Schaper, Benz & Wise
INVESTMENT COUNSEL, INC.

Economic and Market Summary
January 2009

Last year will not be easily forgotten. The housing market collapsed, iconic financial institutions went bankrupt, credit seized up, and an extremely volatile stock market struggled to find a bottom. Massive greed combined with too much leverage resulted in severe economic and financial turmoil. We witnessed fear, financial panic, economic carnage, and broken trust. Today, the markets are slowly trying to heal. Recessionary conditions are still with us and may linger for another few quarters despite the likelihood of a large fiscal stimulus plan announced by the new administration, a near 0% federal funds target, and quantitative easing initiatives. In the near term, we should not be surprised to see a further rise in the unemployment rate, pressure on corporate profits, poor consumer sentiment, record bankruptcies, and a continued downturn in manufacturing activity, among myriad other negative headlines. Yet, we look towards the future and see brighter days ahead. On average, the stock market bottoms five months before the recession ends.

Our optimism is predicated on improvement in the housing market. The bursting of the housing bubble had repercussions worldwide, so stopping its downward spiral is vitally important to an economic turnaround. Across the U.S., there are encouraging developments underway. Builders have slowed construction to a pace not seen in 60 years, a time in which the U.S. population was about half of what it is today. Affordability is rising as significant home price declines are combined with lower mortgage rates. With the availability of huge sums of mortgage money guaranteed by the government, mortgage rates have fallen to around 5%. With the 10-year Treasury bond yield south of 2.5%, and a historical risk premium of about 1.5%, it is feasible that long-term mortgage rates could decline to 4 - 4.5%. Help is also on the way for burdened homeowners as nearly 1 in 6 homes are worth less than the mortgage owed on it. Government programs designed to lower mortgage payments, including rate cuts and loan balance reductions, should entice these homeowners to remain in their homes. The result should be fewer foreclosed properties coming to market, further reducing the supply of homes. We should see a better balance between housing supply and demand as the year progresses.

Other positive developments include Obama's proposed tax cuts and lower energy prices. Still, the U.S. economy faces critical headwinds. Consumer spending may remain under pressure for some time as a result of the loss of jobs, a major decline in wealth, the need to increase savings, and the difficulty in obtaining credit. The thawing of credit markets will be important to watch. While there has been meaningful improvement, more time is needed before the world's financial system functions normally again.

The amount of liquidity added to the money supply via bailouts and stimulus plans will invariably lead to inflation down the road. For now, risk aversion and concerns about deflation are keeping Treasury bond yields very low. The government has also made clear that it is supportive of low rates, so these rates could stay low for an appreciable time. Given market expectations of elevated default rates, we perceive attractive value in high quality corporate bonds. The first part of the year for stocks may be challenging because corporate news will continue to be disappointing, and earnings will be under pressure. Longer term, the business fundamentals of the companies we own have strong secular underpinnings making these stocks attractively valued.

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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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