

Quarterly NEWSLETTER

Winter 2009



Commonwealth
Bank & Trust Company

4350 Brownsboro Road, Suite 210 • Louisville, KY 40207
502.259.2500 • www.CBandT.com



In the face of a late January market sell off, Government officials have declared the economic recession to be officially "over". Indeed second half GDP outpaced consensus estimates by healthy margins, posting gains of 2.2% and 5.7% for the third and fourth quarters. With the unemployment rate hovering above 10%, the American public tends to disagree with official proclamations of recession's end, as evidenced by the clear message Massachusetts voters recently sent to Washington, essentially demanding that the nation's economic woes be fixed without bankrupting the country in the process. Never in our history have politics and economics been so closely intertwined. That said, it seems to us that Government representatives have performed reasonably well in averting economic meltdown, while the economy and markets have substantially healed themselves from the near death experiences of late 2008 and early 2009. While the early recovery "easy money" has been made at this point, we expect the healing to gradually continue over the next few years, peppered with several bumps along the way of course. We view this healing trend as sufficiently established such that, absent exogenous events, one should feel reasonably comfortable maintaining equity allocations within historical frameworks.

The new year is always a good time for investors to review investment objectives, asset allocations and long term goals. We invite you to call on us to assist in reviewing your goals, and welcome any questions you may have upon reading this winter edition of our newsletter.

As always, we appreciate the opportunity to serve your investment needs and encourage you to contact us if we can be of assistance to you in any way.

- Mark J. Kennedy, Exec. VP
p 502.259.2517
e mark.kennedy@cbandt.com

Wall Street Recovers, Main Street Watchful

This year's theme of optimism tinged with fear continued through the 4th quarter. After the downward spiral through March 9th, markets swung sharply upward and continued the ascent for the rest of the year, helping gain back some of the painful losses of 2008. Investors watched economic data closely for signs of weakness, but saw the markets continue to climb despite unemployment that stubbornly remained above 10%. The Dow gained 7.37% for the 4th Quarter and ended the year up 18.82% while the S&P rose 6.04% for the quarter and 26.47% for the year. The MSCI EAFE Index and the MSCI Emerging Markets Index were up 32.12% and 74.50 % respectively for the year.

Chart 2

S&P 500 Sector Performance 4th Quarter 2009 (Total Returns)

	Q4	Year to Date
Information Technology	10.70%	61.73%
Consumer Discretionary	9.10%	41.28%
Healthcare	9.09%	19.73%
Telecommunication	7.43%	8.94%
Materials	7.36%	48.60%
Utilities	7.26%	11.94%
Energy	5.62%	13.92%
Industrials	5.39%	21.04%
Consumer Staples	5.02%	14.87%
Financials	-3.31%	17.33%

Chart 1

Market Performance - Total Returns 4th Quarter 2009

	12.31.09 Level	Q4	Year to Date
Dow Jones	10657	7.37%	18.82%
S&P 500	1138	6.04%	26.47%
NASDAQ Composite	2286	7.20%	45.36%
Russell 2000	637	3.88%	27.16%
S&P Midcap	745	5.56%	37.37%
Russell 1000 Growth	500	7.94%	37.19%
Russell 1000 Value	566	4.33%	19.72%
MSCI EAFE	1585	2.26%	32.12%
	Yield	Q4	Year to Date
Barclays Municipal	3.62%	-0.96%	12.91%
Barclays Aggregate	3.68%	0.20%	5.93%
Barclays High Yield	9.06%	6.19%	58.21%

is a challenge for the economy and it will take a significant number of new jobs to replace the 7.82 million jobs lost since January 2008. Corporate profits and overall productivity have improved significantly, with companies responding to the economic malaise quickly and cutting expenses to the bone. But the nosedive in home values and stock prices, which melted away trillions of dollars of household wealth, has resulted in consumers, the engine of the US economy, continuing to save more and spend less. Going forward, as in 2009, investors will be closely watching how the administration chooses to wind down the stimulus effort, when and how the Fed finally makes a move with interest rates and the indicators in the housing market in what is likely to be a slow and ever-changing recovery.

