Economic & Market Outlook

- Recent estimates from the Commerce Department indicate U.S. GDP declined 3.8% in the fourth quarter of 2008, the largest percentage decline in 26 years. Rising inventories of goods in supply chains helped to avoid a lower number, but that inventory overhang may stifle GDP growth in early 2009.
- Looking ahead, we expect the global economy to contract over the next several quarters, with U.S. recovery coming in late 2009 or possibly early 2010.
- Due to the slowing economy, unemployment is approaching 7.5%. Layoff announcements have become a daily occurrence, and we expect the level of unemployment to rise even higher in the coming months.
- Federal Reserve officials cut interest rates to historic lows at the December 2008 meeting. The Fed is now targeting rates in the range of 0%-0.25%. The Fed has indicated rates will continue to stay low for an extended period of time.
- At the most recent meeting, the Fed indicated heightened concerns about the deflationary trends occurring in the U.S. economy. A prolonged downtrend in price levels could stall recovery by making it harder for consumers to pay off debts and banks less likely to lend.
- The Fed extended all of its various lending facilities to October 2009. Previously the end date was April 30.
- The 2009 Stimulus Bill has passed the House, and is currently being debated in the Senate. The bill is expected to be signed by President Obama in mid-February. Once completed, the size of the package will likely approach $1 trillion, pushing the Federal deficit close to $1.5 trillion, equal to 10.4% of GDP.
- The U.S. stock market experienced the worst January on record, with the S&P 500 registering a -8.43% return. Stocks were down worldwide as well, with the Morgan Stanley EAFE International Index down 9.81% for the month.
- With Treasury yields falling, the dividend yield on the S&P 500 now exceeds the yield on the 10-year Treasury, a relationship not seen since the late 1950s.
- We believe the equity markets can achieve better returns in the latter part of this year compared to the first half of the year, as investors anticipate an improving economy. Overly optimistic expectations of a quick revival of the U.S. economy starting the year dimmed and expectations will have to remain muted for the next several months.
- Within the equity markets, we remain fully diversified but continue to prefer domestic stocks over international stocks, large cap over small cap and growth over value on a relative basis. Returns in January followed this hierarchy.

Economic & Market Outlook

- We believe stocks of high quality companies with less exposure to problems in the credit markets should do relatively well in a slowing economy. Companies with significant international sales should benefit if the dollar weakens. We remain conservative and defensive in nature.
- With short-term rates reaching a bottom, we expect longer-term yields will decline as well over the next 6-12 months, due to weakness in the U.S. economy. Beyond that, we expect Treasury yields to rise due to additional Treasury borrowing and glimmers of an economic recovery. The Federal Reserve's threat to buy long-dated Treasury bonds to keep rates low may mitigate the size of the yield increase. Meanwhile, money market yields will likely remain near zero for all of 2009, based on the Fed Funds futures market forecast. We believe investors are better off purchasing intermediate-term non-Treasury bonds with significantly higher yields than waiting in money market for the Fed to hike rates.
- We expect low single digit returns from Treasury securities and mid-to-upper single digit returns from U.S. corporate, municipal and MBS securities in the next 12 months. We favor taxable municipals with A or better underlying credit ratings, selected corporate bonds, agency mortgage-backed securities with premium coupons, and AAA-rated agency bonds with good call protection.
- In tax-exempt municipals, a strong rally in January has reversed much of the fourth quarter sell-off that was fueled by Wall Street illiquidity. We continue to buy and hold bonds with investment grade underlying credit ratings, independent of the bond insurers' status, and see value in the 11-20 year part of the curve, as the 0-10 year segment is crowded with more buyers than sellers.
- We encourage investors to stay focused on their long-term goals in the midst of this current market volatility. It is especially important to stay diversified and to reaffirm that our clients' current asset allocation is consistent with their long-term goals. We advise clients to remain cautious toward risky assets with time horizons less than 3 years.

Products offered through Bremer Trust are not FDIC insured, are not a deposit or other obligation of, or guaranteed by, the depositing institution, and are subject to investment risk including possible loss of principle amount invested. This report has been compiled using data and other statements of fact derived from sources which we believe to be accurate and reliable. However, such data and other statements of fact have not been verified by us, and we do not make any representations as to their accuracy or completeness. Any opinion expressed herein reflects our judgment at this date and is subject to change.