

Investment Policy Committee Notes

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Economic and Stock/Fixed Income Market Outlooks

Economic Outlook

Recent Reports

- September Industrial Production (+0.7%, -6.1% YOY) & Capacity Utilization (70.5%) increased more than expected and positive revisions.
- September Housing Starts (590K, +0.5%) & Building Permits (573K, -1.2%) were roughly 20K below expectations.

Upcoming Reports

- (10/23) September Existing Home Sales (5.35M vs. 5.10M, +4.9%).
- (10/27) October Conference Board Consumer Confidence (54.0 vs. 53.1).
- (10/28) September Durable Goods Orders (1.0% vs. -2.4%) & Orders Ex-Transportation (0.6% vs. 0.0%).
- (10/28) September New Home Sales (440K vs. 429K, +2.6%).

Longer-Term Outlook

- After a brutal economic downturn and a period of repair, we believe we are moving towards the recovery phase, where credit and equities can happily co-exist. The data suggests that the recession ended this summer.
- But that doesn't necessarily mean that credit will continue to outperform equities going forward in all scenarios. This will be a function of the recovery trajectory. For now, growth is occurring from very depressed levels and is still fragile, as much is from temporary sources (government stimulus, inventory rebuild).
- If the recovery proves to be one of higher growth/expansion, the credit bear market will begin and equities will extend this bull market recovery and quite possibly break out of this decade's long-term range-bound market over the next several years. That said, we continue to be proponents for the likelihood of a "new normal", meaning lower spending, growth and investment returns.

Market Outlook

Equity Outlook

- Risk assets have been the "sweet-spot" and have rallied sharply. From here, we expect low equity returns in all but our most optimistic scenario.
- Large-cap is priced to outperform small-cap over the next few years, but near-term small-cap may continue to lead as recovery gets priced in. We are neutral on growth vs. value but believe dividends may prove to be an important component of returns.
- The valuation of high vs. low quality stocks is the most attractive it has been in a long time; buy quality for the long-term.
- Many foreign markets are growing faster than the U.S. (especially Asia/emerging markets). We recommend exposure to these markets directly and via companies that export to them.

Fixed Income Outlook

- The credit (investment grade & high-yield) rally could continue; however it is probably on its last leg. We recently reduced our "spread product" valuation ratings to neutral.
- Treasury yields are likely to stay constrained because the level of debt is so high there is a natural "choke-point" for the economy if yields rise too quickly.
- This year, municipals have rallied sharply. However, October's substantial pullback may prove to be a buying opportunity as we approach yearend.

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	1.7	31.8	-33.5	20.9	9.1	Marketweight
Consumer Staples	3.2	12.9	-15.4	15.1	11.7	Marketweight
Energy	9.3	17.8	-34.9	20.3	12.5	Overweight
Financials	-0.3	20.8	-55.3	26.1	14.9	Underweight
Health Care	0.4	10.1	-22.8	12.2	12.4	Marketweight
Industrials	1.6	16.5	-39.9	17.8	10.3	Marketweight
Information Technology	3.0	50.4	-43.1	18.6	18.9	Overweight
Materials	2.6	42.0	-45.7	32.7	3.5	Marketweight
Telecommunication	-2.8	-1.4	-30.5	13.8	3.0	Underweight
Utilities	1.9	6.3	-29.0	12.7	3.7	Underweight
S&P Composite 1500	2.3	22.8	-36.7	18.2		
S&P 500	2.4	22.1	-37.0	17.8		
S&P MidCap 400	1.6	32.2	-36.2	20.8		
S&P SmallCap 600	0.9	20.5	-31.1	26.2		

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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