Are we there yet? . . . Where are we heading?

Overview

The short answer to the question of "Where are we heading?" is that the economy has turned the corner and is now heading out of the most severe downturn since the 1930s. With the worst likely behind us, investors must now navigate through both opportunities and headwinds during a recovery that promises to differ from those of the recent past and challenge our patience as investors. No, we are not there yet but after a painful contraction we are finally moving in the right direction to regain our economic prosperity.

Many positive economic developments are taking place such as rapid growth in household wealth, rising home prices and easing of credit. We continue to face strong headwinds on our path to recovery, however. Record levels of fiscal spending to spur economic growth come at a heavy price in the form of mounting federal debt. Meanwhile consumer spending continues to suffer from a weak job market and a desire to reduce household debt.

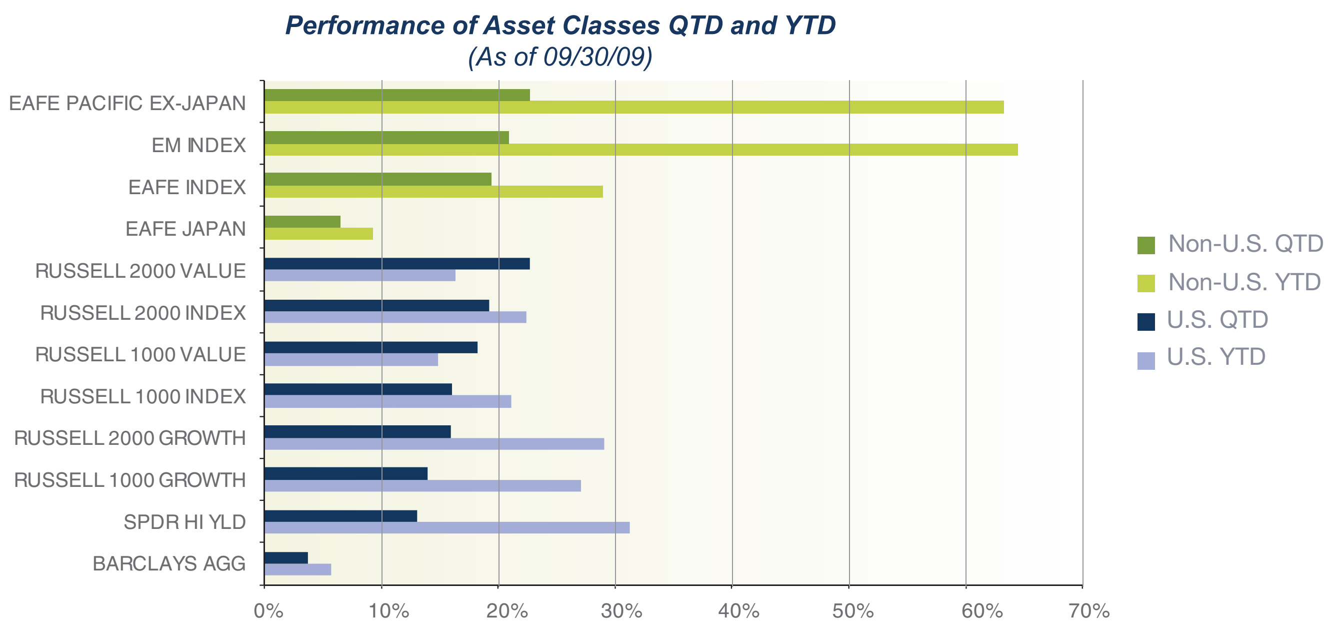
In other words, the economic recovery will likely be longer and bumpier than most of us have experienced in our lifetimes. The best investment advice we can provide for what lies ahead is to avoid investing out of fear. We should each concentrate on our long-term investment goals and strategy while remaining open to opportunities to enhance returns and manage portfolio risk through dynamic shifts in strategy. Recovering from this recession will require changes in the very structure of several economic drivers, such as the functionality of our credit market. We, as investors, should be prepared to respond to and capitalize on these changes as they develop while trusting our long-run, strategic asset allocations to guide us toward recovery.

> "The best investment advice . . . avoid investing out of fear."

LAIRD NORTON TYEE

Market Recap

The capital markets continued their sharp rebound in the third quarter and investors willing to accept corporate and country risks were well rewarded. Returns on equities surpassed those of fixed income securities around the globe, and our overweight of international stocks relative to domestic stocks continued to pay off as the Russell 3000 Index and MSCI EAFE Index returned 16.3% and 19.5% respectively. U.S. investment-grade bonds climbed 3.7% measured by the Barclays US Aggregate Index. High-yield corporate bonds returned 9.4% - more than twice that of investment grade – as credit spreads narrowed considerably during the quarter. Spreads have narrowed a very impressive 10% so far this year.



