

Investment Policy Committee Notes

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Economic and Stock/Fixed Income Market Outlooks

Economic Outlook

Recent Reports

- January Retail Sales (1.0%, -9.7% YOY) unexpectedly rose breaking the record 6-month slide. Sales less Autos (0.9%, -6.6% YOY) also rose.
- January Housing Starts (466K, -16.8%) fell much more than expected. Building Permits (521K, -4.8%) also fell.
- January Industrial Production (-1.8%, -10.0% YOY) fell more than expected with negative revisions. Capacity Utilization (72.0%) also fell.
- President Obama announced the Homeowner Affordability and Stability Plan which has three initiatives: Refinancing for Responsible Homeowners Suffering from Falling Prices, A Comprehensive \$75 Billion Homeowner Stability Initiative, & Support Low Mortgage Rates by Strengthening Confidence in Fannie Mae and Freddie Mac.

Upcoming Reports

- (2/19) January Producer Price Index (0.3% vs. -1.9%, -2.4% vs. -0.9% YOY) & PPI Ex-Food & Energy (0.1% vs. 0.2%, 3.8% vs. 4.3% YOY).
- (2/20) January Consumer Price Index (0.3% vs. -0.8%, -0.1% vs. 0.1% YOY) & CPI Ex-Food & Energy (0.1% vs. 0.0%, 1.5% vs. 1.8% YOY).
- (2/24) February Conference Board Consumer Confidence (36.0 vs. 37.7).
- (2/25) January Existing Home Sales (4.81M vs. 4.74M, 1.5%).

Longer-Term Outlook

- We believe we are in the midst of what will be a lengthy and deep recession. Earnings are likely to recover only slowly after the recession finally ends. The process of reducing debt and rebuilding balance sheets will take individuals and institutions a number of years.
- But bad news and investing can be counterintuitive. Markets typically bottom well before the economy because markets are forward looking. If prices more than adequately discount economic weakness, returns will be decent.
- We believe the markets are already discounting major economic damage but risks remain high. Secular bear markets usually end at extreme levels of undervaluation.

Market Outlook

Equity Outlook

- In similarly lengthy and similarly terrible past market periods, ensuing returns over the multi-year periods that followed were very good.
- Even assuming a very negative earnings environment (the worst since the Great Depression) and a historically below-average P/E, stocks would earn mid-single-digit returns over the next five years. In less negative scenarios returns would be higher.
- However, overall the evidence does not conclusively suggest that stocks are at highly compelling valuation levels or that we hit the final bottom in November. Recent indicators may point to a new bottom as the Dow traded below 7500 and the S&P Financials continue to record new lows.

Fixed Income Outlook

- We have been allocating to the many fixed-income opportunities that exist: municipals, investment grade bonds, TIPS, etc.
- Relative to equities, high-yield bonds are directly competitive in most scenarios, with similar returns, a narrower range of outcomes, and possibly less risk.
- Like the other fixed income opportunities, municipals have really began to enhance our performance results, particularly in January. The recent stimulus package temporarily increases the bank-qualified limits to \$30 million which will encompass the majority of KY deals. This could prove at some point prove to be a catalyst as community banks getting TARP capital begin putting it to work.

S&P 500 GICS Sector Performance and Recommended Sector Weightings

S&P 500 Sector	% Total Return			Forward P/E Ratio	Actual Sector % Weightings	Forward Looking
	MTD	YTD	2008			CB&T Sector Emphasis
Consumer Discretionary	-5.8	-15.8	-33.5	23.1	8.1	Underweight
Consumer Staples	-2.8	-10.1	-15.4	12.5	13.1	Overweight
Energy	-6.8	-9.7	-34.9	12.6	13.7	Marketweight
Financials	-14.1	-36.7	-55.3	11.1	9.6	Underweight
Health Care	0.0	-1.3	-22.8	11.2	16.6	Overweight
Industrials	-6.2	-18.0	-39.9	10.2	10.4	Marketweight
Information Technology	2.0	-1.1	-43.1	14.3	17.3	Marketweight
Materials	-2.6	-9.5	-45.7	16.0	3.1	Marketweight
Telecommunication	-6.1	-15.4	-30.5	11.4	3.7	Underweight
Utilities	-7.7	-8.3	-29.0	10.6	4.4	Marketweight
S&P Composite 1500	-4.3	-12.4	-36.7	12.6		
S&P 500	-4.3	-12.4	-37.0	12.5		
S&P MidCap 400	-4.0	-10.9	-36.2	12.6		
S&P SmallCap 600	-4.9	-17.0	-31.1	14.5		

Sector recommendations are market-cap weighted, influenced by economic, fundamental, and technical consideration.

The above information is provided by outside data vendors; CB&T cannot guarantee the accuracy of the data provided.

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