



October 15, 2009

Dear Clients:

As we head toward the last quarter of the year, U.S. and global economies seem to be turning the corner as it appears that the worst is over for the recession that started in 2007. Stock markets around the world have been looking ahead and rallying as investors pin their hopes on improved economic data and corporate profits.

It may confound investors that the markets should recover so robustly in the face of terrible economic headlines such as GDP contraction, failing banks, massive federal and state budget deficits, a collapsing dollar and rising unemployment. We will simply remind you that the equity markets are a futures market. The markets digest these realities quickly, as witnessed through the collapse in '08 and early '09, and then look ahead. The stock market recovery to-date should be viewed as highly constructive. As a leading indicator, the equity markets are signaling that much better economic times are ahead.

While we are grateful for the robust returns since the low in March, keeping pace with the powerful linear advance of the equity markets since the low has not been easy. As investor risk tolerance has improved, new themes are emerging and old themes are eroding at a rapid pace. This is certainly not uncommon as we have witnessed this scenario play out many times before. Let us assure you that this is normal within the confines of our discipline at the inflection points of major equity market transitions - in this case, a transition from a bear to a bull market.

As you are likely aware, our methodology is predicated on investing in the dominant *long-term trends* (typically 18-24 months) that exist in the market. As a result, coming into the March low, in a continued effort to protect investor capital, our portfolio held a large concentration of more defensive sectors (i.e. consumer staples & health care) and little exposure to long-term underperforming sectors such as financials. As this market transitions from bear to bull, it is very normal that some of the more depressed, oversold areas (the long-term relative underperforming areas) will garner the most attention in the initial phase of recovery. This has certainly been the case, as sectors such as financials and basic materials have performed extremely well off the bottom while defensive areas have underperformed. It may be helpful to think of the crushing bear market as a rubber band that gets stretched so far in one direction that when the tension is released it snaps back sharply. Sectors that were stretched the most (financials, basic materials etc.) have snapped back the most in the early stages of the recovery.

The world's best investors concede that trying to consistently pick tops and bottoms in the stock market over the long term is near impossible. As such, *prudence* dictates that we wait for an accumulation of evidence to confirm that short-term price action indeed represents the start of a new bull market rather than simply a brief countertrend rally within a longer-term decline. Absent such confirming evidence, an investor is simply gambling on the markets and ignoring sound risk management.

Over the past several months, we have significantly reduced exposure to defensive areas and added to improving areas such as consumer discretionary, information technology, financials, and

basic materials. We feel we are in the later stages of this transition period and expect to finish the year strong.

Looking ahead we are increasingly confident that the equity markets are in the early stages of what will be a longer-term (5-10 year) bull market. Unprecedented global central bank cooperation, easing credit markets, extremely low interest rates, and an unprecedented amount of “sideline” cash (estimated to be 3-4 trillion dollars) is a recipe for growth. If human nature remains constant (which it always does), the rampant fear of the equity markets will soon turn to “fear of missing out”, a powerful catalyst to send the markets higher. We believe that we are still in the first inning!

Thank you again for your confidence in choosing Contravisory as your investment advisor. Please give us a call should you need further information on your portfolio.

Sincerely,

William Noonan  
President, CEO

