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New President, New Market, New Tactics

Dear Clients & Friends: April 15, 2009

During the first quarter, the U.S. inaugurated a new President and hoped for fresh policies that would resolve the credit crisis and lift the U.S. out of the recession in which we find ourselves.

In his first few weeks, President Obama appeared to underestimate the necessity of stabilizing the U.S. banking system. His first budget presentation to Congress put most of the emphasis on the social programs that dominated his election platform. Although important, this was not what the markets were looking for. The stock market voiced its disapproval by declining 25% through March 9, and some credit markets appeared ready to freeze.

The good news is the administration apparently got the message. In what could have been a coordinated effort, three members of the administration; Bernanke at the Fed, Bair at FDIC, and Geithner at Treasury; all made speeches at the same time supporting the need to stabilize the banking system. A leaked memo from CitiBank and comments from Warren Buffett also pinpointed today's rich profit environment for banks, and helped change the mood.

From the low on March 9th, the S&P 500 index rallied 17.9% to close the quarter 11.7% below where it started the year. As of this writing, the market is up 27% from the March low, and less than 5% below where it started the year. Here is how the markets performed during the 1st quarter:

	1Q
Dow Jones Industrial Average	(13.3%)
S&P 500 Index	(11.7%)
NASDAQ Composite Index	(3.1%)
MSCI EAFE Foreign Index	(11.0%)
Barclay's Aggregate Bond Index	0.1%

Outlook

A big question facing Summit is when to rebalance more money into depressed equity funds. Is the current rally simply a bear market rally that will reverse to an even lower low, or something enduring? Our research sources are still sending mixed signals, which supports continued caution. However, several developments give us hope that stocks will continue the upturn in anticipation of economic improvements by the end of the year.

As we write this letter, the "mark to market" accounting rule that has exacerbated the current crisis at financial institutions has been loosened to allow bankers to use

an appropriate amount of discretion when valuing assets for which no liquid market exists.

In addition, three other initiatives are underway. Increased government spending, an extension of unemployment benefits, and other provisions were mandated by the most recent stimulus package, the *American Recovery & Reinvestment Act of 2009*. The U.S. Treasury has proposed a *Public/Private Partnership* to buy $500 billion of mortgage-related "legacy" assets from financial institutions to remove some of the uncertainty about bank balance sheets. Additionally, the Federal Reserve will purchase up to $1.15 trillion of mortgage backed securities, agency and Treasury securities to inject liquidity into the economy and force down interest rates for new or refinanced mortgages.

A common expectation, and a concern of ours, is such spending will produce excessive inflation. However, we believe that deflation is still the biggest threat today. Threats of higher inflation, interest rates and taxes all loom on the horizon and will require adjustments to investment portfolios in the future. At the end of the day, our job is to assess the potential impact of these changes and adjust our tactics to achieve your investment goals.

Exchange Traded Funds (ETFs)

To that end, we have come to believe that adding ETFs to our equity allocations will improve performance. ETFs are essentially index funds; however, they provide more flexibility and variation than their traditional mutual fund counterparts. Although they began competing with mutual funds in many equity categories about 15 years ago, recent innovations and new offerings have created compelling opportunities for today's portfolios.

We have cautiously observed the behavior of ETFs under both bull market euphoria and bear market stress. The behavior of ETFs within the kind of multi-fund portfolios Summit uses has been convincing. Some of the advantages are:

> <u>Very Low Fund Expenses</u>
> As with index funds, ETF expenses are a small fraction of what you pay for traditional mutual funds. The average annual expenses for a portfolio of equity ETFs is about two-thirds less than traditional mutual funds. That can make a big difference over your investment horizon.
>
> <u>More Tax Efficient</u>
> Mutual fund managers must pass through capital gains when they sell stocks. The specific way ETFs trade allows gain and loss offsets, which may reduce capital gains and improve returns in taxable accounts.
>
> <u>Tradability</u>
> ETFs can be freely bought or sold without exit fees or penalties. Many mutual funds we use prevent or penalize clients who exit funds within specific periods of time. Ten years ago we could trade mutual funds much more freely. Today, the "stickiness" of many funds hinders our response to a changing investment environment.

More Transparent

Mutual fund holdings aren't as transparent as ETFs. ETFs consist of a published index of stocks in a defined equity subsector; usually based on cap size, industry or valuation. Therefore, ETFs help us do a better job of embracing or avoiding certain types of stocks, which may improve your performance.

ETFs aren't perfect, but their disadvantages are manageable. We avoid ETFs that are too narrowly focused or that use leverage. Other things being equal, we believe a portfolio that includes ETFs can perform better than one using 100% actively managed mutual funds.

Why Now?

With all the uncertainty, why is now a good environment to add ETFs? With the markets at today's level, existing mutual funds can be replaced by ETFs without producing capital gains. Clients should also benefit from lower fund expenses. In addition, today's high level of market uncertainty argues for wide diversification and more flexibility.

ETFs may be new to you and your portfolios, but they are in fact an extension of the strategies Summit has always employed. While our underlying philosophies have not changed, we continually adapt our tactics. We will be communicating more with you in the coming months about our use of ETFs. In the meantime, if you have any questions, please contact your Summit financial advisor.

Tax Issues

By the time you receive this, the April 15th tax deadline will be past. We did a considerable amount of work in December to eliminate or minimize your 2008 capital gains. In many cases, we even generated capital losses that can be used to offset 2009 gains, without disrupting your investment strategy. Our goal is to make certain Summit clients are not blindsided by avoidable capital gains and higher taxes, the way some do-it-yourself mutual fund owners are.

Thank you for your faith in us. That is something we say in every letter, but it takes markets like this to reinforce how much we mean it. Be assured we are doing all we can during these uncertain times to chart a prudent course for your investments.