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Fourth Quarter 2009

Quarterly Economic News

2009 was a year of "ups and downs" on all fronts. After hitting its low for the year in early March, the stock market rallied and reached its high just before year-end. The high price of commodities, led by gold and oil, were viewed as a sign of market strength. Just as the downward trend in the housing market seemed to have reversed, the number of pending home sales fell sharply in November. This was the first decline in nine straight months of gains, and only time will tell if the recent reversal will lead to another housing downturn. Unemployment, now hovering around 10%, has been slower to correct than the overall economy, but recent employment numbers showed signs of improvement. Global recovery seems to have come first to emerging markets which have experienced strong growth.

The Market's Long Rebound

As the credit crisis eased, investors sought riskier assets and began purchasing equities. Stock markets also responded to solid economic figures - the Dow Jones Industrial Average (DJIA) rallied 8% for the quarter and nearly 23% for the year. Gains were seen across all major equity indices, including small cap and international. The Russell 2000 small cap index was up more than 25% for the quarter and the MSCI EAFE international index had its best year since 2003 with an increase of 2% for the quarter and 28% for the year.

The strong rally in domestic and in developed international markets was a welcome relief, but returns paled in comparison to those obtained in emerging markets. The MSCI Emerging Markets index returned 73% in 2009. As investors regained their appetite for risk, many looked to emerging markets (Brazil, Russia, India and China) to lead the global economic recovery. The following table shows returns for various indices:

Index	4th Qrt	1 Year	5 Year	10 Year
S&P 500	6.0%	26.5%	0.4%	-1.0%
Russell 2000	3.9%	27.2%	0.5%	3.5%
MSCI EAFE	1.8%	27.8%	0.9%	-1.1%
Barclays Agg. Bond	0.2%	5.9%	5.0%	6.3%

Source: Wall Street Journal January 6, 2010

The S&P 500 is a commonly used measure of common stock total return performance.

The Russell 2000 is a commonly used measure of small capitalization stocks.

The MSCI EAFE is a commonly used measure of common stock total return performance of international markets.

The Barclay's Aggregate Bond Index (formerly Lehman Brothers' Aggregate Bond Index) is a commonly used measure of the bond market.

All referenced indices are unmanaged and not available for direct investment.

Past performance is not a guarantee of future results.

Mirage

From the world's highest tennis court at the Burj Al Arab Hotel to Ski Dubai, a 22,500 square meters indoor ski resort in the Mall of the Emirates, both serve as examples that Dubai's building boom was becoming excessive. Over the Thanksgiving weekend, Dubai World (the government-owned holding company for Dubai) shocked markets when it announced its intention to restructure $26 billion of debt. This event proved a reminder that the credit crisis is still having an impact. Dubai, well known as a financial hub and tourist destination, has little oil revenue to compensate for the debt incurred by excessive building. Furthermore, Dubai World is highly invested in real estate projects across the globe and has felt the impact of the worldwide property slump. Markets were calmed in early December when Dubai's oil-rich neighbor Abu Dhabi provided $10 billion to help Dubai World avoid default on a $4.1 billion bond payment. With the immediate crisis quelled, investors began to take a longer look at sovereign debt and creditworthiness. Dubai's debt problems raised concerns about the sovereign debt of Greece and a number of other nations. In Dubai's wake, Greece saw its credit ratings lowered and its cost of borrowing increased. Bankers, and the stock markets, will most definitely pay closer attention to sovereign debt in 2010.

"Dubai Debt Crisis Will Force More Transparency, DIFC Saidi Says", Henry Meyer, Bloomberg, December 16, 2009.

"Abu Dhabi Expected to Prop Up Smaller Brother", Andrew England and Siemon Kerr, Financial Times, November 27, 2009.

The yield on the ten-year Treasury bond increased nearly 0.5% during the quarter, and finished with a yield of 3.84%. This increase was due in part to the strengthening economy and to the belief that a stronger economy will lead to inflation and higher interest rates. High levels of government borrowing were also a concern for bond investors. Bloomberg reported that, in 2009, Treasury bonds had their worst year since 1978. Treasury bonds were considered a safe-haven during the credit crisis, but as the economy climbed out of recession investors traded in their Treasuries for higher yielding debt. Many factors likely contributed to the junk bond market's impressive 57.5% return in 2009, including the strengthening economy, increase in lending and ability of corporations to once again access debt markets.

