LTBC CAPITAL ADVISORS LLC

Dear Investor Friends,

Q2 2009

Is the stock rebound sustainable?

Is the current stock market rebound really the start of a new bull market? Is the economy close to a bottom? Will the rebound be U, L, or V shaped? Will we retest or break below the bottom of March 2009? Are we in the midst of a lost decade for stocks like the 1930's or 1970's? Economists and prognosticators seem to be wrong more often then right. Prescient prediction of the turn is rare and even if you do it, no one listens, as it contradicts the obvious state of the world at the time. We will try to provide a historical perspective on trying economic times and how they affect the stock market.

At LTBC, we realize it is difficult, if not impossible, to time the market. Rather we position our client's portfolios to preserve capital while at the same time being prepared to participate when markets revive. The past year or so have been extremely difficult. Virtually all asset classes did poorly, foreign markets falling more than the US. Most asset classes supposedly non-correlated with stocks all went down. Real estate, convertibles, preferreds and most bonds were all losers; even a money market broke the buck. Commodities were about even after a wild ride up in the first half, then falling off a cliff in the second. The lone winners were US Treasuries (prime beneficiary of flight to safety) and to a lesser extent, gold up somewhat. At LTBC in the past year we added commodities including gold and TIPS (Treasury Inflation Protection Securities) reducing exposure to stocks.

We all knew we were in a recession long before it was officially declared. In January 2009, The National Bureau of Economic Research (NBER) confirmed the U.S. Economy slipped into recession in December 2007 despite the fact that the economy continued to grow at a real rate of 1% through August 2008. This suggests we are in the U shaped recession. The 1.2 million lost jobs in 2008 was the biggest factor in determining the start date. Many of us believed a recession was defined as two consecutive quarters of negative GDP. In fact, the definition is quite subjective. The NBER weighs numerous factors, heavily weighted by employment. A long recession coupled with the crises of confidence in the financial system seemed to drag on forever.

Now with the banking stress tests behind us this may finally be over. A violent drop in GDP (recent two quarters in excess of 6%) often leads to a quick V shaped recovery as the massive inventory destocking and layoffs leave the economy under supplied. If you believe the recession began in Sept. 2008, a V shaped snapback may very well be in the offing. For the period ending March 31, 2009, we have had six consecutive negative quarters in the stock market which is unheard of. The accumulated loss from the absolute S&P high (1562 10/07) to the absolute low (666 3/09) equates to a 57% fall. Was March the low? Is the Bear Market finally over? Should we be buying or selling?

Buy or Sell?

Six Six Six on the S&P 500 may turn out to be a very fitting number if it was in fact the low. With 20/20 hindsight, it appears this was the case. At the time, not only were the economy and markets in free fall but it looked as though the entire financial system was on the precipice of oblivion. Markets were incredibly volatile and many were understandably succumbing to capitulation and completely giving up on stocks. Some were talking of a financial apocalypse and a repeat of the Great Depression (the L recovery). We all know 666 signifies Satan but I checked with Wikipedia for reference and they have a plethora of tidbits. Appropriate to today's markets was the following from the King James Bible:

> "And that no man might buy or sell, save he that had the mark or the name of the beast, or the number of his name. Here is wisdom. Let him that hath understanding count the number of the beast: for it is the number of a man; and his number is Six hundred threescore and six".

One needed to be a daimon or daemon to have bought stocks at or even close to 666. That is not to say that buying anywhere near a bottom, even now, is not still a good idea. After a major bottom, the market often goes back up significantly over the next few years, often doubling or even tripling.