Source of Data: Morgan Stanley, Barclays Capital, Russell Indices, Standard & Poor's

Small cap stocks led large cap stocks with the Russell's Micro Index beating the 1000 Index by nearly 5%. Styles traded the lead with value outperforming growth in the quarter, but growth continues to lead value on a year-to-date basis – a trend we expect to continue through this phase of the recovery.

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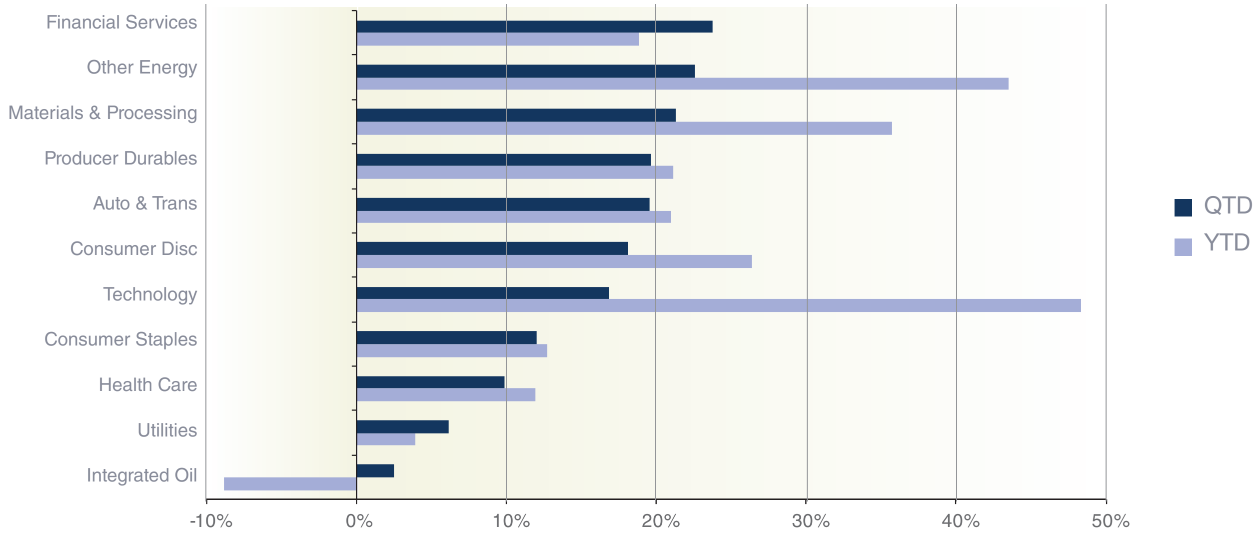
Performance of Equity Industries QTD and YTD
(As of 9/30/09)



Source of Data: Russell Indices

The Road Ahead

Consumer Spending

Consumer spending consistently contributes approximately 70% of growth in the nation's real GDP. Gains in consumer spending have also been vital to most of our economic recoveries contributing on average 55.6% of real GDP gains in the first year following the trough in economic output during the previous seven recessions. As we analyze investment opportunities, the outlook for consumer spending is obviously high on our list of priorities.