Performance Results

	Managed Equity Composite 1,4	Small Cap Composite 2,5	Multi Cap Composite 3,6	S&P 500	S&P Mid Cap	S&P Small Cap7
Fourth Quarter	5.94%	1.36%	6.73%	6.04%	5.56%	5.12%
One Year	21.32%	22.54%	33.95%	26.47%	37.38%	25.57%
Three Year	-4.98%	-7.36%	-1.58%	-5.61%	-1.83%	-4.78%
Five Year	1.08%	3.89%	-0.71	0.42%	3.27%	1.36%
Since Inception ⁴	8.57%	NA	NA	7.69%	10.80%	NA
Since Inception ⁵	NA	9.04%	NA	0.87%	7.09%	6.89%
Since Inception ⁶	NA	NA	7.82%	8.65%	12.04%	NA

There is no assurance that any of these investment strategies will meet its investment objective. Performance results for each strategy are computed on the strategy's overall returns. Each strategy and index includes the reinvestment of dividends. Past performance does not guarantee future results. Current performance may be lower or higher than the performance results quoted. ¹ Gross of management fees; performance results of CB&T; actual performance results would have been lower as a result of investment advisory fees. ² Net of management fees. Performance results since January 1, 1999 were obtained using sub-advisors engaged by CB&T. Assets under management using this small cap strategy range in amount from \$2.6 million at January 1, 1999 to \$27.2 million at December 31, 2005. Small company stocks may be subject to a higher degree of market risk than the securities of more established companies because they tend to be more volatile and less liquid. ³ Net of management fees; performance results of SMC Capital and/or its principals as advisor from inception to 2/28/06 and as sub-advisors to CB&T since 3/1/06. ⁴ Inception date: 1/1/93. ⁵ Inception date: 1/1/1999. ⁶ Inception date: 7/1/1989. ⁷ Index began 12/31/1993.

Fixed Income

Fixed income performed as expected during the 4th quarter. Treasury yields could basically go nowhere but up. After peaking in June, yields grinded lower through November but increased dramatically in December. Corporate, municipal & high-yield bonds had tremendous return potential given their record spreads. For example, high-yield indices produced returns of nearly 60%, well surpassing equities. These classes are now more vulnerable to increasing rates which was somewhat apparent in December. Short-term rates remain near zero, producing tremendous demand for other assets, particularly fixed income. As measured by the TIPS market, inflation expectations increased significantly for the quarter ending at a more reasonable 2.4%. Longer-term price expectations bottomed at 0% during the severe downturn. Over the next five years, our fixed income portfolio return expectations are fairly low at an annualized 3 to 5%.

The FOMC language continues to suggest that the Federal Funds rate will remain near zero for an extended period. On December 16th, their statement acknowledged that economic activity has continued to pick up. It will be interesting to see how the markets react when the quantitative easing (asset purchasing) comes to an end and how they react to changes in the language itself.

For the quarter, the 10-year Treasury rose 0.5% to over 3.8%. This produced negative returns for U.S. Treasuries and Municipals. Agencies & Mortgage-Backed Securities were basically unchanged. Credit was marginally higher and High Yield produced big returns once again as spreads tightened.

Managed Equity Composite

Total return for the Managed Equity Composite was 5.94% for the 4th quarter of 2009 compared to 6.04% for the S&P 500, 2.26% for the MSCI EAFE Index and 3.88% for the Russell 2000 Index.

UPS (UPS), the world's largest integrated air and ground package delivery company, continued to show fatigue from the recession. Despite reporting earnings down 42% compared to the same quarter last year, UPS reported sequential growth from the prior quarter which was well ahead of analyst's expectations. Shares of UPS gained 2.4% for the quarter and 7.8% for the year. UPS recently raised guidance for the current quarter from a range of \$0.58-\$0.65 to \$0.73-\$0.75 citing cost savings initiatives combined with better-than-expected results globally. As a result, shares have risen sharply in the early days of 2010.



Food distribution company Sysco (SY) is also benefiting from improvement in economic conditions noting "stabilization of our volume trends" in its recent earning release.

Even with a challenging period for all of Sysco's end-users, Sysco has navigated the difficult period well as demonstrated by its modest decline in earnings. Potential market share gains and ample liquidity allowed Sysco management to emerge from the recession more formidable than ever. In November, management approved an increase in the quarterly dividend, giving it a current yield of 3.5%. After a 14.5% gain in the quarter, the stock may be set for a pause in the short-term. Improvement in employment and an access to liquidity for its end-users could be the next catalyst for Sysco.

