THE CONROY REPORT

Outlook

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Economic Forecast

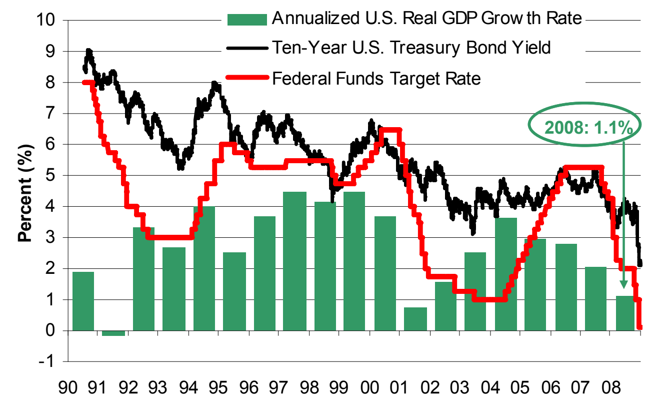
A slowing economy is typically coupled with lower inflation and this was evident in the fourth quarter of 2008. The U.S. economy grew by only 1.1% in 2008, as measured by the annualized change in U.S. Real GDP (see **green columns** on Chart 1). At the same time, consumer prices dropped sharply, particularly in fuel costs, resulting in a drop in inflation of 8.3% in the fourth quarter (see **black line** in chart 2). Given that the slower growth and lower inflation relationship has become evident, inflation may become less of a risk to economic growth, at least in the near term. Going forward, massive fiscal stimulus, with the government pumping in vast amounts of cash into the public sector, could foster inflation in the years to come. Over the past two years we were very concerned about the potential for high inflation to put pressure on consumer demand. During this time, inflation rose to about 6%, significantly higher than the long term average of about 3% (see **red line** in Chart 2).

If inflation is contained, economic growth should come to the forefront of investor's concerns. It is clearly troublesome that the U.S. economy contracted by 6.3% in the fourth quarter of 2008. There is virtually no where to go in terms of lowering regulatory borrowing rates to stimulate demand, with the Federal Reserves' Target rate just slightly above 0% (see **red line** in Chart 1). As a result, the government remains focused on fiscal stimulus now more than ever to support economic activity. There has been a tremendous amount of money handed over to struggling businesses, primarily in the financial services and, also, automotive industries. The theory of one bank or insurer or some other entity being "too big too fail," in terms of the country's dependence on its solvency, may seem passé given recent developments. Yet the government remains steadfast on supporting these institutions to the best of their ability despite rising budget deficits. The government is also introducing the prospects of new jobs, but this is clearly a troublesome area. Will these jobs be permanent or temporary? The unemployment rate has risen 3% to a level just under 8%, which is the highest it has been since the early 1980's (see **black line in** Chart 3).

We continue to prefer cash and other money market instruments. With inflation having hovered above the long term average over the past two years, we had been worried that slower growth plus high inflation would cause tremendous problems for consumer demand and, hence, economic growth. This was reflected in the dismal performance of stocks and corporate bonds during that time. Our recommendation to invest in cash and other money market instruments, as a result of this concern, performed very well. We note that short term interest rates have risen sharply with one year CDs offering yields that are more than 1% higher than a year ago.

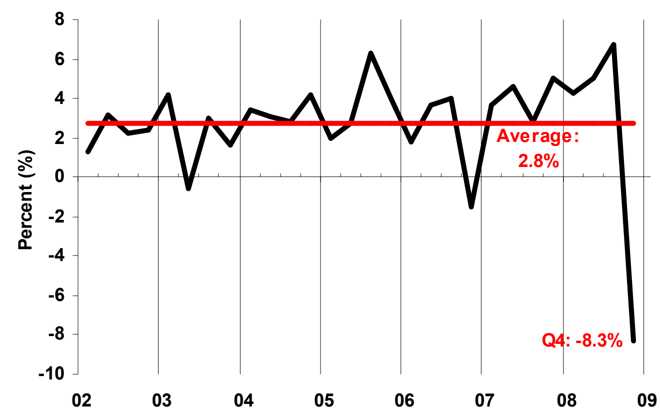
For investors that are seeking greater returns we believe corporate bonds may offer a good alternative to other investments including stocks and money market investments. We believe the main risk to investing in this market is default risk, and, therefore, we advise against buying bonds in sectors that contain companies that are at a high risk of failure, including those in the financial and automotive industries. We continue to favor corporate bonds that mature in less than two years.

Chart 1. U.S. Economic Growth and Interest Rates



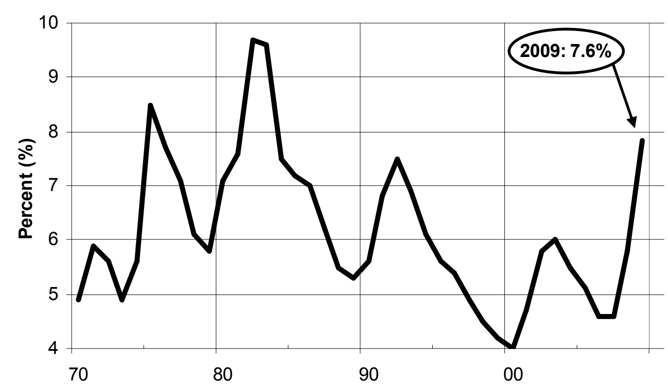
Sources: Federal Reserve, U.S. Department of Commerce Bureau of Economic Analysis, Yahoo! Finance.

Chart 2. Inflation Remains High



Sources: U.S. Department of Commerce Bureau of Economic Analysis. Data series shows seasonally-adjusted quarterly changes in the Consumer Price Index on an annualized basis.

Chart 3. Unemployment Rate is on the Rise



Sources: U.S. Department of Labor, Bureau of Labor and Statistics. Seasonal unemployment rate.

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