Investment Review & Outlook

First Quarter, 2009

In the News

CCM's Managing Director, **Tom Graff**, appeared on FoxBusiness.com to discuss the "Bad Bank" Plan and the Federal Reserve's decision to buy longer-term Treasuries. If you missed it, visit our website for a video clip.

Later this month...Chief Investment Officer, **Jim Dugan**, will give a presentation on "Enhancing Financial Knowledge" at the University of Maryland, Baltimore County. For more information, visit our website.

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TREASURY UNVEILS PLANS TO REMOVE TOXIC ASSETS

After nearly five months of anticipation, the Treasury Department and Federal Reserve have finally released a plan to remove toxic assets from bank balance sheets. This is a crucial step in ending the vicious cycle of asset valuation declines, requiring further bank bailouts, which then results in more fear and more asset valuation declines.

Unfortunately, the plan may not be all it could be. The plan has two major parts: the Legacy Securities Program and the Legacy Loans Program. The outline of the Legacy Securities Program suggests it will be a smashing success. However, the outlook for the Legacy Loans Program is much weaker.

To learn more about both programs, read Managing Director Tom Graff's full article on our website, www.cavcap.com. An insert defining the various new government programs has been included with this newsletter.

INFLATION: THE NEXT CRISIS?

In response to the current economic crisis, the federal government has taken unprecedented action to prevent job losses, support banks, unfreeze credit markets and abate the housing market catastrophe. In order to pay for these actions, the government has borrowed and printed trillions of dollars and there is more to come. As this tremendous quantity is thrust into the marketplace, it only makes sense that our currency would lose its value causing the dollar to weaken and inflation to grip the U.S. economy. However, the trade-weighted dollar has actually strengthened in each of the last four quarters and the market forecasts less than 0.5% annualized inflation over the next five years according to the premium on the Treasury's inflation-protected bonds

So, where is the disconnect? What does the market see that we do not? Visit our website, www.cavcap.com, to find these answers and to see CCM's inflation analysis.

EQUITIES, COMMODITIES, & REITs MARKET REVIEW

Credit crisis continues, but March rebound brings glimmer of hope

Now over two years old, the financial crisis which began in subprime mortgages has become a crisis in housing, banking, credit, and ultimately the global economy. This quarter, like last quarter, began with steep losses across financial markets but ended with a significant rebound. In spite of the rebound, investment losses over the last two quarters have been historic.

- Financial stocks led the S&P 500 to its sixth consecutive quarterly loss, losing 11% this quarter.
- From September 2008 to February 2009, the S&P 500 declined 42.7%, the worst six-month period since January—June of 1932.
- REITs were the worst performer for both the quarter and last 12 months as they faced the combination of declining real estate prices, skyrocketing cost of debt, and rising vacancy rates.
- Financial markets rebounded in March with all major asset classes posting gains.
- Emerging Market (EM) equities was the only asset class to post a positive return in first quarter of 2009.
- China and Russia drove the EM market higher gaining 30% and 23% respectively after both nations experienced devastating 60%+ drops in 2008.

Equity Index Returns (%)
As of 3/31/09

Index	March '09	QTR	Last 12 Months
S&P 500 (large-cap U.S.)	8.76	-11.01	-38.09
Wilshire 4500 (small- and mid-cap U.S.)	8.76	-9.27	-38.67
MSCI EAFE (international - developed)	6.34	-13.94	-46.51
MSCI Emerging Market (international – emerging)	14.37	0.95	-47.07
DJ Wilshire REIT (real estate)	3.22	-33.92	-60.66
S&P Goldman Sachs Commodity	4.50	-10.64	-56.50

MULTI-ASSET CLASS (MAC) STRATEGY

The MAC strategy's diversifying exposure to commodities, REITs, and international stocks have not aided performance during this period because the effects of the crisis have been so broad. Additionally, REITs have been especially affected because they are significantly involved in both the real estate and credit markets. Traditionally, real estate and credit have been far more stable than the stock market and their performance has been fairly unrelated. However, one of the unique aspects of this crisis is that real estate and credit led the stock market into it.

In spite of the shortfalls in the last two quarters, in the long-run, commodities, real estate and international exposure will help diversify the risks of a portfolio while still providing competitive returns.

FIXED INCOME SECTOR RETURNS

- Treasury bond yields were modestly higher during the quarter, though fell sharply after the Fed announced a Treasury purchase program on March 18.
- Credit spreads fell sharply in January and early February, only to give up all gains in March.
- MBS outperformed other sectors due to a combination of low duration and government support.
- Federal stimulus packages helped fuel a broad based muni rally. CCM believes a number of the provisions will help state and local governments through this difficult economic period, but the full effect will take time to unfold.
- Muni liquidity improved during the quarter. California came to market with its first State General Obligation (GO) deal in over a year. The deal proved so popular with investors that it was ultimately upsized to $6.5 billion, making it the fourth largest municipal bond deal of all time.