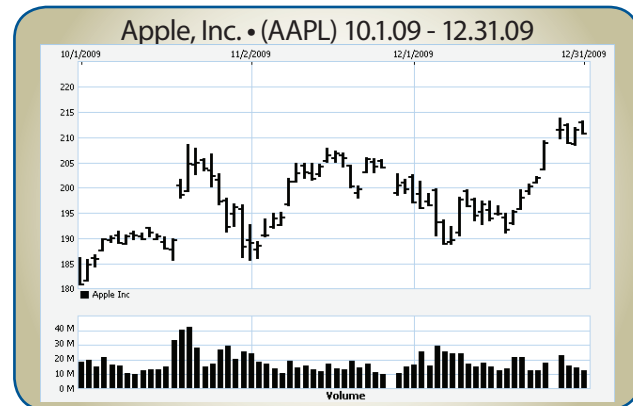
Science & Technology Strategy

At the start of 2009, the information technology sector felt the continued effects of the financial crisis, causing the tech-heavy Nasdaq Composite index to decline 19.6% through early March. From those lows, however, evidence steadily emerged that the worst of the recession was over and that a new growth cycle in the info tech sector was slowly gaining momentum. Since that point, the index has rallied 78.9% through December to bring Nasdaq's year-end return to 45.4%. Having moved from a defensive position to a more aggressive one in late 2008, the Science & Technology Strategy was able to capture this dramatic shift in fundamentals, posting a total return of 53.5% for the period, solidly outpacing the Composite.

The primary driver for the Strategy's outperformance was Apple Computer (AAPL), which saw its shares climb 146.9% in 2009. Sales of the compa-

ny's iconic iPhone consistently exceeded Wall Street consensus despite a slow consumer discretionary sector and investor expectations that ratcheted higher as the year progressed. In addition, the shares of Marvell Technologies (MRVL), the leading chip supplier to the computer storage market, surged 211.1%. Marvell saw a substantial inflection in orders, driven by historically-low component inventories and a return to growth within the larger computer hardware market. Although we are pleased with the performance of these portfolio holdings as well as the SciTech Strategy's other cyclical positions, the remaining defensive holdings represented a drag on SciTech's overall performance. For instance, Gilead Sciences (GILD), the market-leading manufacturer of HIV therapies, saw its stock decline 15.4%, due to diminished demand for healthcare-related stocks. More importantly, the company experienced several setbacks in its new drug pipeline, which bears closewatching going forward.

Despite the strong tech rally in 2009, significant incremental upside remains as we look to 2010 and beyond. As the tech recovery transitions to its mature stage, the rally should broaden from semiconductors and computer hardware to include software and services. Moreover, the secular growth driven by the proliferation of Internet-enabled wireless devices such as the iPhone will benefit a growing list of companies. Cisco Systems (CSCO), the dominant provider of data networking equipment, will benefit from the resulting increase in data traffic as will Qualcomm (QCOM), a key component supplier to the smartphone market. Bought at reasonable valuations, these stocks have the potential to be major performance drivers in 2010. As a result, we hope to continue to capture the growth created by Silicon Valley's ongoing innovation, while strictly maintaining our core investment discipline.



Tax Managed Strategy

After outpacing the S&P 500 in 2008, the Tax Managed Strategy was able to repeat the feat in 2009, narrowly beating the benchmark, 27.63% vs. 26.47%. The technology sector led the charge thanks to a 146.9% rally in Apple Computer (AAPL) and a 72.8% surge in Adobe Systems (ADBE). Apple's novel iPhone continued to see market share gains versus other Internet-enabled cell phones, driving better-than-expected sales growth for the year. Adobe, the market leader in digital document software, was driven by a successful new product launch as well as investor optimism that, with the end of the recession, businesses would resume buying software to improve office productivity. Gilead Sciences (GILD), a leading performer in 2008, represented the laggard for the year. Although the company's franchise HIV therapies continue to win in the market place,

Small Cap Composite

The Small Cap Value Composite returned 1.36% for Q4, versus 3.63% for the Russell 2000 Value index. For 2009, the Composite Portfolio returned 22.54%, versus 20.58% for the benchmark index.

For the quarter, the top relative contributing sectors in the Portfolio were Energy and Financials. Our Financials holdings benefited from being underweight the index, as the Small Cap Financials sector was relatively weak during the period. Conversely, our Energy holdings benefited from positive stock selection. One top contributor during the period was independent oil and gas producer Encore Acquisition Co. (EAC, +21%). In early November, Denbury Resources (DNR) offered to purchase EAC for \$50 per share. EAC was our largest Energy-related position and the buyout was precisely \$1 dollar higher than our assessed Absolute Value. Evolution Petroleum (EPM, +47%), a small, independent energy exploration and production company, was another top Energy holding. In late 2003 when oil was then trading under \$30/bbl, the company acquired the Delhi Field in northeast Louisiana. When the price of oil moved higher, the significant reserves of the field became economical to develop. Since EPM didn't have the capital to independently develop Delhi, the company sold the field at an attractive gain to Denbury Resources (DNR) in June 2006, while retaining a 25% working interest (a back-end, profits-based payment) and a 7.4% royalty interest (revenue-based payment). Other top contributing holdings included full-service investment firm Oppenheimer Holdings Inc. (OPY, +37%), specialty apparel retailer Dress Barn, Inc. (DBRN, +29%) and closeout retailer Big Lots Inc. (BIG, +99%).



