MURRAY
INVESTMENT MANAGEMENT

1st Quarter 2010 Update

Economic Review

The U.S. economy grew 5.6% in the 4th quarter of 2009 marking the second consecutive quarter of expansion. Estimates for the 1st quarter of 2010 are for continued improvement as monetary and fiscal policies continue to stimulate growth.

The Federal Reserve continued in a very accommodative stance during the quarter keeping its main policy tool (the Fed Funds Rate) at historically low levels (0% - .25%) and maintaining its intention to stay this way for an "extended period." The Fed Funds Rate is the rate that banks charge for loans to each other and serves as a benchmark for setting other interest rates in the economy. The Fed did raise the Discount Rate (the rate it charges banks on loans from the Fed) from .50% to .75%. The rate had been lowered to free up credit during the credit crisis and is being increased since credit markets have somewhat normalized.

The U.S. employment situation showed some signs of improvement with the March jobs report posting a monthly gain of 162,000 jobs. Some did note the impact that temporary Census workers had on this number, and at 9.7%, the overall unemployment rate has only modestly improved since the end of the year.

After the Democratic Party lost a seat in Massachusetts, the health care bill appeared to be finished. The Obama administration, however, was able to revitalize the stalled bill and passed sweeping Health Care reform in March. This bill will have broad implications for both the economy and the stock market going forward.

Equity Market Performance

	1Q10	YTD
S&P 500	5.39%	5.39%
MSCI EAFE (International index net return)	0.87%	0.87%

Domestic equity markets began the year under pressure as Sovereign debt issues in Greece, potential U.S. financial reform and tighter Chinese monetary policy weighed on performance. Markets clawed back as the quarter progressed, however, led by Small and Mid Cap stocks which outpaced the 5.39% increase of the S&P 500. Even with stellar performance (up around 75%) since March 2009, the S&P 500 still remains approximately 25% below its October 2007 high.

The broad International markets were modestly higher during the quarter but underperformed the U.S. market. The fear of Greece's credit crisis spreading to other areas weighed heavily on International markets.

Domestic Market Sector Performance

S&P 500 Sector (price only returns)	YTD
Industrials	12.45%
Financials	10.82%
Consumer Discretionary	10.05%
Consumer Staples	5.04%
Health Care	2.89%
Materials	2.41%
Information Technology	1.67%
Energy	0.08%
Utilities	-4.61%
Telecommunications Services	-5.66%

Sector performance within the S&P500 varied widely during the first quarter. Overall market performance was largely driven by the top sectors: Industrials, Financials and Consumer Discretionary. These sectors are considered to be more cyclical and are performing well as the economic recovery unfolds.

Bond Market Performance

	1Q10	YTD
BarCap US Aggregate Bond (Broad Bond Market)	1.78%	1.78%
BarCap Municipal	1.25%	1.25%
BarCap US Corporate	2.30%	2.30%
BarCap US Corporate High Yield	4.62%	4.62%

The broad bond market produced positive returns during the quarter led by High Yield Corporate bonds. This continues the 2009 trend when High Yield also produced strong results. Other areas of the bond market were modestly higher.

Economic Outlook

As many economic numbers have improved, the potential for a double-dip recession has diminished. In addition, most expect the economy to continue to grow as the year progresses. The recovery, however, is anticipated to be modest, and there is concern about how the economy will function once the monetary and fiscal stimulus is removed.

A weak housing market and high unemployment are currently weighing on the Fed and keeping them from raising rates, but a rate hike in the next 6-12 months is a reasonable expectation.

Source: standardandpoors.com, bls.gov, Morningstar, BEA.gov, CNBC.com and federalreserve.gov.
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 03/31/2010. Except as noted, index returns are Total Returns.

The timing of this hike is critical, and acting too soon could upset an already fragile recovery.

While a Fed rate hike will tighten credit and slow economic growth, the hike can be viewed as a positive sign that the economy is getting better and that the Fed feels confident enough in our outlook to remove some of the stimulus.

Given that Consumer Spending contributes approximately 70% of U.S. GDP, continued economic growth will largely hinge upon increased consumer spending and an improving employment environment. While the jobs picture has improved, we still have a long way to go to significantly reduce the unemployment rate from current levels. Consumers remain cautious and the adjustment to the world of less credit and more saving will impact the path of the recovery. The days of more and more debt to finance discretionary spending are likely over.

Longer term, how the U.S. Government approaches its annual deficit and ever increasing debt levels is a major concern. Taxes are going to rise, but spending will have to slow as well. These concerns have been around for a long time but have been heightened recently with the passing of the Health Care bill and the financial bailout.

Market Outlook

Improving U.S. and International economies along with stronger corporate earnings and solid balance sheets are currently serving as a favorable backdrop for equity markets. Even with a significant rise since March 2009, domestic market valuations do not seem unreasonably stretched. Assuming Operating EPS (Earnings per Share) of $80 for 2010, the S&P 500 was trading at a PE (Price to Earnings) Multiple of 14.6 times at the end of the quarter. This is not unreasonable compared to historical PE multiples, and any PE expansion or more favorable earnings growth could push markets higher.

Given that interest rates are likely to rise, we generally believe that holding Shorter Term fixed income securities makes sense right now. Bond prices move in an inverse relationship to interest rate movements, so rising rates cause bond prices to fall. Shorter term bonds typically do not fall as much as Longer Term bonds in rising rate environments.

We should expect increased market volatility as monetary and fiscal stimulus is slowly removed. While increased market volatility may be the near-term result of a rate hike, investors may ultimately cheer this decision as a signal of an improving economic environment.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call. Also, please pass along our name to anyone that may be in need of investment advice.

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