



January 4, 2010

An economic recovery is underway and financial markets have responded strongly. Formidable crosscurrents remain and the current low interest rate environment presents challenges to investors. We continue to recommend a diversified portfolio of global and domestic high quality equities. New commitments to fixed income must be selective.

Financial Markets

In a remarkable turn, stocks, as measured by the S&P 500 Index, gained 27% in 2009 and rallied 68% from the bear market low last March. High growth and small company stocks led the gains in 2009 followed by the blue chip stocks that had held up relatively well in 2008. As early beneficiaries of a stronger economy, consumer and technology stocks were especially strong.

One factor behind the rally in stocks was stronger than expected earnings growth in the second half of 2009. Most of this growth was due to aggressive cost cutting; revenue growth was largely absent. With analysts forecasting year-over-year gains of roughly 25%, expectations for earnings in 2010 are high. Without a return of meaningful sales growth these expectations could prove to be too optimistic.

Returns in the debt markets in 2009 were notably mixed. Having run up sharply in 2008 as a “safe harbor,” US Treasury securities in 2009 lagged other sectors of the bond market. The Barclays Intermediate Credit Index of corporate bonds, for example, returned 16% versus -9% for the 10-year Treasury note. The yield on the short-term 90 day T-Bill is still very low at 0.05%, almost unchanged from a year-ago.

Roth IRA Conversions. Beginning this year, owners of traditional IRAs have an opportunity to convert to Roth IRAs regardless of their income level. While your individual situation should be reviewed with your tax advisor, a conversion may have significant long term advantages, particularly if you expect to pass your IRA on to future generations. Please call your Birch Hill portfolio manager to discuss the potential benefits of a Roth IRA conversion.

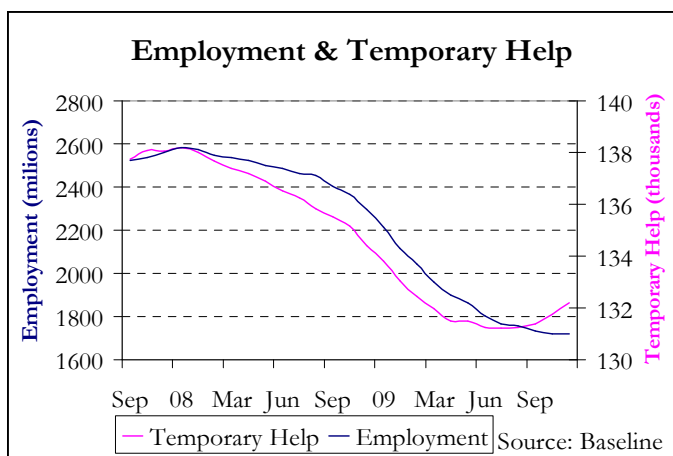
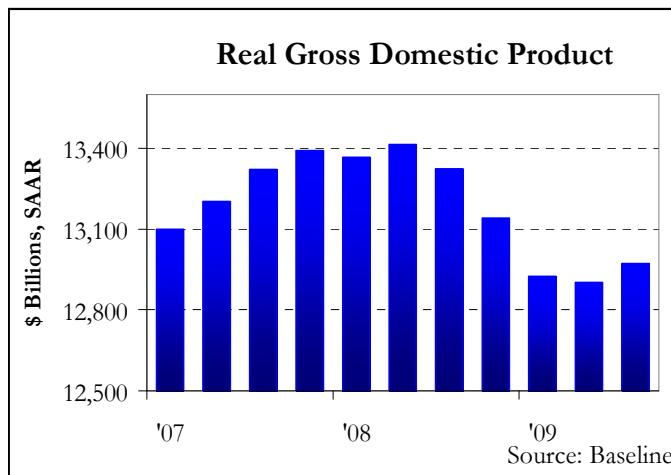
Market Indicators 12/31/09