The sectors with the lowest contribution to relative return for Q4 were Consumer Discretionary and Materials. One large negative contributor during Q4 was discount general merchandiser, Fred's Inc. (FRED, -20%). Fred's enjoyed a favorable environment for the first half of 2009 with same store sales up +0.8%, but

the stock began to underperform in early November when the company announced that advertising expenses would cause the company to fall short of its fiscal Q3 earnings guidance. Other negative contributors were Pike Electric Corp. (PIKE, -23%), which provides powerline, engineering, and related services to electric utilities and American Dairy, Inc. (ADY), a Chinese producer of premium infant formula. Ironically, ADY ranks as one of our top negative contributors for Q4 (-22%) AND one of our top positive contributors for 2009 (+48%).

As stated in our Q3 commentary, we believe the market is transitioning from the early "low quality, high beta, high return" stage of the recovery to one distinguished by "higher quality, lower volatility, and lower returns." This portends a focus on fundamentals in the year ahead and favorable performance for higher quality companies trading at attractive discounts to their respective cash flows. As these factors imply, this stage of the cycle has historically been favorable for our style of investing.

healthcare stocks lost favor as investors sought higher-risk investments in 2009. In addition, the company's portfolio of new drug candidates suffered several setbacks in the FDA approval process, adding incremental negative sentiment for the stock.

Despite the disappointing short-term stock price performance, we're sticking to our guns on Gilead. The company's patient base continues to grow and Gilead's novel combination therapies hold the promise of increased drug efficacy, going forward. In keeping with our goal of maximizing after-tax returns through long-term investing, we will maintain our core position in the stock. At this point in time, we do not see a valid threat to Gilead's core franchise. Moreover, the stock is trading at a price well below its intrinsic value. As a result, Gilead's risk/reward remains quite attractive for investors with a long time horizon.

Multi Cap Composite

The Multi Cap Composite returned 6.73% for the fourth quarter, in comparison to 6.04% for the S&P 500. For the full year of 2009, the fund returned 33.95% vs. 26.47% for the S&P 500.

For the 4th quarter, two of our stellar contributors were familiar names to most of us, Master Card (MA) and Visa (V). Master Card returned 25.9% for the quarter, while Visa was close behind with 22.8%. Both Visa and Master Card are in the business of providing services and support to credit and debit card payment systems. Worldwide growth of the use of these cards leads us to believe that they can continue to grow earnings in the vicinity of 20% annually for some time. In a totally different direction, Allegheny Technology (ATI), a specialty steel products company, rose 24.8% for the quarter. Allegheny operates internationally and produces such products as alloys and super alloys incorporating metals such as titanium, nickel, cobalt, zirconium and tantalum, to name a few. It also produces engineered metal products such as tungsten powder and tungsten carbide. International demand for specialty steels has increased dramatically in recent years. Continued growth in the mid teens seems likely for ATI. Although they enjoyed only modest performance in the 4th quarter, we continue to believe that Boeing (BA), the world's premier aircraft manufacturer and Apple Computer (AAPL), maker of excellent computers and all hand-held things beginning with i, will continue to be major contributors to the success of the fund.

Kentucky Municipals

After an extraordinary 3rd quarter, tax-exempt returns declined roughly 1% for the 4th quarter. Previously, we cited being very selective and somewhat defensive and that a pause seemed likely. Comprehensive index returns on the year were an astounding 13-14%. Supply/Demand dynamics played the key role with the stimulus-created taxable Build America Bonds (BAB's) being a substantial part of the new issue market. Valuations are again basically in line with historical norms throughout the yield curve. As obvious by the returns, municipals were one of the "fat-pitch" opportunities within fixed income. Tailwinds will continue to be supply driven in 2010. Other positive demand factors are the inevitable tax increases. Headwinds will continue to be negative headline risk with respect to budget/deficit issues. Kentucky seems to be further away from the news actually impacting market values.

New bond issuance by Kentucky municipalities came in at a substantial \$1.568 billion with 50 issues. New issue size averaged \$31.4 million. BAB issuance accounted for \$856 million or 55% of the above total. As proponents of taxable municipals, we welcome the increased supply. The stimulus plan also modified bank-qualified (BQ) rules including increasing limits to \$30 million from \$10 million. However, BQ issuance only accounted for \$175 million or 11% of the above total. In general, BQ bonds yield less but this varies depending on maturity. Basically this means we need to be more selective as we participate in new issues.

