

Investment Policy Committee Notes

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Economic and Stock/Fixed Income Market Outlooks

Economic Outlook

Recent Reports

- April Leading Economic Indicators (1.0%, -3.0% YOY) rose more than expected breaking declines that were prevalent since June of '08.
- Conference Board Consumer Confidence (54.9) jumped in May by the most in six years. This was much better than anticipated.
- April Existing Home Sales (4.68M, +2.9%) was in line with expectations. Prices improved for the 3rd month but supply (10.2 months) rose.

Upcoming Reports

- (5/28) April Durable Goods Orders (0.5% vs. -0.8%) & Durables Ex-Transportation (-0.3% vs. -0.6%).
- (5/28) April New Home Sales (360K vs. 356K, +1.1%). Also in a separate report, 1Q Mortgage Delinquencies (7.88% 4Q).
- (6/01) April Personal Income (-0.2% vs. -0.3%) & Personal Spending (-0.2% vs. -0.2%).
- (6/03) May ADP Employment Change (-555K vs. -491K).

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 to rally sharply in April & overall remain positive for May. The large-cap S&P 500 has established a trading range around 900 which we recently cited as the high-end of our fair value range. That said, risk appetites are obviously returning to the capital markets. An example being the recent emerging-market outperformance.
- 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. Beginning this year, we warned that Treasury rates could only move higher. Away from Treasuries, recent outperformance of spread product has made valuations less compelling. High-yield bonds, mostly funded from equities, continue to perform very well if not beyond our near-term expectations.
- Tax-Exempt bonds have continued their gains in May but are hitting resistance as Treasury rates move higher. While valuations could support additional outperformance, we would not be surprised to see this pause continue. This week marked KY's first Build America Bond (BAB) issue by Fayette County Schools. As expected, these Federally-subsidized taxable bonds have sparked a supply-side rally over the last few months.

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	-2.1	6.7	-33.5	41.4	9.1	Underweight
Consumer Staples	3.6	-4.3	-15.4	13.4	12.1	Overweight
Energy	6.2	-1.5	-34.9	17.5	12.9	Marketweight
Financials	7.5	-6.3	-55.3	20.0	13.2	Underweight
Health Care	4.7	-4.4	-22.8	10.9	14.0	Overweight
Industrials	0.4	-6.4	-39.9	13.6	10.2	Marketweight
Information Technology	0.2	17.1	-43.1	16.8	17.9	Marketweight
Materials	1.3	14.3	-45.7	30.3	3.3	Marketweight
Telecommunication	-3.5	-7.2	-30.5	12.6	3.5	Underweight
Utilities	0.9	-9.4	-29.0	10.9	3.9	Marketweight
S&P Composite 1500	2.3	0.3	-36.7	16.0		
S&P 500	2.6	0.0	-37.0	15.7		
S&P MidCap 400	0.3	5.2	-36.2	17.2		
S&P SmallCap 600	-0.4	-2.7	-31.1	21.4		

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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