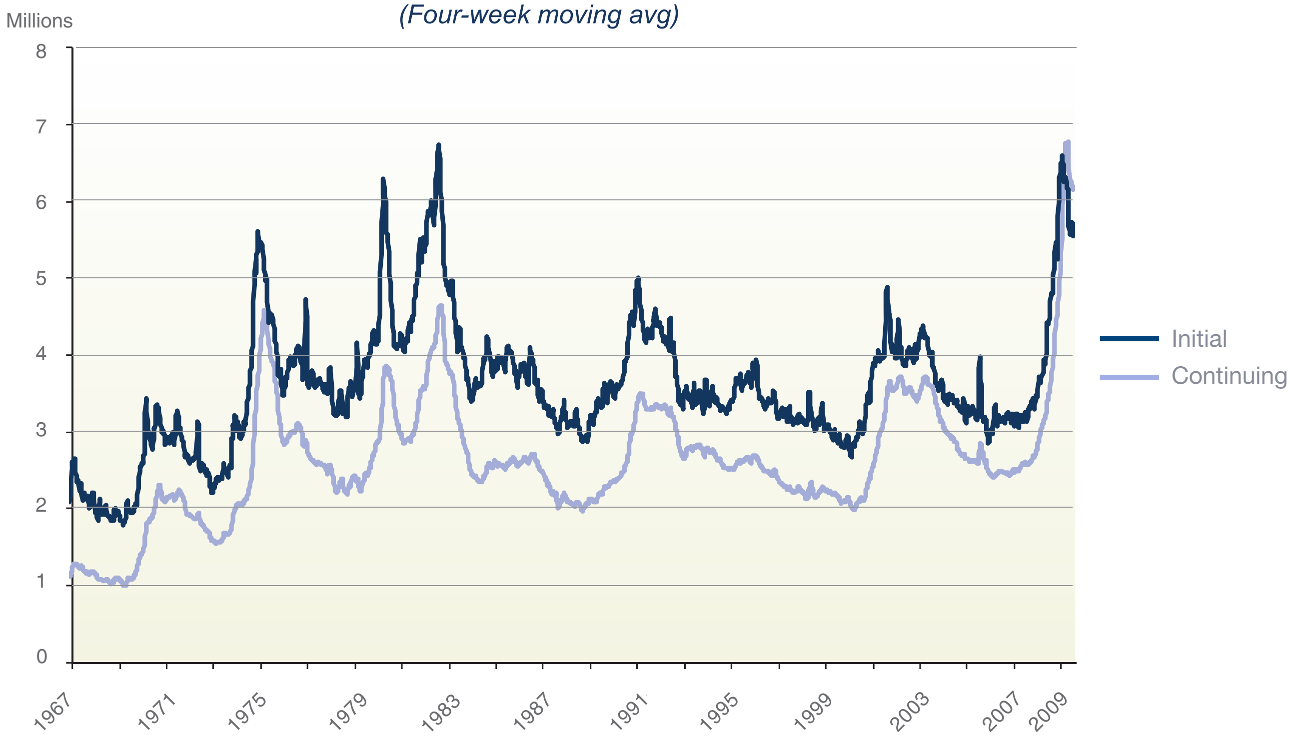
At this point in the economic cycle, consumers have been saving more of disposable income and paying down debt. Loose credit requirements prior to the recession led to record debt loads that consumers are finding difficult to justify in today's economic climate.

U.S. consumers are proven spenders historically and that is unlikely to change meaningfully once the recovery gains traction. Major drivers of consumer spending are employment opportunities, availability of easy credit and household wealth. Looking at each of these factors individually suggests consumer spending will muddle along an upward slope as opposed to the robust rebound experienced in several past recoveries.

Signs of Stabilization in employment

Unemployment continues to be the largest source of concern in our outlook on consumer spending as the headline number reached 9.8% in September. Unemployment is typically a lagging indicator and looking deeper into the September data gives us an indication of where the number is headed before it begins to drop. If the discouraged workers who voluntarily stopped seeking work in September were added back, the headline number would have reached 11% - not materially higher but it would take us over an important psychological hurdle. If we add the individuals who accepted part-time positions but would prefer to have a full-time role (the “U-6” series), the unemployment number would jump to 17%. With additional layoffs being announced (such as Caterpillar and Saturn), there is little doubt that we will soon experience unemployment rates in the low double digits, which may add to the pessimism felt by consumers.

Continuing and Initial Unemployment Claims
(Four-week moving avg)



Source: Bureau of Labor Statistics

Importantly, unemployment is a lagging indicator in economic recoveries. Looking at initial claims as well as continuing claims, the number of unemployed workers appears to be stabilizing. In other words, while some layoffs continue, many workers are finding jobs at alternative industries – just as you would expect in an economy at a turning point. While employment is not yet providing a boost to consumer spending its negative impact may well be waning.

Credit: Cheap and Becoming Easier to Access

Consumer credit paints a brighter outlook for the growth in consumer spending. Following excessively easy credit, lenders shut the door on many options for consumers to access capital. As the value of real estate used as collateral for loans fell, banks were forced to increase their reserves and therefore had less capital to lend. This dynamic left little cash available for consumers, even with the emergency liquidity provided by federal programs. The situation is improving as lender surveys indicate a sharp increase in the number of firms loosening their lending restrictions relative to those tightening restrictions. We fully expect this trend to continue if property values continue to stabilize.

Additionally, credit is quite cheap due to the low interest rate environment. While accessing credit will continue to be more challenging than had been the case from 2004 through the first half of 2007, we anticipate access to improve as write-downs on property values subside.

