

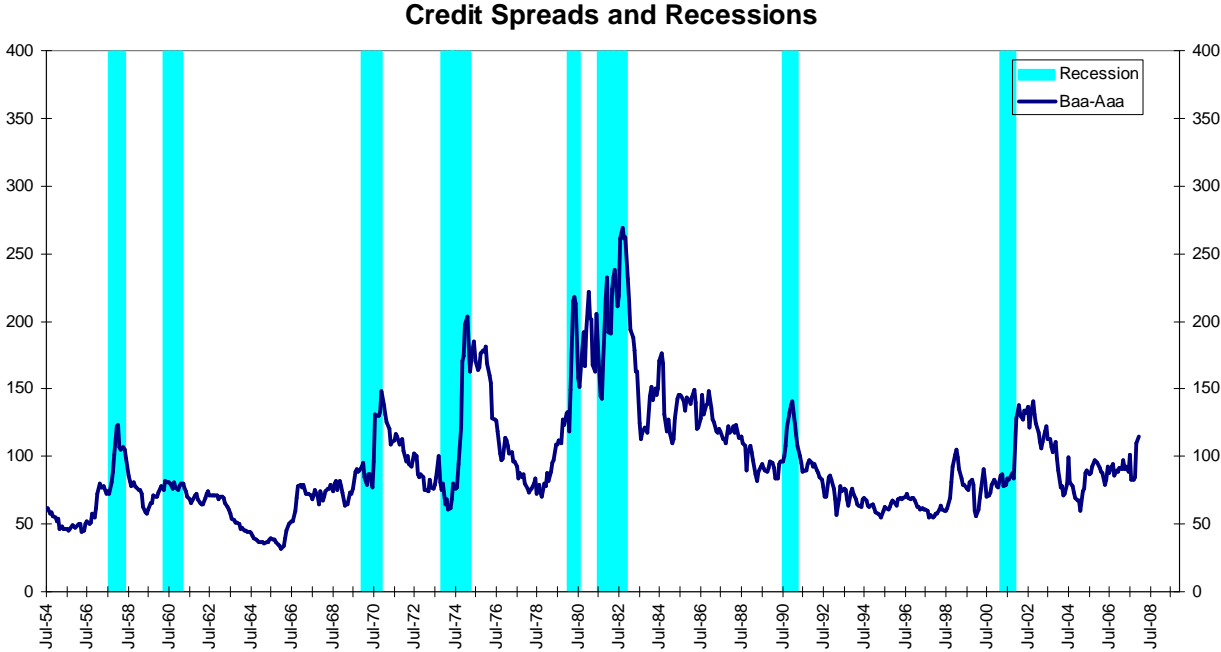
KILEY PARTNERS, INC.

KILEY PARTNERS, INC.
13241 Oakmeade
West Palm Beach, Florida 33418
800.995.4539
561.630.5006

January 20, 2009

Market Commentary

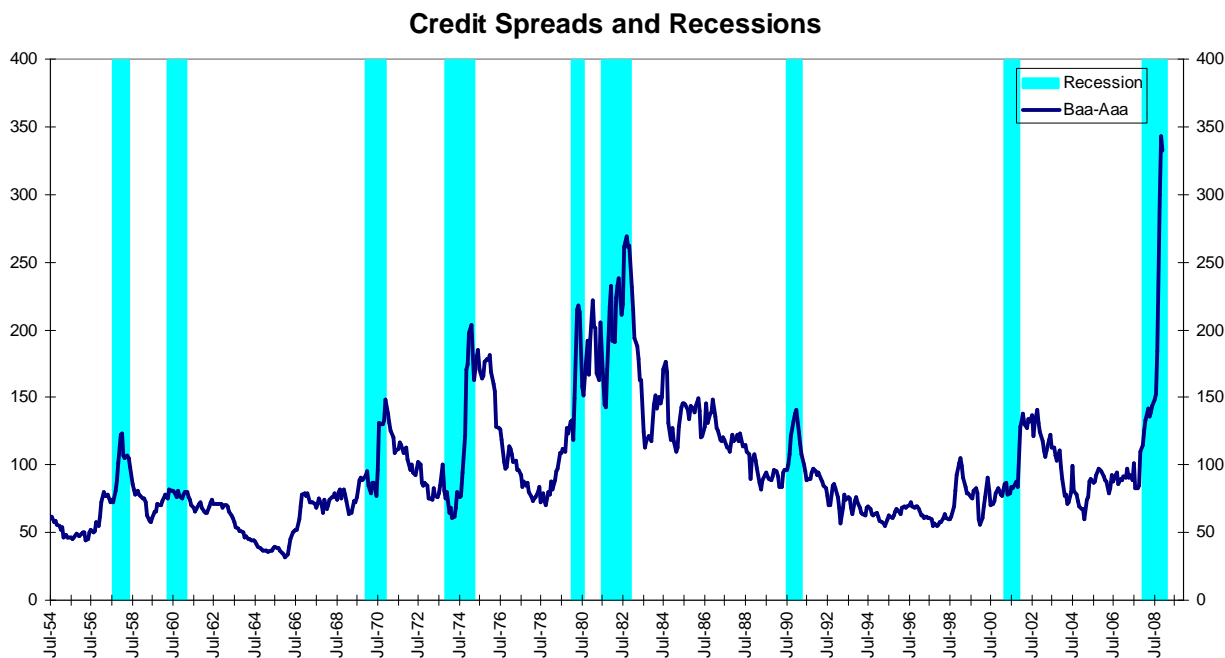
A year ago we had not yet been told that we were in a recession. Yet the signs that a recession was coming were everywhere, the most important of which was that the yield curve had inverted, an accurate predictor of every recession since World War II. At that time, the spread between yields on seasoned triple-A corporate bonds (as reported by Moody's) and ten-year government bonds was +137 basis points, 40 basis points higher than a year earlier. The spread between triple-A corporate bonds and Baa-rated corporate bonds was +115 basis points. The chart below shows credit spreads since 1954.



