

### Summary

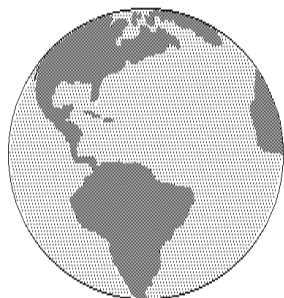
- The market gave us both qualified “bear market” declines and “bull market” advances in the first quarter.
- The S&P 500 fell 11.0% for the quarter and is down 37% since the beginning of 2008.
- Stocks in the financial sector continued to be hit hard. Financials were down another 29% while REITS dropped over 30%.
- The U.S. dollar strengthened, causing overseas investments to lose value for American investors. Despite outperforming in local currencies, international investment returns were weaker than U.S. benchmarks due to the currency values.
- Emerging market stocks returned +1.0% for US investors while rising 4.2% in local currencies.
- Alternative investments produced mixed, though generally positive results this quarter.
- Bonds generally enjoyed positive returns this quarter.

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Being in a new year did not stop the market’s volatile run. A “bull market” is defined as a 20% rise in stock values and a “bear market” is a 20% fall, and the first quarter of 2009 delivered both. From January 6<sup>th</sup> to March 3<sup>rd</sup>, the S&P 500 fell by 27.6%. From March 9<sup>th</sup> to March 26<sup>th</sup>, it rose 23.1%. Even after the best one month gain in more than six years, the quarter finished with double digit losses in most sectors. The Dow Jones Industrial Average lost 12.5%, the



average lost 12.5%, the S&P 500 lost 11.0% while the tech heavy NASDAQ lost 3.1%. Bonds and some of the holdings in the alternative category did better this quarter and offset some of the market’s losses with gains of their own.

While investor sentiment can never be fully explained, the market’s first quarter fall was spurred by some jaw dropping statistics released during the quarter:

- US Gross Domestic Product (GDP) fell by an annualized rate of 6.3% in the 4<sup>th</sup> quarter of 2008, the worst quarter since 1982. Initially estimated at -3.8%, GDP was later revised downward as more data became available. The original forecast drastically underestimated the extent to which consumer spending would contract – leading business to further slow production and reduce excess inventory.
- Corporate earnings for 2008 fell 40% from 2007. Massive writedowns by financials and a poor economic environment contributed to the truly extraordinary drop.
- Since the recession was declared in December of 2007, over five million jobs have been lost, swelling the unemployment rate from 4.9% to 8.5%. Over 2 million jobs were lost just during the first quarter of this year.
- Nationally, year-over-year home values fell an average of 19%. While not all regions have been impacted equally

(Northern California fell 32.4% while the best performing area, Dallas, is only down 4.9%), home values in all areas of the country have fallen.

- With market losses and falling real estate values included, more than \$50 trillion of global wealth was lost over the last 18 months.

March finally brought a market rise, which was a welcome respite after the seemingly relentless declines of the preceding months. In part, the run up appears to have been inspired by investor perception that stocks were beginning to be too cheap to ignore. More importantly, the government signaled its commitment to combat the most dramatic impacts of this recession with its unprecedented measures to stimulate the economy and continued support of the credit markets. The range of governmental actions included:

- The Federal Reserve took two primary paths to keep interest rates low and thereby encourage economic activity. Its Federal Funds rate stayed at a record low of 0%. Additionally, the Fed began buying 30 year Treasury Bonds, in an effort to lower the interest rate on long term debt and bring down the cost of mortgages. As a result, on March 26<sup>th</sup>, Freddie Mac reported that its average 30-year fixed mortgage rate had dropped to 4.85%—the lowest in the history of its rate survey, which dates back to 1971. While nearly 80% of the applications were for refinances rather than new home purchases, according to the Mortgage Bankers Association, this was still considered a positive, as lower payments will free up cash for consumer purchases.

- Treasury Secretary Tim Geithner released his long awaited plan for removing toxic assets from bank bal-

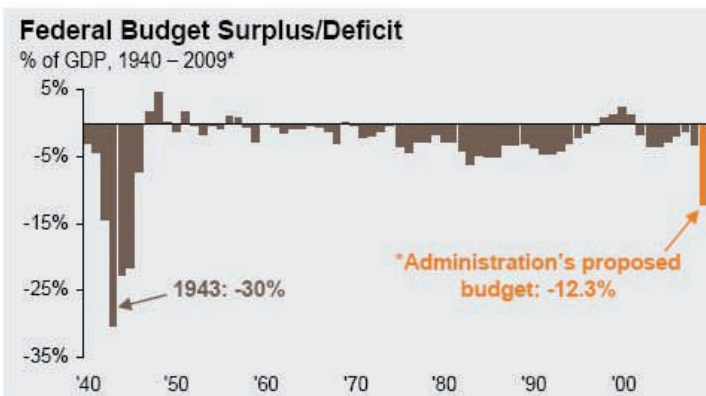
ance sheets, what he called “The Public-Private Investment Partnership.” The plan pools public, taxpayer investment money with private investors. If the purchased assets go down in value the government (taxpayers) will absorb the majority of losses but if asset values go up, the gains will be prorated and distributed. While this clearly puts taxpayer money at risk, it is intended to improve the capital position of banks and ultimately continue to free up credit. There is at least some opportunity that taxpayers might not only be fully repaid but possibly even make a profit on the venture.

- Congress passed President Obama’s aggressive stimulus package, which will slowly begin to fuel the economy. Lower tax revenues and the increased costs associated with the stimulus plan will both contribute to a projected record federal budget deficit of 12.3% of Gross Domestic Product (GDP). While the change in federal priorities has the support of many, the fear is that the heavy deficits involved will become institutionalized and over time cause a steady erosion of U.S. financial strength.