Another positive regarding credit is that lenders have been able to remove some of their "toxic assets" from their balance sheets. This reduces their need to hold cash reserves and frees more capital for generating loans to businesses and consumers. Supporting this trend, five Public Private Investment Partnership (PPIP) funds have raised $1.94 billion to purchase troubled securities backed by residential and commercial mortgage loans. With the matching funds and loans from the Treasury, these five funds alone are capable of putting $12.27 billion to work starting in the current quarter. The program is expected to expand to $40 billion as additional funds are launched and more investment capital is raised. The PPIP program should significantly improve the ability of banks to lend in 2010.

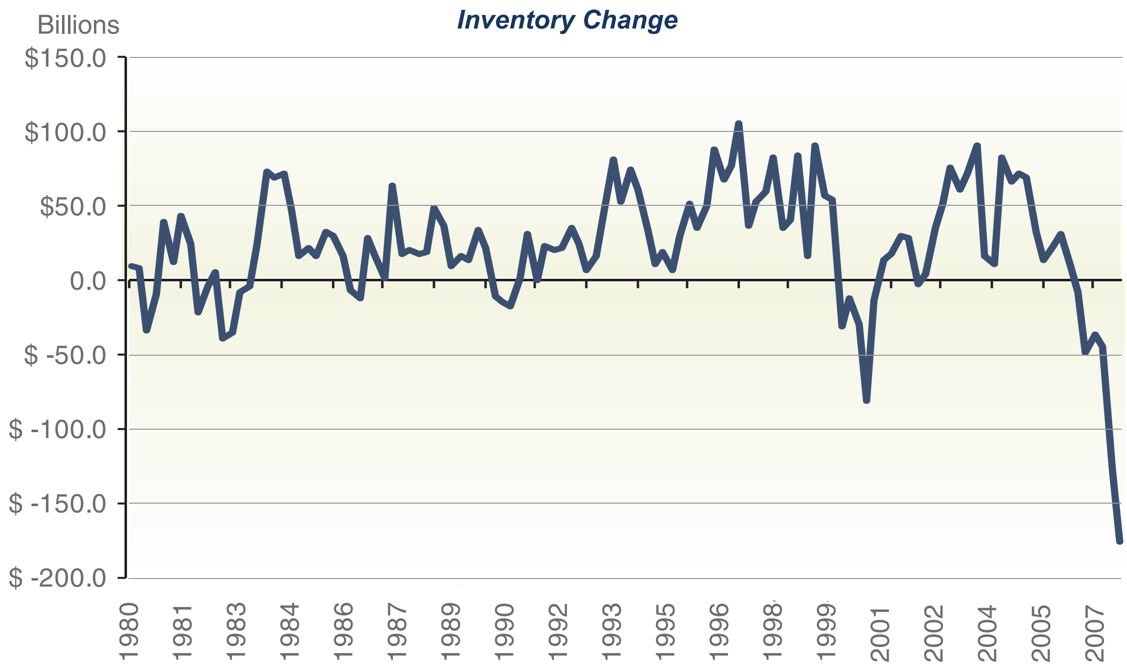
Household Wealth Improving

Household wealth is showing the strongest rebound of the three main drivers of consumer spending. Wealth improved dramatically in the second quarter – rising $2 trillion – and capital market returns suggest another strong increase occurred in the third quarter. Gains in house prices and investments drove the increase with equity returns providing the bulk of the gains.

Housing prices as measured by the S&P/Case-Shiller Home Price Index are exhibiting renewed life with small but positive month-to-month changes resulting in a 2.4% gain in the three months ending in July– a trend we expect to continue.

