

# Investment Policy Committee Notes

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## Economic and Stock/Fixed Income Market Outlooks

### Economic Outlook

#### Recent Reports

- August Nonfarm Payrolls (-216K) were slightly better than expected but negative revisions (-49K). The Unemployment Rate (9.7%) increased more than expected to a 26-year high.
- July Consumer Credit fell by a record \$21.6 billion, or 10 percent at an annual rate, to \$2.5 trillion. Credit fell for a sixth month, the longest series of declines since 1991.

#### Upcoming Reports

- (9/15) August Advance Retail Sales (1.7% vs. -0.1%) & Sales Less-Autos (0.4% vs. -0.6%). Also, Producer Price Index (0.8% vs. -0.9%).
- (9/16) August Industrial Production (0.7% vs. 0.5%) & Capacity Utilization (69.1% vs. 68.5%). Also, Consumer Price Index (0.3% vs. 0.0%).

#### Longer-Term Outlook

- After a brutal 12 months, it would have been nice to relax just a little this summer. But the environment remains as interesting and challenging as any we're likely to see in our careers (at least we hope this proves to be the case) and we remain in analytical overdrive mode as we try to balance numerous potential opportunities amidst a wide range of possible outcomes.
- We will add that we are not willing to make significant bets on any one outcome unless our confidence in that outcome is extremely high (which is almost always not the case when it comes to assessing macro variables).
- Right now we are not concerned about inflation in the near term nor do we think we are on the verge of a strong or sustained economic rebound. Thus, our expected returns from U.S. equities and bonds are relatively low from current levels.

### Market Outlook

#### Equity Outlook

- Broad domestic equity returns are projected to be in a single digit range the next few years based on most scenarios we've reviewed. More encouraging is that the recent market dysfunction has created enough valuation discrepancies that we believe we can add value to that forecast with good stock picking. Given the fragility of the economy and the extensive government intervention, it is likely that we will experience more periods of market volatility over the next year or two that could also provide us with compelling opportunities to buy quality stocks.
- We still believe that another powerful leg down in the stock market is possible. However, it's more likely that, the systemic meltdown risk has passed and there are enough positive developments so that we believe the odds of retesting the March lows are basically gone.

#### Fixed Income Outlook

- Investment-grade bonds continue to be characterized by a U.S. Treasury market that is very unattractive over a five-year horizon, while other sectors are more attractive. The valuation discrepancies between Treasuries and other sectors of the market have given active bond managers an opportunity to add enormous value in recent months.
- We believe reasonable potential remains, though the opportunities are not as compelling as they were several months back. In general, investors will not get rich from their bond investments, however they still play an important role in diversifying portfolios and decent returns are likely over the next few years. Longer term we have some concerns about inflation and are implementing strategies to hedge that risk.
- Intermediate/Longer-term municipals performed well in July and August. Valuations and the steep yield curve, as well as supply/demand dynamics, should provide some support when rates begin to rise. At current levels, we find ourselves very selective and somewhat defensive.

## 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	2.5	26.0	-33.5	21.0	9.2	Underweight
Consumer Staples	1.1	6.7	-15.4	14.4	11.5	Overweight
Energy	2.6	5.6	-34.9	18.3	11.8	Marketweight
Financials	-1.2	17.4	-55.3	25.6	15.0	Underweight
Health Care	0.5	9.1	-22.8	12.3	13.4	Overweight
Industrials	3.9	11.7	-39.9	16.9	10.2	Marketweight
Information Technology	1.7	42.2	-43.1	18.5	18.6	Marketweight
Materials	3.0	35.8	-45.7	33.1	3.5	Marketweight
Telecommunication	0.0	-1.5	-30.5	13.4	3.2	Underweight
Utilities	-0.8	2.1	-29.0	12.2	3.7	Marketweight
S&P Composite 1500	1.4	17.2	-36.7	17.6		
S&P 500	1.3	16.5	-37.0	17.2		
S&P MidCap 400	2.5	26.2	-36.2	20.0		
S&P SmallCap 600	2.0	15.9	-31.1	26.5		

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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