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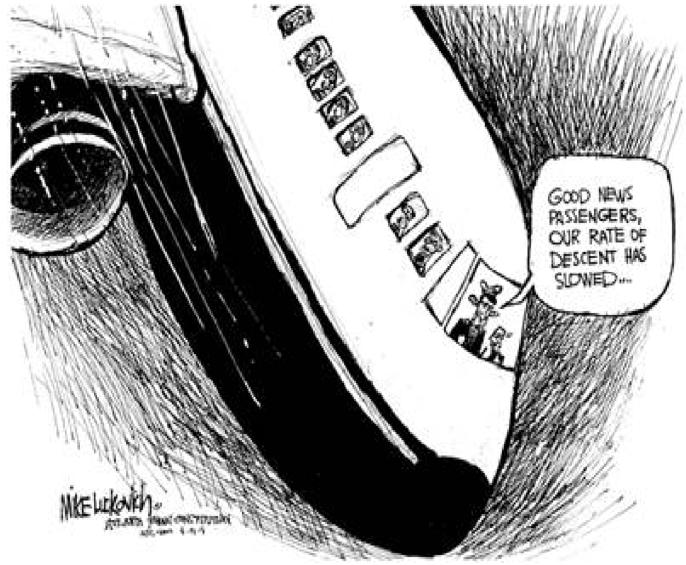
Economic Rebound ?

"Green shoots" are popping up all over

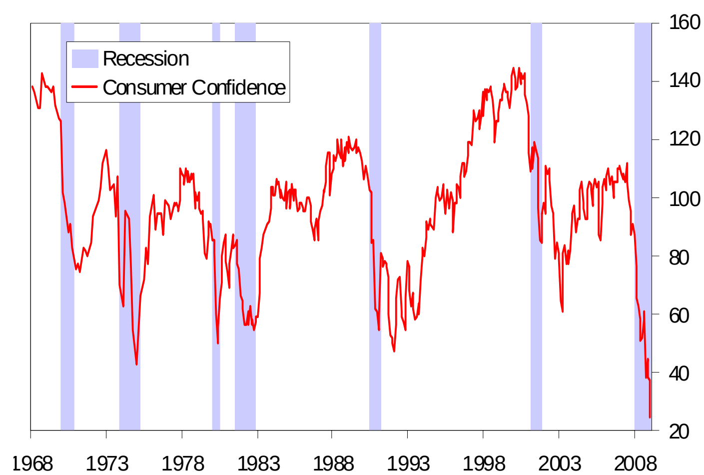


More often than not the stock market begins moving up three to six months before the economy turns and begins growing again. That is not to say that the stock market is a perfect predictor of the future economy. There can be false starts or bear market rallies only to resume the cyclical slide. It is encouraging that we are now seeing some promising indicators that indicate we may be turning the corner. Spring is in the air and we are seeing the much spoken of green shoots starting to pop up all over. Of course, to the untrained eye, green shoots some times are just weeds.

Many of these green shoots are not really positives but more the second derivative type, where the rate of decline is slowing and therefore the bottom is assumed to be near. In April, nonfarm payrolls fell only 539,000, which was the smallest decline in six months. This job cuts number was less than expectations and down from the 741,000 in January. Similarly, in April private sector jobs fell only 491,000 as opposed to the 650,000 forecast, again a positive. The economy has shed 5.7 million jobs since December 2007 and the unemployment rate is 8.9%, which is the worst number since 1983. Unemployment may well top 10% before we are done but unemployment is a lagging indicator. More often than not unemployment continues to increase even after the economy has turned positive.

Other green shoots include existing home sales that have increased the last four months and the financial, credit and commodities markets moving up. Money markets are once again functioning and credit spreads are narrowing. Long US treasury yields may be rising, from ridiculously low levels, but far more important is that the yield spreads are tightening, lowering company's financing costs. Oil, Gold and commodities across the board have been moving up from depressed levels, as it looks more and more as though the US and the rest of the world will not be in a global depression after all. Although the cartoon is not meant to be analogous to the future of the economy I just could not help but include it.