Demand Rising

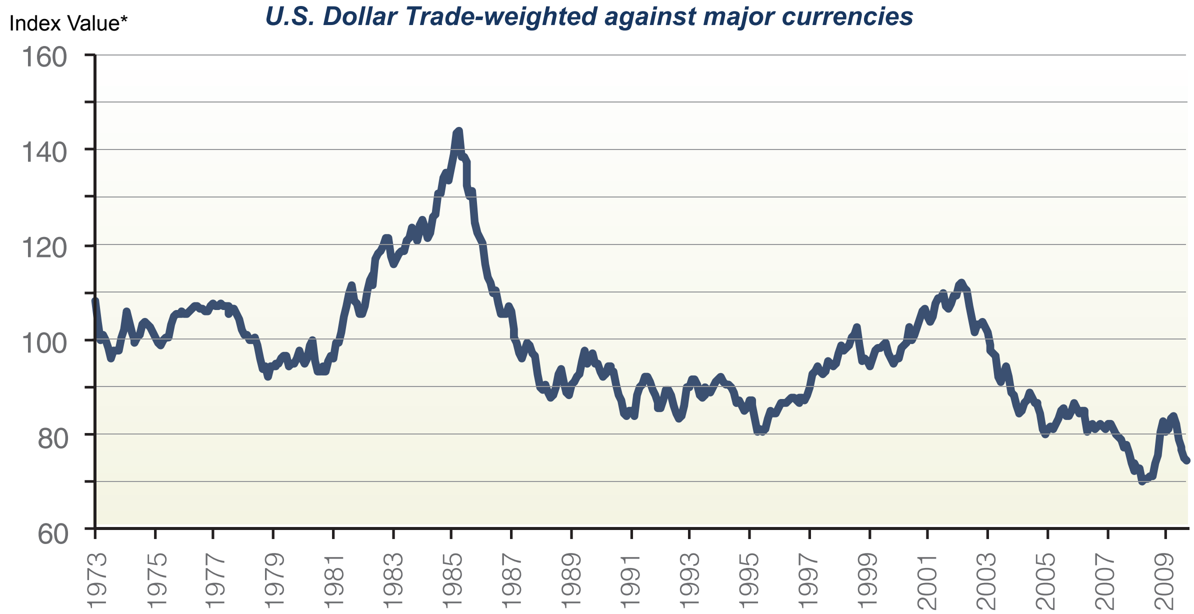
Economic growth will also receive a boost from inventory replacement. Inventory has fallen to unsustainably low levels after declining by $442 billion since the recession began in the last quarter of 2007 as businesses focused on reducing costs in response to weak sales. Institute for Supply Management's New Orders Index has been in expansion territory for three consecutive months (falling to 60.8 in September but still positive) suggesting that demand is improving for U.S.-manufactured goods. Even a slight uptick in demand will require many businesses to increase output and inventory levels to meet orders.



Source: Bureau of Economic Analysis

U.S. Dollar to Weaken Further

The value of the U.S. dollar has fallen relative to the currencies of our major trading partners by roughly a 1% annualized rate since 1973. The pace of the decline has accelerated during the recession falling 7.5% this year. Analysis suggests that the dollar will continue to decline as the federal deficit increases. While this will improve the competitive positioning of U.S.-produced goods in the global market (another positive indicator for demand of U.S. produced goods), it also increases the inflationary pressure in our economy. Our expectation of further weakening of the dollar is one of the drivers behind the current overweight in international stocks at the expense of domestic equity.



Source: The Federal Reserve
*Index = 100 in March 1973

Summary

While the job of determining the official end of the recession resides with the National Bureau of Economic Research, several signs suggest that we have made it through the worst economic downturn since the 1930s. Still, current data suggest that this recovery will feel more like a slow, uphill slog rather than a sprint. Looking forward, the chief questions we need to address are what will be the drivers of the recovery and how should we position our investment portfolios to prepare for the way ahead.

LAIRD NORTON TYEE

Inventory replenishment and government spending appear to be the primary contributors to economic growth today; however, they are by their nature short-term drivers. Consumer spending is the principle driver of the U.S. economy and a pick-up in spending is essential to a sustained recovery. Consumer spending is currently quite low as high unemployment and a trend toward de-leveraging of households has motivated many to cut back on purchases in favor of saving. Rising household wealth and low returns on cash-like assets should offset these trends over time suggesting a slow but upward path for the recovery.

In response to this environment, we continue to recommend a higher-than-normal allocation to international equities. This allows greater participation in higher-growth regions as well as a means to increase exposure to non-dollar currencies.

During the credit crises, we took advantage of incredibly wide corporate bond spreads by establishing an allocation to high-yield bonds in several of our model strategies. As corporate spreads narrowed we reduced these allocations and may eliminate this opportunistic position if spreads continue to narrow.

The fundamentals of investing still apply in today's environment. Our long-term, investment strategies are based on the cornerstones of modern investment theory and are structured to help you achieve your investment goals. The crisis we've experienced has left a mark in the value of our portfolios, however, and provided an opportune time to revisit where we stand and what we hope to obtain as investors. It is important to continue to maintain an open dialogue with your advisor to ensure that he or she continues to understand your risk tolerance and investment goals. Investment policy statements are meant to be evolving documents that capture the relevant and unique aspects of your investment objectives. Your advisor continues to be one of your greatest assets in planning for the investment road ahead.

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