's world, but the growth potential of today's global economy and the rise of the world's emerging economies are historic developments. Strong global growth and the success of U.S. companies in expanding overseas leads us to believe that corporate profits and U.S. GDP growth will both be stronger than expected in 2010.

Conclusion: The Road Ahead

We begin a new decade and, as investors, confront a landscape that appears much less benign and much less certain than that of ten years ago. Then, our economy and power as a nation was unrivaled and showed little vulnerability, stocks were immensely popular and viewed as superior long term investments. It was "easy" to invest in 2000, it was "easy" to make money. Today it is hard to do either. But those that invest today, when it is hard, may be very pleasantly surprised a few years down the road, just as the easy investments a decade ago often led to disappointment.

There is also a risk to doing nothing. Rising interest rates (inevitable off today's historic and artificial lows), a return of higher rates of inflation, a declining dollar, and continued global growth could all undermine in real terms the value of "riskless" cash and fixed income investments. Inflation and a declining dollar erode the value of so called riskless assets such as cash equivalents or U.S. treasury bonds. Stocks, however, have the capability to maintain or even increase their value in more inflationary environments. In a new decade that could be marked by such trends, investors would come to regret a failure to invest in equities and other long lived assets such as resources or real estate.

So, as we take stock of the last decade, we are reminded of the frequent perversity of the market: many times the best returns come in the midst of difficult times. It has been said that we should buy our stocks like we buy our socks, when they put them on sale. 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 opportunites – 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 opportunites for the long term equity investor.