Many believe the most predictive index is the consumer-confidence index. This index is composed of ten components including stock prices, money supply, jobless claims and new orders by manufacturers. It usually bottoms out very close to the end of a recession at around 60 (+ or -). This deep recession has depressed this index to the mid twenties far surpassing any in the last forty years. This lends cadence to the idea that this recession has surpassed the pain of the 73-74 downturn and was only surpassed by the enduring contractive period of the 1930's, though a repeat of the Great Depression is highly unlikely.



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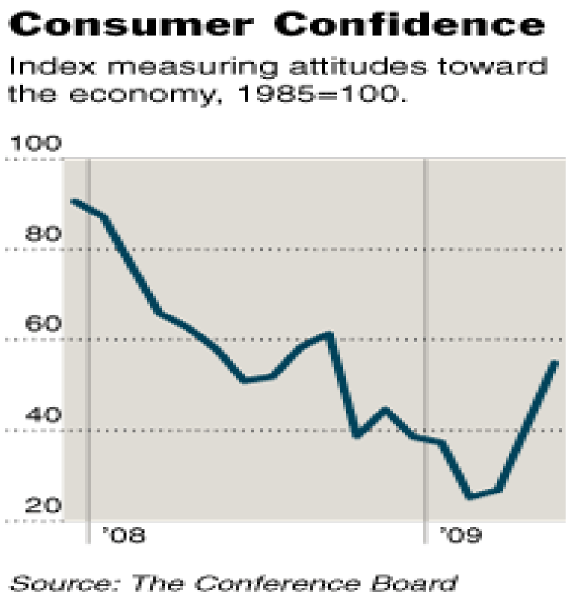
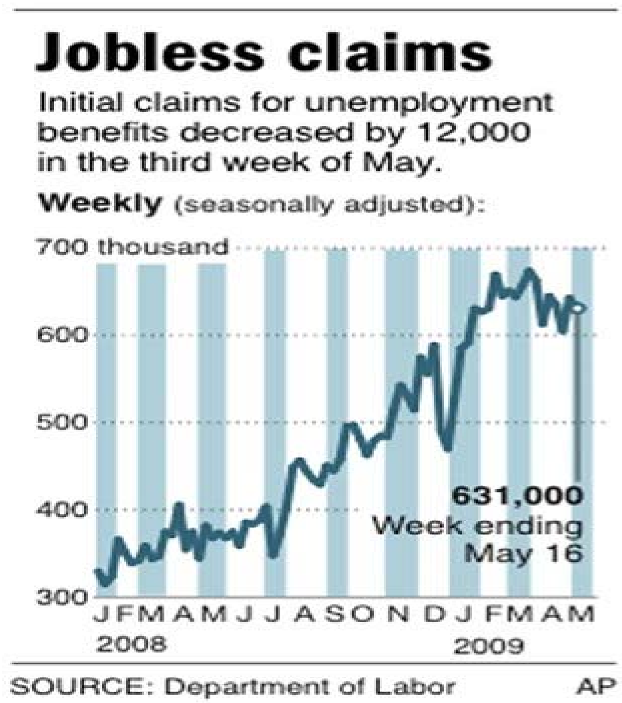
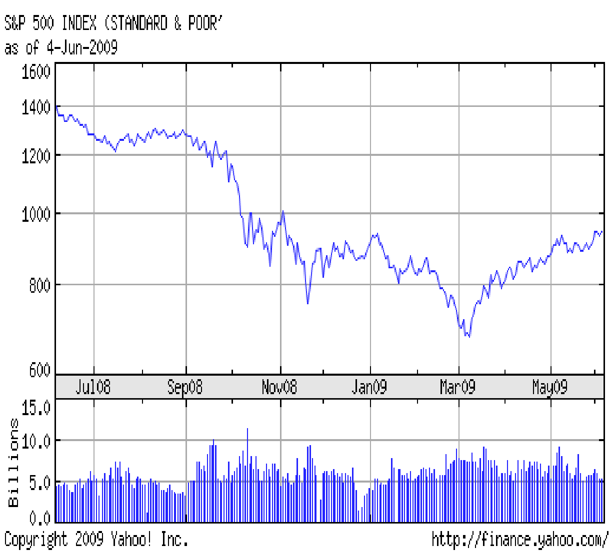




Some believe that new claims for unemployment are the best indicator for the end of a recession. This normally peaks a month or two before the economy bottoms. This also appears to have peaked in March at 658,000. Between the jump in consumer confidence, the peaking of jobless claims and the jump in the stock market, it looks like we really have turned the corner.