"For Rebuilt Markets, a Test in 2010", Tom Lauricella, Wall Street Journal, January 4, 2010.

"Emerging Markets Soar Past Their Doubters", Heather Timmons, New York Times, December 29, 2009.

"Treasuries Set for Worst Year Since 1978, as US Steps Up Sales", Daniel Kruger and Anchalee Worrachate, Bloomberg, December 30, 2009.

Economic Recovery

The economy is continuing to show signs of recovery: the third quarter GDP grew at a rate of 2.2%, consumer spending has increased, and manufacturing indicators in the last week of December exceeded expectations. This expansion in manufacturing is leading economists to forsee improvement in employment for 2010 as manufacturers rehire workers to meet demand. Furthermore, many companies are now experiencing reduced inventories, and consumer demand will most likely spark production. Despite disappointing numbers in November, the housing market has shown signs of stabilizing in 2009, and the Case-Shiller housing index showed some markets' home values are increasing.

The consensus among economists is that economic growth will continue in 2010, but the weak labor market is tempering the predictions. If unemployment remains near its current level, economic growth is expected to remain sluggish. If employment increases, then growth is expected to be higher than projected. Recently released job figures are encouraging, and unemployment claims during the last week of the quarter fell to their lowest levels since the summer of 2008.

Chart from WSJ.com, Economic Chartbooks

"Companies in U.S. Expand at Fastest Pace Since 2006", Bob Willis, Bloomberg, December 30, 2009.

"U.S. Jobless Claims Drop To Lowest Levels Since 2008", Courtney Schlisserman, Bloomberg, December 31, 2009.

Commodity Strength

Commodities were strong throughout the year buoyed by demand from emerging market countries and a weak U.S. dollar. Oil rose rapidly early on in the year, remained above $70 for most of the year, and increased to more than $75 for most of the fourth quarter. Gold hit a historic high of $1,227 an ounce during the fourth quarter before pulling back and ending just above $1,100.

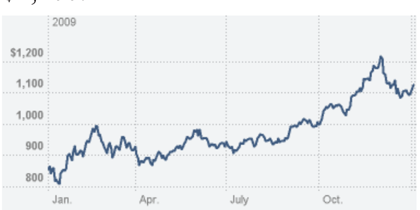

Chart from nytimes.com

Lost Decade

The "zeros", the "aughties", the "noughties" - whatever you want to call them, the first ten years of the new century are over. The decade was bracketed by the bursting of the "dot com" bubble and by the recent financial crisis, each of which led to a recession. The Financial Times reports that the S&P 500, in real terms, has lost 37.5% since 2000. The Washington Post states that the "aughties" were the worst period for the U.S. economy in modern times. The economy, as measured by GDP, grew only 17.8% from 2000 – 2009 compared to 38.6% in the '90s, 34.9% in the '80s, and 38.1% in the '70s. The employment picture was even worse, with zero percent job creation. The new decade holds promise for growth as the measurement begins at the end of the worst recession since the Great Depression.

"Aughts Were A Lost Decade For U.S. Economy, Workers", Neil Irwin, Washington Post, January 2, 2010.

"The Noughties and 1930s Look Very Alike", John Authers, Financial Times, December 29, 2009.

Conclusion

Most stock markets around the world began to rally in March and this continued through the fourth quarter, with all major indices reporting sizeable gains for the year. The economy followed suit and began to grow again in the third quarter with growth expected to continue into 2010. The wild card at this point in the recovery rests with the labor market. While recent signs bode well for employment, economists remain cautious in their outlook, looking for further proof that the worst financial crisis in a generation is largely behind us.

The Executive Compensation Group

325 Williamson Boulevard
Suite 120
Daytona Beach, Florida 32114
Office: (386) 255-0519
Fax: (386) 252-4084

www.excg.com