Schaper, Benz & Wise
INVESTMENT COUNSEL, INC.

Economic and Market Summary

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After a rocky start, financial markets were strong in 2009 with the S&P 500 index up 26.5%. What is in store for 2010? Although no one knows for sure what the future holds, it may be helpful to remember the old stock market adage that says: "every bull market climbs a wall of worry." We can point to valid concerns about government policies, credit, employment, geopolitical issues, and the pace of the recovery. Much less attention has been directed to the significant strides our economy has made since the recession ended last summer. Aggressive monetary policy has led to dramatic improvement in the functioning of the financial markets, and Federal Reserve officials have yet to indicate any change in their extremely accommodative policy stance. Fiscal stimulus will also remain positive in this election year. The government is planning more programs to boost hiring by businesses, support state and local governments, and increase infrastructure outlays.

Because consumers are increasing savings and reducing debt, growth in consumer spending is projected to be less robust than in prior expansions. Instead, we will likely see an investment led recovery whose components include business investment, inventory replenishment, and homebuilding. Business spending remains 20% below its 2008 peak. Cash-rich companies have the wherewithal to increase investment in productivity-enhancing technology significantly as confidence improves. While firms continue to shed inventories that remain high in relation to sales, a slower pace of liquidation will add to growth in 2010. After 14 consecutive quarters of drag, investment in residential construction was a positive contributor to GDP in the third quarter of 2009. The rebound in housing has considerable upside and has already begun to stabilize employment in housing related industries.

Across the board, employment is running below sustainable levels as jobs were cut severely. Firms are so lean that they will have no choice but to hire additional workers to keep up with rising demand. Caveats to strong job growth include government policies and legislative proposals involving environmental regulation, health care reform, and marginal taxes that threaten to increase costs for business and lower returns on invested capital. Although discussion and enactment of these policies have the potential to limit both job gains and business investment, we believe pent-up demand will outweigh the drag from uncertain government actions over the next year. We expect 2010 GDP growth to be in the 3-4% range.

Global utilization rates of capital and labor remain depressed and have collectively pushed core CPI inflation (ex food & energy) in the developed world down to around 1%. We believe deflationary forces will continue to offset rising commodity and material costs in the near term. However, inflation has the potential to be problematic in the years ahead if banks start lending in a meaningful way the trillions of dollars governments have printed. With unprecedented amounts of stimulus in the system, and execution risk associated with central bank exit strategies, we are cautious on fixed income securities.

Not surprisingly, investors as a whole remain risk averse in the aftermath of the financial crisis. More money flowed into bonds than domestic stocks in 2009, and cash levels remain high. Risk aversion should abate as the economic recovery unfolds, increasing demand for stocks. We remain optimistic regarding the outlook for common stocks due to very low interest rates, benign inflation, and robust corporate profits. Better than expected revenue growth combined with prior aggressive cost reductions will lead to higher profitability. We believe positive earning surprises are in store for 2010, making the valuation of stocks on our coverage list especially attractive and paving the way for continued appreciation in the year ahead.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address below.

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