Bubble Manias, Hangovers & Recovery

People like to make comparisons between the recent dreadful period and those of the past. The only periods that begin to compare are the Great Depression and the 1970's. Both saw speculative stock market bubbles, much like our recent speculative bubbles (internet and real estate). Following past bubbles came many years of subpar economic growth and subpar stock market returns.

All bubbles and their aftermaths have three basic factors that effect and exaggerate their outcomes: economic fundamentals, the monetary situation and investor psychology. Throughout time Manias both to the upside and downside in the stock market are perpetuated by the herd mentality and the madness of crowds.

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The Great Depression

After WW I, America prospered and took over from Britain as the leading manufacturer and exporter to the world. The big difference was that Britain had to import raw materials from other parts of the world and then sold them back to the rest of the world. This kept the monies coming and going (balance of payments) about even. Britain, of course, made a tidy profit (increase in national income) that made them the envy of the world. If you lived in Africa, the Americas, Asia, India etc. and provided the raw materials, you likely thought this symbiotic relationship a little inequitable.

The U.S had abundant natural resources and when it became the dominant exporter, the monies (balance of payments) just kept rolling in, with little going out. Not only did "Robber Barons" get rich, but all of American society's income rose to become the new envy of the world. The combination of abundant natural resources, rising population, cheap labor (immigration), abundant capital and the rule of law, which protects property rights, produced a booming economy. Sounds a little like China today. One result of all this excess income was a booming stock market. By the mid 1920's anyone could and did buy stocks, many on margin (as little as 10% down). Schoolteachers and newsboys were giving out stock tips as well as acting on them. As in every bubble, prices and valuations got to absurd levels. Sounds a bit like our internet period. Then came the 1929 crash.

We all know the two major mistakes made by our policy makers that made the situation even worse than it might have been. First, they shrunk the money supply and tightened credit. This plunged more and more companies, banks and individuals into bankruptcy and produced massive unemployment. Conversely, in response to today's banking crises, the Fed has flooded the system with money. The more visceral error that prolonged the Great Depression was the Smoot-Hawley Act that raised U.S. tariffs on over 20,000 imported goods to record levels.

A third more fundamental problem is largely forgotten. It preceded the 1929 crash and was likely the real reason for the prolonged Great Depression. During WW I the agricultural capacity of Europe was decimated. In response, there was a dramatic expansion of American farmland. After the war, European supply came back, and crop prices plunged. American farmers were a huge part of the economy and they started going into debt long before the '29 crash. Real estate prices had peaked in 1925. Hebert Hoover, while running for the Presidency in 1928, promised to increase tariffs on agricultural products to help farmers. Once elected he asked Congress to initiate a bill to <u>increase tariffs on agriculture</u> and <u>decrease tariffs on industrial goods.</u> His own party, who dominated both houses of Congress, came up with the bright idea to sponsor the bill that passed, which <u>raised tariffs on both</u>.

Some people believe protectionist policies save domestic jobs and are even patriotic. These people have little understanding of economics. Other countries retaliated and increased tariffs on American imports even before the law passed in 1930. The result: U.S. imports decreased 66% from US$4.4 billion (1929) to US$1.5 billion (1933), and exports decreased 61% from US$5.4 billion to US$2.1 billion, both decreases were far more than the 50% decrease of the GDP in the period. Reed Smoot and Willis Hawley were both defeated for reelection in 1932, their tariff bill being a major factor. Their constituents learned this lesson quite quickly but I am fearful that today far too many have forgotten the self-defeating outcome of protectionist policies.

