CYPRESS

ASSET MANAGEMENT, INC.

MARKET COMMENTARY **January, 2009**

Stock markets and investors suffered in 2008. The past year saw equities fall the most since the Great Depression as the global economy froze in financial crisis and then slid into recession. One of the things which characterized this meltdown was its devastating swiftness and severity. The demise of many of the major global financial firms, the American automobile manufacturers, numerous hedge funds, and even the Madoff swindle all occurred essentially over the final three or four months of 2008. In response to all of this, we are now seeing unprecedented coordinated worldwide monetary and fiscal stimulus, led by the U.S. Federal Reserve. The massive policy response, combined with the huge drop in oil and commodity prices, and the advancing maturity of the recession itself (now over four quarters in duration according to the start date of December 2007 from the National Bureau of Economics Research) give 2009 the potential to surprise on the upside, with both the economy and the markets doing better than expected.

The Policy Response

In contrast to the 1930's when the Federal Reserve did nothing to help the banks, the Fed and Treasury have communicated a determination to do whatever it takes to restore the banks and financial systems to health. The Fed has reduced its target interest rate to 0%, essentially guaranteed all bank and money market deposits, and loaned/invested about $1 trillion into the banking system. Quantitative easing (printing new money to increase the supply of money) has been employed to combat asset deflation, buy troubled assets, and lower lending and mortgage rates. Fed policy has already shown some success with the prime rate down to 3.25%, 30 year mortgage rates down to 5%, and significant reductions in credit spreads (the three month LIBOR Inter-bank lending rate is down to almost 1% from a peak of over 4% in late 2008, and the TED credit spread has dropped below 1% from an October peak of 4.5%).

In addition, more fiscal stimulus is on the way with a government stimulus package of about $1 trillion sought by the incoming Obama administration. This is expected to involve a combination of lower tax withholding rates (tax cuts) and infrastructure spending. In contrast most policy makers in the 1930's initially sought increased taxes and reduced spending to cut budget deficits, the wrong prescription for a serious economic downturn.

The end game of Fed policy is to basically force money out of so called riskless assets (low yielding Bank Certificates of Deposit, Treasury Bonds, etc.) and into higher return, higher risk assets (i.e. stocks, bonds, real estate, etc). At some point in 2009 the money which flooded out of the financial markets to hide out in mattresses, CD's and Treasuries should begin to creep back into the markets. This unthawing might start almost imperceptibly at first and then perhaps move with an unexpected force and suddenness to rival the selling frenzy of the fourth quarter 2008. We would argue that there may be greater risk in 10 year Treasuries at 2% than in high quality stocks and corporate bonds.

The Cypress Portfolio Response: Portfolio Strategy for 2009

Recent changes in our portfolio, while relatively modest in number, should significantly strengthen our position going forward into 2009 and beyond. We continue to be positive about energy and resources over a one to three year time frame, and look for these stocks to experience a strong recovery in the second half of 2009 given just a modest pickup in global economic activity. Energy and resources are fundamentally supply constrained, and this condition will persist for some time into the future and could produce a surprisingly strong recovery in the next up cycle. Despite our favorable long term outlook, we made the decision to reduce our holdings in the oil service sector, which is more vulnerable than the oil and gas producers to a prolonged global recession and reduced spending on exploration and development. We remain focused on the high quality producers with strong balance sheets and quality reserves, good future growth prospects, and healthy cash flows even at current low prices.

Proceeds from energy services and other more cyclical holdings have primarily been redeployed into consumer staples and health care, which are much less dependent on economic growth. We have recently made investments in Nestle, Unilever, and Merck, global leaders that are at attractive values and have good dividends. As a result we have augmented an already sizable defensive growth position in consumer staples.

Looking beyond the current financial crisis and recession, we also see the likelihood of monetary reflation and a weak dollar resulting from the huge federal stimulus now in the pipeline. We have been building a position in Barrick Gold, the world's largest gold mining company, as a gold based investment play. Barrick Gold will be both a beneficiary and a hedge against rising inflationary risk and a weaker dollar. Energy and resource holdings will also be major beneficiaries of this same trend.

Conclusion: An Optimistic View of the Future

It has been a tough year, albeit a tough decade, for equity investors. Performance has been miserable in the short term and unrewarding in the long term. Valuations are at historical lows, performance has been statistically poor. We think of equity investors as standing at the edge of a great chasm. No one knows how wide nor how deep is the chasm. But the rewards on the other side, as Warren Buffet has noted, could be substantial. As you know, we have always tried to focus on quality companies. During this period, we have redoubled our efforts to hone the portfolio down to survivor companies that should get us to the other side of the chasm. A long term optimist would say that U.S. stock prices are down a statistically significant amount, valuations are at very attractive levels, dividend income is far above average, most corporate balance sheets are strong, investor sentiment is horrendous and there is no appetite for risk (as noted, the U.S. government is able to issue short term paper at essentially no cost). A long term optimist, Warren Buffet, has already made his bets in Goldman Sachs, Wells Fargo and General Electric – at higher prices. A market historian might even conclude that the last ten unrewarding years set up good prospects for equity investments going forward. We look forward to working with you, our clients, to participate in these long term opportunities in the market.