AR SCHMEIDLER & CO
INVESTMENT ADVISORS
A Hudson Valley Bank Company

The Outlook

May 28, 2009

As of 5/28/09		
Index	**Market Value**	**YTD % Change**
Dow Jones Industrials	8403.80	-4.2%
S&P 500	906.83	0.4%
Nasdaq Composite	1751.79	11.1%

This distinct economic environment is presenting a rare investment opportunity for investors to build capital and protect purchasing power. Our investment work continues to be focused on the beneficiaries of a weaker U.S. dollar and stronger economic growth in the emerging economies, including China and India. The recent election in India, a country with a population of approximately 1 billion people, could represent a sea change for that nation and its impact on the global economy. When combined with China's continued development as a world economic power, these two countries could be key drivers of the eventual global economic recovery. In contrast, the developed economies will continue to weigh heavily on global growth.

In the developed world, banks with impaired balance sheets have curtailed lending, while over-leveraged consumers have cut back spending. The normal capital flows have slowed to a trickle, and the world's central banks are now providing monetary stimulus to restore capital flows and create economic improvement. After bringing short-term interest rates down to their lowest possible levels, the Federal Reserve, other central banks and governments have initiated no fewer than 640 policy initiatives including tax cuts, industry rescues, housing subsidies, infrastructure programs and other stimulus programs. The United States has already committed to finance or backstop nearly $12 trillion, which is equal to 85% of Gross Domestic Product. **It is clear that governments and central banks around the world will do whatever it takes to stimulate the global economic system to restore growth.**

As we have written since last December, a select group of equity securities and corporate bonds will continue to be beneficiaries of these government initiatives. **The areas of focus for equity portfolios continue to be agriculture, energy, materials, precious metals (particularly gold), healthcare, infrastructure, transportation and defense companies. In the corporate bond area, we remain focused on investment-grade issuers with an emphasis on maturities in the 1-4 year range.**

The Impact of Monetization

The Federal Reserve is engaged in a delicate balancing act of attempting to stimulate the economy without swelling the deficit, creating excessive inflation or causing interest rates to rise too far too soon. To date, the Federal Reserve has committed

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nearly $1.4 trillion to quantitative easing (QE), essentially printing money and using it to purchase treasuries, mortgage bonds and other securities. The goal of QE is to pump liquidity into our economy and attempt to keep interest rates low. Federal Reserve Chairman Ben Bernanke has said that once the economy shows signs of improving, there will be sufficient time to withdraw money from the system to prevent excessive inflation. However, that balance may prove easier said than done. The difficulty of achieving the right balance is compounded by continued rising unemployment which will pressure the Federal Reserve to keep rates low. Another growing problem is the deterioration of state and local government budgets resulting in the states appealing to the federal government for financial assistance which, if granted, can further increase deficit spending and put additional downward pressure on the U.S. dollar.

In response to the economic crisis, a record supply of treasuries will be issued to pay for a mounting budget deficit which the Congressional Budget Office recently estimated at $1.84 trillion. In total, including refinancings, the U.S. Treasury will issue a record $3.25 trillion of debt for the fiscal year ending September 30th. **This anticipated massive issuance along with the record debt is putting downward pressure on the dollar and is making U.S. treasury securities less attractive to foreign investors.** The dollar index which tracks the U.S. currency vs. the Euro, Yen, Pound, Swiss Franc, Canadian Dollar and Swedish Krona has fallen more than 11% from its high this year reached on March 4th.

The United States is in the fortunate position of having its dollar as the reserve currency of the world and therefore its dollar debts can technically be discharged by simply creating more dollars. This solution is very tempting for it reduces the value of its debts in real terms, but the invariable result will be a devaluation of its currency. A devalued dollar weakens other nations' competitive trade positions thereby forcing their central banks to create more of their currencies to offset the trade disadvantages of the weaker dollar. England's monetary creation contributes to its weakening currency, is aimed at keeping its interest rates low and is intended to stimulate its economy. At the same time, the European Central Bank (ECB) is feeling similar pressure because the European economies have been contracting and their unemployment has been rising.

The developed nations are experiencing record and rising budget deficits leading to downgrades and the potential for additional downgrades. As a result, the cost of financing these deficits is rising. Standard & Poors (S&P) indicated that they may cut Britain's AAA credit rating as debt heads toward 100% of GDP. Next year Britain's debt will be 67% of GDP according to the IMF, the United States will be at 70% and the 16 nation Euro area will be at 68%. According to the Independent Institute for Fiscal Studies in London, rising debt costs will eventually crowd out funds available for roads, schools and hospitals.

Since there is no tangible asset backing any country's currency, central banks are monetizing these deficits (printing money). This is contributing to raising the prices of vital and globally traded materials needed for economic growth and industrialization, such as oil and copper. We are also witnessing a continued increase in the price of gold which has appreciated over several years and is increasingly being viewed as a store of value.

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Investing, Borrowing and Productive Capacity

As a result of the global recession, the world is seeing a growing divergence in the emerging economies and developed economies as well as in the creditor nations and debtor nations. This means that countries addressing the problems of their own recessions or slowdowns are approaching it from very different perspectives. **When a country invests money it already has to stimulate its own economy, it increases its productive capacity and therefore strengthens its currency.** As the largest creditor nation, China is the single best example. **When a country creates money it does not have to stimulate its economy without increasing its productive capacity, it increases its debt and weakens its currency.** The U.S. as the largest debtor nation is in this category as is the United Kingdom and many European nations.

The Implications for Investments

The impact of the massive monetization efforts by various governments is having a fundamental bearing on investment policy. Since capital ultimately flows to the highest rate of return, U.S. pension plans that are underfunded and holding large cash balances raised during the recent market decline are under increasing pressure to earn higher returns. There is a record level of cash held by other market participants earning virtually nothing, and there is a growing need to get this cash invested as well. The dimensions of this are striking when one realizes that the equivalent of 50% of the U.S. GDP or $7 trillion is sitting in cash and cash equivalents. These assets will lose purchasing power and opportunity. At the same time, the companies that are the beneficiaries of this outlook should appreciate in value. **These beneficiaries are companies that are positioned to prosper from currency creation, stimulus programs, advancing technologies and increasing trade to satisfy large populations' growing demands for higher living standards.**

In a difficult economic environment, it is critical to invest in needs first as any increase in consumption will initially go to the areas of greatest importance. Among these are food, energy, infrastructure, defense, healthcare and increased productivity. Investors should be best served by remaining disciplined in identifying undervalued assets in each of these areas. With respect to fixed income securities, we continue to emphasize the importance of shorter-term maturities among investment-grade issuers and will continue to be selective in the use of treasury securities.

The development of a two-tiered market should not be a surprise where the beneficiaries become standout investment opportunities irrespective of broader market returns. This is true in both equity and fixed income investments as evidenced by the experience of 1973-1980. **This is an environment for thoughtful security selection in a more complex global environment.**

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