1970's Stagflation

Some believe the 1970's may be a better corollary to today. We hope policy makers of today will not lead us down that same path. The 1970's malaise was far more the result of monetary and fiscal policy than any fundamental problems such as the farming problems of the 1930's.

Following WW II, the American economy prospered, growing at robust rates with steady prices (low inflation) from 1945 to 1973. There were only a handful of cyclical recessions (mostly mild) with corresponding downturns in the stock market. The only sizable stock market tumbles came during the 1962 Cuban missile crises and the 1970 recession, which was deeper than most as inflation had already taken hold. During the 1960's the seeds of change (both social and fiscal) were brewing. The high rates of growth were becoming unglued by years of high domestic spending (begun during the Kennedy administration and continued with the Great Society campaign) and funding for the Vietnam War. By the late 1960's above average inflation had taken hold and would only get worse through the 70's. About this same time a stock market bubble was forming in the late 60's and early 70's that was not unlike our internet bubble. The great growth companies of the day called the Nifty 50 were getting ridiculous valuations. These companies included companies like IBM, Pepsi, Polaroid and Honeywell, among others, and were considered one-decision stocks. It was thought you could buy and hold forever and it did not matter what price you paid. Sounds a little like our internet period. Valuation always matters and paying 30X, 50X or 80X earning just does not make sense, no matter how exceptional a large mature company is in any era.

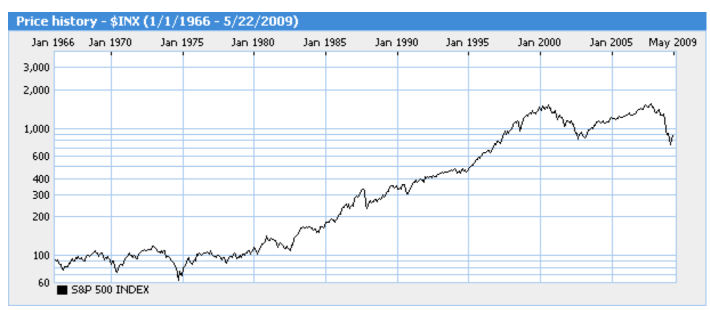
Many of us who lived through the 70's, and experienced high inflation remember how debilitating it can be. Inflation erodes a currency's purchasing power when incomes do not rise as fast as prices, ultimately eroding the standard of living. The natural state of a capitalistic economy is where prices increase at a low but steady state and the increase in population plus increases in productivity outpace the price increase thereby increasing in the standard of living for all.

What was changing was the balance of power, as the most productive exporter, was moving from the US to Germany and Japan. Most of the developed countries experienced inflation between 1973-80 similar to that of the US (double digits +/-) with Germany (4%) a bit lower. In that period the US dollar lost significantly in purchasing power vs. the Yen (16%) and Mark (32%). With the manufacturing industries in relative decline, the US recorded its last trade surplus in 1975 and it has only declined since.

What most us do not remember except those who experienced the 30's is that deflation is even more debilitating. In both high inflationary and deflationary periods, the standards of living decrease. The fixed costs, be they mortgages, rents or fixed business costs such as wages do not move as fast as the price level. In protracted deflationary periods, this produces pronounced unemployment as company's top and bottom lines shrivel and the only way to reduce costs is to decrease employment, as fixed costs cannot adjust in the short term. The oil shocks of 1973 and 1979 only added to the existing ailments and helped conjure even higher inflation. The misery index (the sum of the unemployment rate and the inflation rate) reached an all-time high of 21.98%. The economic problems of the 1970s resulted in a sluggish cynicism replacing the optimistic attitudes of the 1950s and 1960s. This cynicism resulted in a prolonged period of very low valuations for stocks (PE averaged 9X earnings).

How did stocks perform in the 1970's?

