

Investment Policy Committee Notes

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Economic and Stock/Fixed Income Market Outlooks

Economic Outlook

Recent Reports

- April Durable Goods Orders (1.9%) & Durables Ex-Transportation (0.8%) were much better than expected but negative revisions.
- April New Home Sales (352K, +0.3%) lower than expected. In a separate report, 1Q Mortgage Delinquencies (9.12%) increased to record highs.
- April Personal Income (0.5%) unexpectedly increased but Personal Spending (-0.1%) declined as expected.
- May ADP Employment Change (-532K) was in line with expectations. April revisions increased declines by 54K to 545K.

Upcoming Reports

- (6/04) May ICSC Chain Store Sales (0.5% vs. 0.7%).
- (6/05) May Change in Nonfarm Payrolls (-520K vs. -539K) & Unemployment Rate (9.2% vs. 8.9%).

Longer-Term Outlook

- While we think that the policies and programs recently announced are likely to help move the economy towards recovery, they will not solve the serious problems we are facing and we expect more government actions in the months ahead. But in our opinion, no matter what policies are introduced, the impact of consumer and financial system deleveraging will almost certainly be a significant drag on economic growth over the next several years as saving and paying down debt replaces borrowing and spending. We also believe that no matter what the short-term outcome, there will be a price to pay down the road for the current policy actions—potentially in the form of a weaker dollar, higher inflation, higher interest rates and tax rates and, consequently, subpar economic growth and corporate profits, and lower stock market valuations.
- That being said, we are encouraged that the actions discussed above have taken the worst-case economic scenarios off the table. We are also encouraged by- the massive amounts of cash on the sidelines; earnings are (finally) being lowered to a level that reflects the weak economy; we are seeing glimmers of hope in some economic indicators. We are also encouraged by the improving signals in both equity & fixed markets.

Market Outlook

Equity Outlook

- Stocks continued their advance in May as large-caps & international outperformed. The S&P 500 finished up over 5% and is now positive for the year. It did appear to establish a trading range around 900 which we recently cited as the high-end of our fair value range. Smaller-cap indices for May were up only 1-3%. International performance was outstanding with EAFE up nearly 12% and emerging-markets over 15%.
- We believe we are in the midst of a period in which the environment for stock picking may be much better than the overall outlook for the market. Over the past few months, we have been able to find a lot of companies that meet our stringent criteria, and we remain confident that our disciplined investment approach will add a lot of value in this environment.

Fixed Income Outlook

- Fixed income has been performing as expected. Treasuries continued their year-to-date decline in May while corporate & municipal bonds advanced. High-yield bonds, mostly funded from equities, continue to perform very well, finishing up over 7% for May. This recent outperformance of “spread product” has made valuations less compelling and we have adjusted our asset class rankings accordingly.
- Tax-Exempt bonds hit resistance as Treasury rates moved higher but finished up 1% overall in May as longer-term maturities outperformed. This outperformance is attributable to the success of the Federally-subsidized taxable Build America Bonds (BAB). In May, KY’s first BAB issue came in the form of Fayette County Schools. Valuations have returned to historical norms throughout most of the yield curve.

S&P 500 GICS Sector Performance and Recommended Sector Weightings

	% Total Return			Forward P/E Ratio	Actual Sector % Weightings	Forward Looking
	MTD	YTD	2008			CB&T Sector Emphasis
S&P 500 Sector						
Consumer Discretionary	4.5	12.9	-33.5	43.5	9.2	Underweight
Consumer Staples	2.7	0.3	-15.4	14.0	12.1	Overweight
Energy	0.5	3.2	-34.9	18.1	12.9	Marketweight
Financials	-2.1	-3.4	-55.3	20.4	13.1	Underweight
Health Care	1.1	-1.3	-22.8	11.2	13.9	Overweight
Industrials	3.1	-0.9	-39.9	14.4	10.3	Marketweight
Information Technology	2.4	22.8	-43.1	17.6	17.9	Marketweight
Materials	0.8	20.4	-45.7	31.8	3.4	Marketweight
Telecommunication	-0.7	-5.7	-30.5	12.8	3.4	Underweight
Utilities	0.4	-6.5	-29.0	11.3	3.8	Marketweight
S&P Composite 1500	1.6	4.9	-36.7	16.6		
S&P 500	1.4	4.4	-37.0	16.3		
S&P MidCap 400	1.7	9.6	-36.2	17.8		
S&P SmallCap 600	4.2	3.4	-31.1	22.7		

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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