

July 1, 2009

# McCullough & Associates LLC

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INVESTMENT COUNSEL

Before we share our thoughts on the current economic environment we felt it would be helpful to reflect on the extraordinary financial events of the past nine months. In hindsight, the 2008 financial collapse seized international money flows and brought global economies to an abrupt halt. Governments, banks, businesses and individuals were badly shaken, resulting in a drastic sell-off in the stock market. This in turn caused a dramatic decline in consumer confidence, which accounts for over two thirds of domestic GDP. It's now widely accepted that March 2009 was the market bottom, since then conditions have slowly improved and the fears of recession are fading. As we write this letter the S&P 500 Index has rebounded 36% from its lows.

Looking forward, the residue of unrestrained financial leverage combined with loose government regulation serve as an impediment to hopes for a quick and substantial domestic recovery. Individual balance sheets and personal wealth must be repaired in order to reenergize consumer spending and create a sustainable economic expansion. Lastly, uncertainty surrounding the future course of monetary policy, interest rates, inflation versus deflation and fiscal policy will create a drag on global growth.

Though the environment is challenging, we believe seeds are sown for steady economic improvement; not the "V" shaped recovery anticipated by those who are more optimistic and clearly not the "L" shaped forecast embraced by market naysayers. Businesses have taken steps to restore earnings and cash flow by cutting back on fixed investment and staffing while bringing inventories into better alignment with sales. Financial markets now seem reassured after the major US banks passed the Treasury "stress test" and capital adequacy has been defined.

Early evidence appears to back up these observations with better than expected Q1 corporate earnings. In the recent Fed meeting they noted that the pace of economic contraction is slowing and that households and businesses alike are adjusting to this "new" environment. In addition, the housing market appears to be bottoming, personal savings are on the rise and household spending shows signs of an upturn.

We remain committed to several themes that have served us well. First, a philosophy to invest in industry leading companies with strong balance sheets and cash flows. Second, a recognition that the real anchor to recovery rests in global economic growth. Mature economies such as the US must restore growth, while emerging countries such as China and India are challenged to manage new growth. As always, we continue to look for companies with strong management teams.

In closing, we feel that a sideways market through the end of the year is realistic, but within our selective investment philosophy there are opportunities. We will continue to focus on investments that provide opportunities for both dividends and price appreciation. That being said, we will value a larger cash position than is normally our style and remain cautiously optimistic.

***McCullough & Associates LLC***