Some people like to say the 70's were a terrible period for stocks. The Dow touched 1000 in 1968 and did not top it to stay until 1982. This may be true but does not tell the entire story. In fact the market topped in 1973 at about 1050, got killed in the 73-74 bear market (74 recession), and then dealt with recessions in 1980 and 81-82. All of these were exaggerated by the '73 and '79 oil crises. I have never put much credence in technical analysis or the predictive power of charts but one cannot help notice resemblance on occasion.



The two humps in the chart below '67-74 (nifty fifty) looks a lot like our internet and aftermath period of 98-08. Both periods ended with the longest and deepest recessions since the Great Depression. The good news is from the low in 1974 the market (S&P 500) then gained 227% in the next 6 years or 14.6% per year. Now the 70's pooh pooh-ers will say that the inflation of the period ate up the returns and at 9% inflation, they may have a point.

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	1975	1976	1977	1978	1979	1980	AVG
Div Yield	4.7%	4.2%	5.1%	5.9%	6.0%	6.1%	5.3%
PE	10.1	7.7	10.5	10.1	10.0	7.3	9.3
CPI	9.1%	5.7%	6.5%	7.6%	11.3%	13.5%	9.0%

	Oct-74 Low	Nov-80 High	Total Rtn	6 year Annual Rtn	Avg Div	Total Rtn	CPI	Real Rtn
S&P	62	141	227.4%	14.6%	5.3%	19.9%	9.0%	11.0%

Proposed new investment vehicle

LTBC Smid Cap Growth

A number of friends and clients have suggested that LTBC provide an aggressive growth investment vehicle. While managing investments at LTBC (3+ years) and previously at Testa, Hurwitz & Thibeault (13+ years) I have always believed in looking for superior value in each individual investment regardless of market cap. We, at LTBC, use a fundamental, research-intensive process to find attractive investments that trade below their intrinsic value. We look for undiscovered gems; often little followed or understood by Wall Street. We do not try to time the market but seek out undervalued investments that we believe will provide above average returns over time. The universe of smaller capitalization companies is far greater than the limited number of large cap companies. This huge universe of smaller stocks contains plenty of laggards but also many undiscovered stars. We believe that careful selection of superior Smid caps can lead to enhanced performance. LTBC plans to organize an aggressive growth "Smid cap" (primarily small and mid cap stocks) investment vehicle in the near future. This may be organized as a private investment limited partnership or a unit investment trust (much like a mutual fund). The assets will be held in custody at State Street Bank & Trust, which is the largest institutional custody bank in the world. Investments will be managed by LTBC Capital Advisors, which is an Independent Registered Investment Advisor. In the near future, we will provide details that are more comprehensive.

However, what they do not usually mention is that you also got an average 5.3% in dividends making the total real return 10.9%, a very respectable return. We believe the economic environment and policy decisions of today are not a repeat of the past. What is similar is we have been going through a decade of backing and filling to erase the excesses of a speculative bubble period (internet and real estate). What I find the most encouraging is what ensued after prolonged periods of stagnant stock market returns in the 1930-40's and the 1970's. In both cases in the 1950's & 60s and again in the 1980's & 90s we experienced multi-decade bull markets. Now that is something we would all love to see repeated

LTBC Capital Equity Returns

Negative returns are never desirable but our goal as long-term investors is to achieve a good return over time. We do not try to time the market but do position our portfolios to both preserve capital in difficult times and most importantly to prosper in the long run.

LTBC Capital Advisors
Composite Equity Returns
Periods ended 5/31/09

	S & P 500 Index @	LTBC Composite Equity Accts @@
2 Months	15.2%	13.7%
Year to date	2.5%	8.5%
Since Inception 41 months @@@	-6.5%	-4.0%

@ = S&P 500 Index includes reinvested dividends
@@ = LTBC Composite Returns are net of fees
@@@ = Multi-year returns are Annualized

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