

ECONOMIC AND MARKET OUTLOOK SECOND QUARTER 2010

Consumer expectations are underestimating the strength of the economic recovery. Until recently inventory rebuilding and stronger capital spending have been the primary ingredients of the domestic recovery. It is becoming increasingly evident that surging exports, rising business investment and improved consumer spending are all contributing to this growth. Moreover the economic expansion now underway has a powerful international dimension. Economic growth of emerging nations has resumed, a trend that was submerged for a time by the financial collapse of developed countries, but never extinguished. The development needs of emerging nations are truly immense. We believe the U.S. is on the threshold of an extended period of vibrant economic growth driven by a broadening out of the domestic expansion and strong overseas demand for U.S. goods and services.

The economic data for the first quarter are fogged up by the extreme weather affecting most of America especially in February. Nevertheless underlying trends are very positive. The domestic economy is on a firm path to show steady growth over the next several quarters and potentially beyond. Past recoveries from recession were led by the consumer. Things are different this time. A weak labor market is holding consumption below historical recovery levels. In the present environment the business sector is taking the lead. A strong inventory rebuilding cycle is underway, accentuated by the extraordinary depth of inventory retrenchment during the recession. Growing optimism among corporate managements is evident in the increasing strength of business spending. Orders for durable goods, a very broad category encompassing everything from semiconductors to heavy machinery, increased in January and February. Regional manufacturing surveys indicate the improvement is continuing in March, and substantiates a solid recovery in business capital spending.

The surge in exports is adding to business confidence in the durability of the recovery. Over the past several quarters exports have grown at double digit rates and the fastest pace in thirty years. The increase has been broad based with industrial supplies and capital goods prominent among the leaders. The rapid growth of such vast and populous underdeveloped nations as Brazil, China, India, Indonesia and others, strongly suggest that exports will be an important driver of economic activity going forward. U.S. business is in a powerful competitive position to supply the legitimate needs to these countries.

Judging from improving trends in new claims for unemployment insurance and a record number of temporary hires, a rise in employment is not far off. The improvement in new jobs is likely to be most notable in the manufacturing sector, the area which suffered the most from the recession. Other indications of improving

economic conditions are surfacing. Recent data show that consumer credit is growing modestly again after record declines in 2008 and 2009. Retail sales have been surprisingly robust and could provide a broad additional lift to economic activity if the early signs of improvement are sustained. Overseas, there has been encouraging news out of the euro zone countries, primarily Germany and France, and in Japan, where exports have turned dramatically upward. There are increasing signs of a synchronized world wide growth phase emerging from the ashes of the terrible recession.

We recognize that it will take time to absorb the 8.4 million jobs lost since the recession began. We firmly believe, however, that the U.S. economy has embarked on a new expansion phase and the spreading advance holds the real possibility for longevity and upside surprises. Corporate profits are likely to remain strong in this environment and the stock market will be the major beneficiary, in our opinion. Still, there are a growing number of issues which carry serious consequences for our national well being, and for which there is no clear outcome. Trade and taxes are unresolved and the enormous level of government spending and debt must be addressed for a healthy private sector to function effectively. A new regulatory framework is still under construction, and the outcome will affect the soundness of our financial markets for years to come. These and other issues impart an unusual level of uncertainty and risk to the current environment. They will need to be assessed carefully for their impact on our national health and growth prospects.

Investment Policy Committee
Alfred A. Lagan, CFA, Chairman
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March 29th, 2010

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