Fixed Income Returns (%)
As of 3/31/09

Index	Dur.	Yield	QTR	Last 12 Months
Treasury	5.40	1.79	-1.32	7.48
Agency	3.51	2.37	-0.14	5.52
Credit	5.80	7.03	-1.78	-5.21
MBS	1.54	3.71	2.20	8.09
Barclays Aggregate	3.73	4.06	0.12	3.19
High Yield	4.10	18.12	5.98	-19.31
Merrill Lynch 1-12 Year Municipals	4.72	3.02	2.23	5.24

- Tax-exempt bond funds experienced strong net in-flows for the quarter, as cash moved out of ultra low yielding tax-exempt money market funds.
- In January, the broad municipal market posted its largest one-month gain since April 1983.

FIXED INCOME PORTFOLIO ACTIVITY

TAXABLE BOND PORTFOLIOS

- Added to Treasury positions, primarily in the 10-year segment of the yield curve, anticipating that deflationary concerns would spur the Fed to purchase Treasury bonds.
- Where appropriate, increased exposure to corporate bonds. Used an iShares Liquid Corporate Bond ETF for part of the exposure, which we believe will protect client liquidity. Subsequently added individual corporate names.
- Reduced taxable municipal positions opportunistically, funding both Treasury and Corporate bond positions.

ENHANCED CASH PORTFOLIOS

- Demand for short-term Treasury and agency bonds remain extremely low in yield. CCM has utilized primarily 1-2 year maturities to garner more yield.
- Continued to add to GNMA Project Loan positions with 0-2 year averages lives. These securities are directly backed by the U.S. Treasury but still carry yields above 2.5%.
- Eliminated any remaining exposure to corporate floating-rate notes.

MUNICIPAL BOND PORTFOLIOS

- Increased duration ahead of the January rally, during December 2008 and early January 2009, leading to strong relative performance for the quarter.
- Focused on liquidity. Increased exposure to State General Obligation (GO) holdings via the primary market. Added WA State, MD State, and CA State GOs.
- With 1-year high quality munis yielding well under 1%, CCM continues to favor short-term bonds in the 2-3 year part of the curve.

OUTLOOK

The Great Recession?

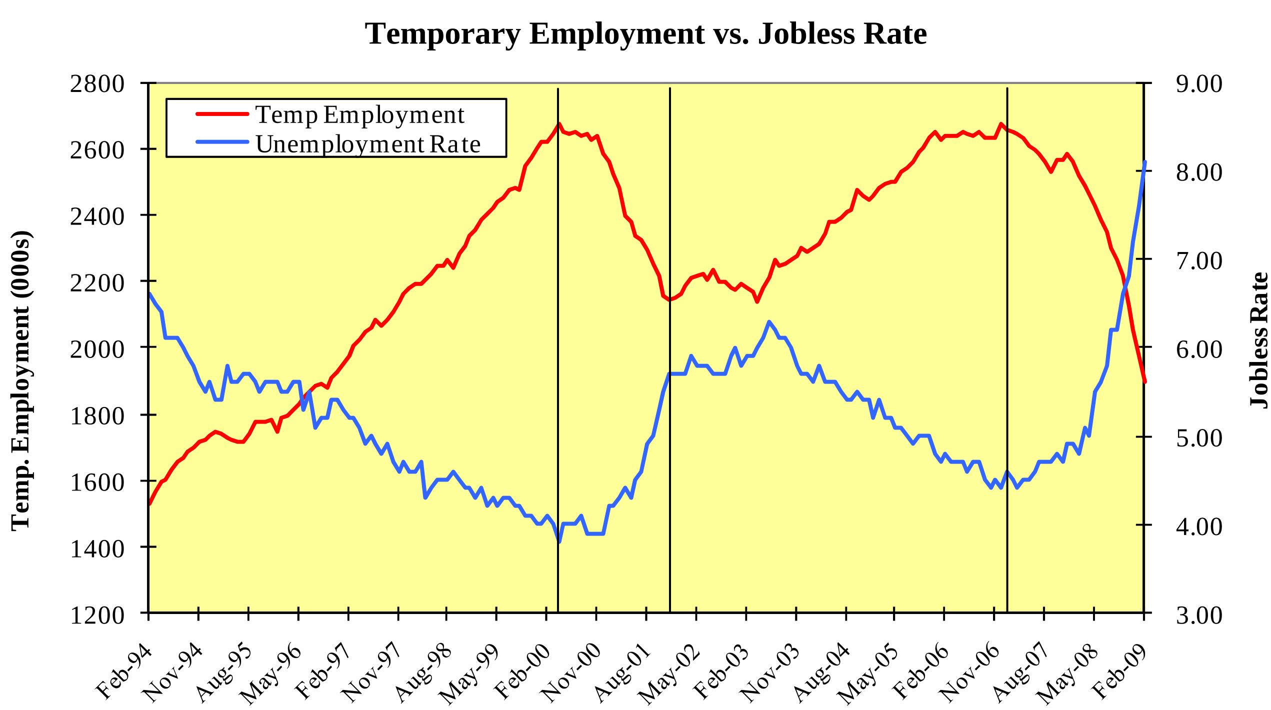
That is the moniker that some folks have tagged onto this economic and market meltdown. As we have written in the past, the current environment is certainly not like the Depression of the 1930's when the United States saw 25% unemployment, bread lines, lost bank deposits, the Dustbowl, and no unemployment insurance, Social Security or Medicaid.