During the quarter, our 10-year KY tax-exempt yield target rose 0.20% to 3.55% from 3.35%. This compares to 4.10% a year ago. 4.0% seems to be a strong central tendency for the 10-year rate over various interest rate cycles. Our 15-year yield target also rose 0.20% to 4.15% from 3.95%. This compares to 5.05% a year ago.

outlook

With the stock market having achieved its best year since 2003 during one of the most turbulent political and economic periods in U.S. history, it is fair to say expectations are on the optimistic side of things for 2010. It is very unlikely, though, that the stock market will have the kind of year it did in 2009.

Our expectation is that the S&P 500 and stocks in general are currently priced to deliver returns in the mid to high single digits over the next few years. As we enter the New Year there are several investment themes that we are emphasizing to give our portfolios an edge:

- Easy earnings and economic comparisons will keep risk assets in the “sweet-spot” in the first half of the year, as will low interest rates. However, the specter of interest rates eventually going up, the extraction of stimulus measures, and income and capital gains tax rates set to move higher as of Jan. 1, 2011, should be persistent headwinds that curtail the market’s bullish bias as the year unfolds.
- Buy Large Cap Quality Stocks– the valuation of high vs. low quality stocks is the most attractive it has been in a long time; we like quality for the long-term
- Buy Pricing Power– with the potential for deflation and tepid end market demand, we like companies that have the ability to raise prices
- Tech stocks remain attractive- corporations have underinvested for several years-secular themes we like are moves toward the mobile internet & cloud computing
- 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
- Large-cap is priced to outperform small-cap over the next few years, near-term small-cap may continue to lead as recovery gets priced in
- The corporate credit (investment grade & high-yield) rally should continue; however it is probably on its last leg
- We expect decent returns for stocks but a retest of the lows is not out of the question, and we would view upside as a cyclical rally rather than an outright return to a bull market
- 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 high... risks for yields are to the upside
- We are evaluating several alternative asset classes that have the potential to improve risk-adjusted returns.
- Municipals are attractive relative to taxable alternatives

- January 4, 2010

Our comprehensive wealth management service integrates Commonwealth Trust Company’s wide-ranging capabilities and highly qualified staff, with a network of external resources and advisors you may designate, such as your personal attorney or accountant. Coordinating these resources, our team of professionals can provide you with the following services:

INVESTMENT MANAGEMENT:

Our staff of investment professionals can serve as a full-service investment advisor, establishing investment objectives, developing asset allocation, analyzing risk, constructing portfolios and monitoring and reporting on performance.

TRUST & ESTATE PLANNING:

Our staff of experts can help develop plans for the effective transfer of assets through wills and trusts. We have extensive expertise serving as trustee or co-trustee for all types of personal and corporate retirement plan trusts, including trusts that have direct investments in private companies, real estate or other less liquid assets. We may also assist with the settlement of estates, serving as executor or personal representative.

CHARITABLE PLANNING:

Our team is highly experienced in all aspects of charitable planning. We can help you locate worthy charities in your area of interest or help you leverage the value of charitable gifts to your pre-selected organization(s). Our expertise will allow you to maximize your charitable giving for the benefit of you and the recipient.

TAX, IRA, AND RETIREMENT PLANNING:

Our staff of experienced financial planning professionals can help minimize the burden of estate, inheritance and income tax through careful planning techniques. We can also assist with the creation or rollover of IRA assets.

CUSTODY SERVICES:

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Our staff of fully-licensed brokerage professionals can help you buy and sell a large selection of securities at competitive commission rates. We offer a variety of accounts designed to fit your individual investing needs and feature unique services to help you plan and implement your financial strategy. While still offering the strength and resources of a large financial organization, our personalized service will also provide you with a one-on-one approach and convenient local delivery.

Investment Research & Portfolio Management: Darrell R. Wells, Steve J. Giacobbe, CFA, CFP®, Holland N. McTyeire, IV, CFA, Brian S. Stivers, James E. Moore, CFA, Stephen L. McCool, W. Shawn Clark, Christopher J. Beneke **Trust & Estate Administration:** Jack M. Combs, Jr., Mary Beth Byron, Patricia L. Hayes, Mark J. Kennedy, Christopher A. Nunnally, Nancye W. Olt, Barksdale F. Roberts, Beth A. Russell **Private Banking and Brokerage Services:** Susan Roberts, Wendy O’Banion, Toby K. Nutt, Gregory T. Jacobs, Alan J. Griffes, CFP®, CTFA

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