Based on the evidence at that time, we recommended reducing exposure to corporate bonds as much as possible and increasing exposure to U.S. government bonds. Over the next twelve months, the return on the ten-year bond was approximately 22%. To the extent that clients had to remain in corporate bonds, we recommended defensive sectors, such as consumer noncyclicals. We also recommended reducing the equity allocation.

© Copyright 2009 by Kiley Partners, Inc. All information contained herein is obtained by Kiley Partners, Inc. from sources believed by it to be accurate and reliable, however, such information is provided "as is" without warranty of any kind, and Kiley Partners, Inc. is not responsible for any errors or omissions or for the results obtained from the use of such information. This report does not constitute an offer to sell, or a solicitation to buy, any security.

A year later, our fears have come true with a vengeance. We expected a bad recession, but not the panic or the breadth of devastation that we have seen in the credit markets and the financial sector. The spread between yields on seasoned triple-A corporate bonds and ten-year government bonds has increased to +259 basis points. The spread between triple-A corporate bonds and Baa-rated corporate bonds widened to more than +340 basis points. The chart below shows credit spreads since 1954, and includes data for the last year



Spreads, which have narrowed only slightly from their peak, stand at the highest level in the last fifty years and more. Further, historically, spreads narrow sharply when recessions end, meaning that Baa-rated bonds purchased at the trough of a recession historically outperform higher rated bonds. In the last fifty years, the average recession has lasted about ten months. The two worst recessions on record lasted sixteen months. This recession, which was backdated almost a year, is now in its thirteenth month. We believe, based on the historic record, that if the stimulus package is passed, the recession will be over in the nine months, whereas if the stimulus package is *not* passed, the recession could last through September. In other words, it will be the longest recession on record, but, more important, no matter what the government does or doesn't do, this recession will probably end late this year.

Recessions end when confidence returns. Confidence is not a matter of throwing money at the problem. In fact, there is strong reason to believe that the kind of stimulus

package being proposed has the opposite effect, convincing people that times must be bad if the government is so concerned, and so it is time to batten down the hatches. Eventually, however, people come to see that the world has not ended, that 92% of the people have jobs, and that stocks and bonds and houses are on sale. That is when recessions end. Confidence begins to return, people (and banks and other companies) begin to put their money to work again.

Turning to the stock market, since World War II, there have been eight bear markets (defined as the S&P 500 dropping 20% or more from its peak), not counting the current bear market. They lasted an average of twenty months, and the average decline was 35.4%, with a standard deviation of 8.1%. The worst bear market began in March 2000 and bottomed in October 2002, with the S&P 500 down 49.1%. This bear market, while shorter than average, has beaten all records since the Depression in terms of severity, with the S&P 500 declining 51.9% through the trough last November. Since then the S&P 500 has climbed 13%.

What does this mean for investors? We believe that stocks and corporate bonds are on sale. We believe this is the time to put money to work again in both markets. In the bond market, we believe government bonds are no longer the place to be. Historically, the lowest rated bonds have out performed from the depths of recessions. There is no reason to think this time will be any different, and the unprecedented spreads that exist now imply that strong returns are likely. The best returns for buyers who stick to the investment grade market are likely to be in the bottom tier, in the Baa/BBB category. We recommend caution, choosing good, solid names very selectively, but we recommend increasing the weighting in this sector and the single-A rated sector as much as possible, within whatever constraints are placed on the portfolio.

The portfolio manager who is nimble will earn superior returns.