However, the speed and depth of the current economic decline is the worst seen in at least a generation, so the simple label of recession seemed inadequate. There is an old saying, "A recession is when the other guy gets laid off – a depression is when I get laid off." In this business cycle, we have seen friends, neighbors, and family members been let go from positions. The Great Recession seems like an appropriate name.

This piece is being written as of April 2 and we have seen the S&P 500 rise 25% over its March 9 lows. Is this a sign the recession will soon be over? Typically, stocks rise six to nine months prior to a rebound in economic activity. Unfortunately, we've been down this path before—from November 20, 2008 to January 5, 2009, the S&P rose 24%, only to fall again over the next six weeks. We won't know if this rally will stick, or whether the economy is turning around until time passes and we have the benefit of historical perspective.

Consumer spending reportedly accounts for about two-thirds of U.S. economic activity. One of the reasons that this downdraft has been so quick and severe is that consumers stopped buying and started saving. With falling home prices, falling equity prices, reduced credit and job layoffs, consumers have become fearful and have cut back expenditures. Job growth will help restore consumer confidence and spending. Ironically, unemployment is a *lagging* economic indicator. Companies will try to avoid cutting jobs in a downturn and they are slow to re-hire people in a recovery. In the economic rebound in 2003, the unemployment rate kept rising until July. By that time, the S&P 500 had climbed nearly 30% off its lows and the yield on the 10-year Treasury was 120 basis points higher.

A more interesting economic signpost may be temporary job growth. Temp workers are easier for businesses to hire and fire as business activity waxes and wanes. In the graph we show the relationship between the level of temporary employment and the jobless rate. Turns in temporary employment have preceded the change in direction in the jobless rate. Thus far in the cycle, the temporary jobs data continues to show a decline, making us cautious about claiming that the worst is behind us.



Glossary of Terms for Government Sponsored Programs

- TAF: Term Auction Facility. December 12, 2007. Allows any depository institution to borrow short-term funds from the Fed against highly-rated pledged collateral. Interest rate determined at a bi-weekly auction.
- TSLF: Term Securities Lending Facility. March 11, 2008. Similar to the TAF, but available to Primary Dealers.
- Primary Dealer Credit Facility. March 16, 2008. Gives Primary Dealers access to a facility similar to the discount window.
- AMLF: ABCP Money Market Mutual Fund Liquidity Facility. September 19, 2008. Allows money market funds to borrow funds from the Fed by pledging asset-backed commercial paper (ABCP) positions. Intended to allow money market funds to meet investor redemptions.
- TMGP: Temporary Money Market Guarantee Program. September 19, 2008. Treasury guarantee assets held in participating retail money market accounts as of the date of the program.
- EESA: Emergency Economic Stabilization Act of 2008. October 3, 2008. Law that established the TARP.
- TARP: Troubled Asset Relief Program. October 3, 2008. Blanket program that gives Treasury funds for various efforts to address problems in the banking system.
- TIP: Targeted Investment Program. October 3, 2008. Gives the Treasury power to purchase any asset deemed distressed from a systemically important institution. This has currently only been used to aide Citigroup.
- AGP: Asset Guarantee Program. October 3, 2008. Gives the Treasury the power to guarantee any asset held by a systematically important institution. This power has currently only been used to aide Citigroup.
- CPFF: Commercial Paper Funding Facility. October 7, 2008. Allows the Fed to directly purchase commercial paper from issuers.
- TLGP: Temporary Liquidity Guarantee Program. October 14, 2008. Allows banks to issue new debt insured by the FDIC to repay bonds maturing between 2009 and 2012.
- MMIFF: Money Market Investor Funding Facility. October 21, 2008. Provide funding for purchase of money market instruments, primarily commercial paper, by a variety of investors, not just money market funds.
- CPP: Capital Purchase Program: October 28, 2008. Program under which the Treasury made preferred stock investments in banks using TARP funds.
- TALF: Term Asset-Backed Securities Loan Facility. November 25, 2008. Provides funding from the Fed for purchase of highly-rated and recently issued asset-backed bonds. Eligible collateral currently includes primarily student loans, SBA loans, credit card, and auto loan securitizations. Is expected to be expanded to include a wider range of assets.
- CAP: Capital Assistance Program. February 25, 2009. Part of the TARP, establishes a stress test for banks and allows avenues for additional Treasury funds for banks that, based on the stress test, need additional capital.
- PPIP: Public-Private Investment Program for Legacy Assets. March 23, 2009. The so-called “Toxic Asset Plan.” Program designed to purchase impaired assets from banks and other institutions through various means.
- PPIF: Public-Private Investment Fund. March 23, 2009. As part of the PPIP, several PPIFs will be formed by private money management firms to purchase assets. The PPIFs will function similarly to leveraged hedge funds with the FDIC and/or Fed providing the leverage.