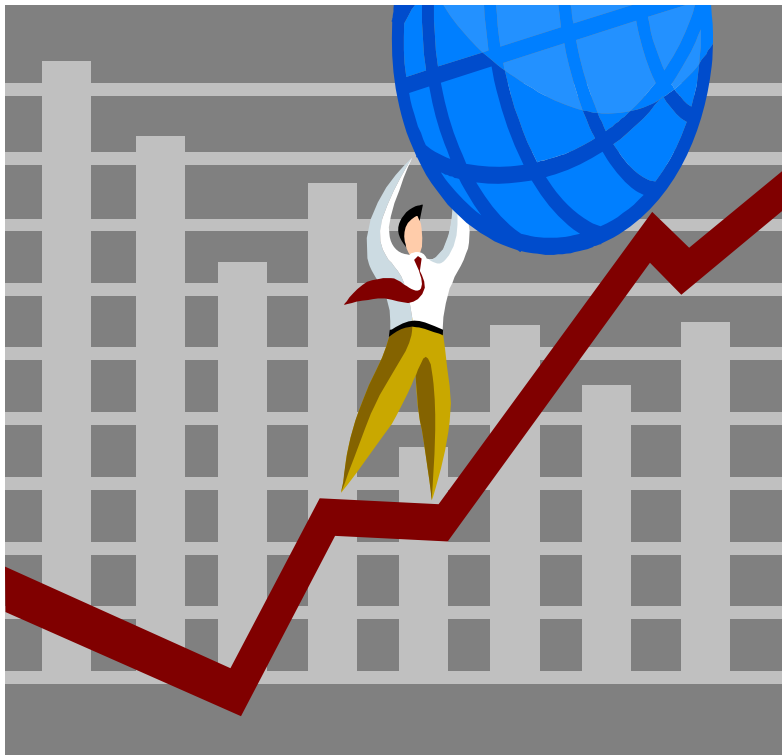


Tug of War

2009 Q2 Quarterly Commentary



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Tug of War

For the past six weeks (through July 19th), markets have been in a trading range between 880 and 956. From our perspective what has happened is that the initial bout of optimism has played out and investors are waiting to get actual confirmation in economic reports and earnings. Over the past week the market has rallied on better than expected earnings and the possibility that unemployment may be improving, or at least steadying. We are hopeful this is the case and think there is the possibility that with GM and Chrysler coming back on line, economic numbers will improve.

But there is a real intellectual tug of war going on, typified by James Paulsen and Ed Yardeni on one side and Bill Gross, Mohammed El-Erian and Paul McCulley on the other. Full disclosure: Paulsen and Yardeni are more equity centric and so are "half glass full" kind of guys whereas the others run PIMCO - the largest bond investor in the world - so they take the "half glass empty" paradigm.

The pessimists say that the world has definitely changed and in a structural way (i.e. long-term). They point out that:

- (1) The financial system is in the process of de-leveraging. This means that less credit is available to both businesses and consumers and will result in less growth;
- (2) A process of de-globalization (think protectionism) is occurring in the world economy whereby countries' politicians enact laws that explicitly favor their own domestic companies and hinder non-domestic companies. This interference in markets precludes businesses from freely choosing what they see as the most efficient processes and also reduces global growth;
- (3) The finance industry as well as many other industries are in the process of being re-regulated by governments. Excessive regulation burdens the private sector as it takes money to comply with regulations and reduces their overall operational flexibility; and
- (4) There is a distinct chance of government overreaching in new spending initiatives - like the new health care legislation - which would have adverse consequences on industry and on the nation's fiscal health.

The optimists point out that:

- (1) A near total and simultaneous collapse of economic activity occurred last year. Even healthy consumers and businesses were frozen with fear. As these fears dissipate, things should improve demonstrably;
- (2) The transmission lag of economic stimulus can be up to a year (which means when the government does create stimulus, it takes upward of a year for the beneficial effects to be felt in the real economy). Given that nearly all the stimulus did not occur until after Lehman Brothers fell in September, then the beneficial impact has not even been felt yet;
- (3) When autos and housing stop their downward slide, they will no longer be a drag on the economy. For example, over the past two years, these two industries have taken off a whopping 1.5% from real Gross Domestic growth rates; and

- (4) Businesses have reduced payroll and expenses so much that they are uncommonly "lean and mean", which means that businesses have much profit leverage - i.e. each dollar of additional revenue goes straight to the bottom line.

Of course, the truth will probably be somewhere in the middle. One point we'd like to make is that in financial markets, as in politics, events rarely follow a straight line. From a real economy perspective, we expect things to continue to muddle through but with an upward bias.

Solid Quarter

The second quarter of 2009 was a beauty. The market, as measured by the S&P 500, went up 15.9% - its best quarterly calendar showing in over ten years and a level that has been bested only five times in the past 30 years.

In discussions with clients in 2002-2003 and again in 2008-2009, regarding how markets behave when they hit bottom and then bounce, we have used a peculiar word to emphasize their nature. We say that markets rally "violently". Of course, they are not violent. But we use that word to underscore the importance of being nimble and not to be closed-minded about the markets' ability to recover when the prevailing conventional wisdom is that the end of the world is at hand... again.

Although we were surprised by the events in 2008, we were committed to protecting and growing our clients' portfolios in this new economic era. So far, I believe we have served you well. On March 9th, when the S&P 500 was down over 25% year to date, our portfolios averaged being down only 9.5%. Further, at that low of the market, our average equity exposure was only 10% so that if an air pocket had emerged - like in the crash of 1987 when the market dropped 20% in a day - our clients would have lost only about 2%. Luckily, this "insurance" was not required, but the bottom line is that at the market low our portfolios were as hard as diamonds.

What is surprising is that given such a risk-averse equity weighting at the low of the market, we should currently be trailing the market's performance, given its recent strong gains. But that is not the case. Due to our nimbleness and our focus we were able to redeploy back into the markets effectively and profitably. We remembered how violent snap-back rallies can be. In fact, as you examine the quarterly reports, recall that the S&P 500 was up 15.9% during the quarter. What may be surprising to you is our firm's performance was achieved with only about a 45% overall stock exposure. As I think you will see, this more conservative stock exposure, which would have benefited us if the markets had turned down again, did not stymie overall quarterly performance.

I'd also like to point out that the Weyland's performance over the past year has beaten the "smarty pants" at Harvard, Yale, Princeton and Stanford. We compare ourselves to them because we run our portfolios similarly, investing in many of the same asset classes (emerging market equities, emerging market debt, commodities, gold, REITS, etc.). As a firm, our return net of all fees for the twelve months ended June 30 was down 16.3%. This compares very favorably with these leading university endowments, as most were down 30%.

Investing for the Long-Term

I'm pleased to say that Weyland is a smoke-free firm now. Frank and I have both quit cigarettes for six months. Further, we are both on diets and are really shedding it. Talking about lean and mean... Seriously, a number of clients over the past few years have taken us aside and mentioned that they would like to see us quit cigarettes. I really appreciate their forthrightness and can say that they made the difference. Now Weyland is truly ready to invest for the long, long-term.

Bob Henkel

Chief Investment Officer

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