

# Red Granite Advisors LLC

## First Quarter 2009 Commentary

As 2009 began, an extended wave of selling culminated in new stock market lows on March 9th, putting the S&P 500 and Russell 1000® Growth Indices at price levels 24.3% and 16.9%, respectively, below year-end levels. Fear and despair among investors reached capitulation levels reflecting overwhelming concerns about the economic malaise and lack of a definitive Treasury plan to solve the financial crisis. With the economy entering its 16th month in recession, stocks had lost more than \$10.5 trillion in value from 2007 highs.

In the face of a still weak global economy, however, investors cheered the prospects of authorities easing strict mark-to-market financial accounting rules and reinstating the up-tick rule for short-selling on domestic stock exchanges. The former would shore-up bank capital by lessening the need for banks to recognize losses on illiquid assets, while the latter was designed to thwart unabated selling pressure on targeted companies' stocks. These proposed rule changes provided the catalyst to reverse overly negative sentiment and caused renewed stock buying. A sharp three-week market recovery ensued, paring losses for the S&P 500 and Russell 1000® Growth Indices to -11.0% and -4.1%, respectively, by the end of the quarter.

The market's recovery also reflected that, after 18 months of price declines, many stocks were more attractively valued and investors owned \$4 trillion in low-yield, short-term investments, much of it available to buy stocks and bonds. Combined with other forms of savings, these cash reserves represented more than 50% of the total equity market value at the low.

During the first quarter, Red Granite's Large Cap Growth Equity portfolios performed in-line with the Russell 1000® Growth Index. We reduced cash balances and expanded portfolio exposure to technology and materials companies, which were the quarter's better performers. Selected health care issues also contributed. Financial and industrial stocks under-performed.

Later this year, the economy should exhibit signs of recovery based on pent-up demand and the lagged effects of massive stimulus. While economic slack abounds and will likely build for a few quarters as deleveraging continues and savings increase, there are early, hopeful signs of trends getting "less worse" in recent data from retailers, the housing market, durable goods orders, and consumer confidence.

Growth prospects for late-2009 and 2010 are being enhanced by numerous stimulus efforts. The Federal Government and the Federal Reserve have created a tsunami of policy initiatives, involving guarantees, direct investment, purchases, loans and stimulus package, that total approximately \$12 trillion to date, or greater than 85% of one year of U.S. GDP. The Federal Reserve also has begun an aggressive quantitative easing involving the purchase of over \$1.5 trillion of Treasury bonds and mortgage securities, further augmenting rapid growth of the money supply.

It is likely that the market has bottomed; the caveats being that further base building is required, more time is needed to solve the country's economic woes and enduring economic gains will require fully functioning credit markets. Sustainable stock market gains will also need "financials" to play a bigger role. While some stocks will likely post new lows, many stronger issues are trending higher and providing evidence of new market leadership. Additionally, over the past few months market volatility has lessened implying an improved appetite for risk and a belief that economic trends will eventually improve.

Joel D. Vrabel CFA  
Chief Investment Officer

David W. Bowman CFA  
Senior Portfolio Manager