	Total Return	
<u>US Stock Markets</u>	<u>2009</u>	<u>4th Qtr</u>
S&P 500 Index	26.5%	6.0%
Dow Jones Industrials	22.7%	8.1%
NASDAQ Composite	45.4%	7.2%
<u>International Stock Markets</u>	<i>ETF Returns in US\$</i>	
EAFE Index <i>(Europe, Australia, Far East)</i>	27.0%	2.0%
Japan (MSCI Index)	2.9%	-1.1%
China (Xinhau 25)	47.0%	3.8%
Emerging Mkts Index	68.9%	7.5%
<u>US Fixed Income Yield</u>	<u>12/31/09</u>	<u>12/31/08</u>
90 Day US T-Bill	0.05%	0.08%
2 Yr US T-Note	1.14%	0.77%
10 Yr US T-Note	3.84%	2.21%

Economic Outlook

An early but fragile recovery is unfolding. The massive stimulus programs are working and US GDP growth has turned positive. Inventory replenishment from historically low levels has boosted manufacturing output globally and the US labor market is stabilizing. Indicators, such as the rise in temporary help, hours worked and productivity growth suggest employment could turn positive soon. Household balance sheets are improving as asset values get a boost from the recovering markets and consumers begin to reduce their mountain of debt. As employment improves, confidence builds and household wages increase, US consumer spending, the core of the US economy, should slowly begin to recover.

Significant questions still remain about the course of this recovery, and difficult monetary and fiscal policy issues need to be tackled before a solid foundation for growth can be established. Policy makers must navigate the fine line of rebuilding consumer confidence and spending while not over stimulating the economy. Extremely low short-term interest rates, for example, have so far been effective at relieving pressures in the financial system. Keeping these rates low for too long, however, could lead to new asset bubbles or other inflationary pressures. As the recovery builds this year, interest rates will almost certainly need to rise. Policy makers also face the challenge of reducing the level of fiscal stimulus without affecting job creation and dampening consumer spending. This is a particularly urgent and daunting task given the rapid growth of the Federal deficit and the growing likelihood of higher taxes.

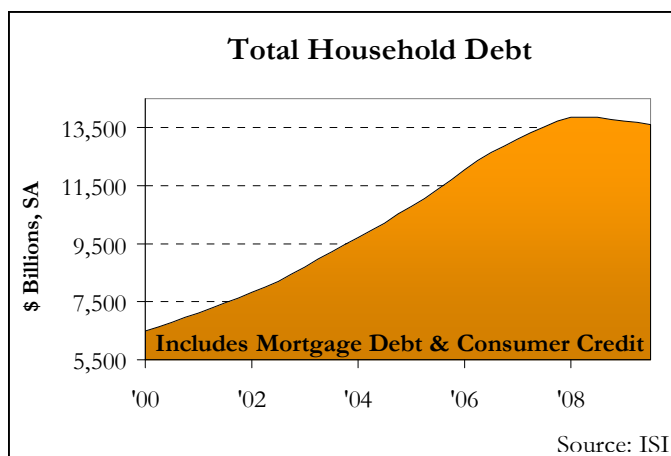


Low Interest Rates are a Challenge

With short term rates at or near zero percent, investors are faced with a difficult choice: accept the current rates or reach for higher returns by taking on higher levels of risk in longer maturities or lower quality issues. While it is understandable that investors want to seek higher return alternatives, care should be taken to avoid situations where prices have already risen beyond what economic fundamentals suggest are reasonable. The challenge is especially difficult today following the strong gains last year in almost all asset classes. However, with higher rates on the horizon, the siren song of higher yields should be resisted for now.

Conclusion

Supported by low interest rates and other powerful stimulus programs, the economy is under repair. The course of the recovery will become evident as these programs unwind, but no quick fix is evident. Investors should continue to own a portfolio of companies with solid growth prospects and strong balance sheets. Care should be taken to avoid reaching for higher risk returns.



Miner A. Cray, CFA

Gary R. Mikula, CFA

Robert A. O'Neil, Jr., CFA

Thomas E. Reilly, Jr., JD

Go Paperless

Market View is now available via email. If you would like to receive future copies of Market View electronically, please email marketview@birchhilladvisors.com or contact your portfolio manager.