- Quietly, on April 2<sup>nd</sup>, the Financial Accounting Standards Board (FASB) significantly modified the “mark-to-market” rule in an effort to aid financial institutions. The old rule required companies to “mark-to-market” their investment assets not expected to be held until maturity. This meant banks were required to value their sub-prime and other “toxic” loans at exaggeratedly low prices—what a willing buyer would pay for them at the time. Without a market for these assets, loans and other bank securities had to be valued at a level well below what banks believed they would actually be able to recover. The new rule relieves much of this pressure. As a result, bank capital levels will be higher and their net worth improved. If successful, the rule change should help financial institutions stabilize their balance sheets. In turn, banks will be expected to increase their lending to businesses and consumers. Many analysts expect this to have a positive impact on US financial institutions’ reported earnings.

## U.S. Stocks

Given their role in the global recession, financial stocks have taken the biggest hit during the market downturn. Financials were the worst performing sector in the first quarter of 2009 losing 28.8%. They are



down 73.9% from the October 2007 high.

“Value” investing traditionally focuses on stocks that are considered “cheap” — often companies that have been hurt by economic trends and are out of favor. In contrast, “growth” investing typically looks for companies showing attractive earnings trends—companies seen to have a bright future. As we’ll discuss further, value investing has achieved superior returns relative to growth over time. Nonetheless, the Russell 1000 Value index lost 16.8% during the first quarter as compared to the Russell 1000 Growth index, which was down only 4.1%. This differential is not entirely surprising given the steep decline in Financials, which currently make up roughly 20% of the Russell value index .

While small stocks can be expected to outperform larger stocks over time, in the first quarter, large cap stocks outperformed smaller stocks. Small cap stocks, represented by the S&P 600, lost 16.8% compared to an 11.0% loss for the large cap S&P 500 Index. Despite the higher returns expected with time, in the current environment, investors have been less willing to take on the risk of holding smaller company stocks and prices have declined accordingly.

The investing world’s caution also affected REITs in the first quarter (and over the prior two quarters). A unique and critical aspect of REITs is that they are required by their legal and tax structure to distribute a majority of their operating income. For REITs to grow—to buy new properties or remodel old buildings—they must borrow heavily, causing them to take on more debt than most businesses. The continuing constraints in the credit markets are still making it hard for many REITs to rollover their existing loans or to obtain loans for new opportunities. In addition, as business fail or jobs are lost during this downturn, the demand for commercial real estate has weakened. These factors and their expected impact on REIT profits caused REITs to decline 31.2% during the quarter.

One positive note for REITs also involves a special regulatory rules change. For the

time being, REITs are being allowed to distribute equity (new stock) in lieu of paying cash dividends. While this dilutes the value of current shares, the ability to retain additional cash will help many REITs weather this financial storm.

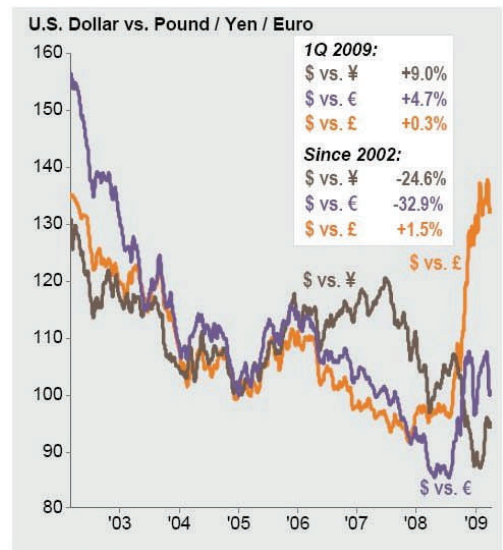
### International Stocks

Since last summer, the “flight to quality” went beyond just impacting U.S. stocks and bonds. International investors fled to the safety of the dollar, the world’s traditional reserve currency. This created a an additional challenge for many foreign investments. During the quarter, the dollar gained nearly 5% against the Euro and more than 9% against the Yen. Without the impact of currency, overseas investment results would have been better than those in the U.S. After accounting for currency, international investment results were worse. The MSCI EAFE Index (Europe, Australia and Far East Index) is the best representation of international stocks. Measured in dollars, the index lost 13.9% for the quarter but was down only 10.0% in local currency (somewhat better than the S&P 500’s – 11.0%). Similarly for small company stocks, the MSCI Small Cap Index declined 9.5% for US investors, but only lost 4.9% in local currency.

Europe and Japan face very different problems. At the end of last year, the Japanese Yen was appreciating, making Japanese exports more expensive. With global consumer spending drying up at the same time Japanese exports were falling, Japan’s GDP fell 12.1% in the fourth quarter of 2008. The

1Q09	
MSCI EME	1.0%
EAFE Small	-9.5%
S&P 500	-11.0%
EAFE Growth	-12.3%
MSCI EAFE	-13.9%
EAFE Value	-15.5%

1Q09	
Mid Growth	-3.4%
Large Growth	-4.1%
Small Growth	-9.7%
Mid Value	-14.7%
Large Value	-16.8%
Small Value	-19.6%



OECD predicts that the Japanese economy will fall 6.6% in 2009. By contrast, Europe's primary problem has been the divided structure of the European Union governments. This has made it virtually impossible to establish a consistent response to the global economic problems. Despite their problems, economic growth and unemployment numbers have been better for most European countries than for either the United States or Japan.

Emerging markets were a bright spot this quarter as they were one of the few asset classes to produce a positive return. Reflecting a similar currency impact relative to the dollar, emerging markets stocks returned 1.0% for US investors while rising 4.2% in local currencies.

The suffering from this recession has been global in nature. This is exemplified by the IMF's prediction that for the first time since World War II, worldwide GDP will shrink. Even so, many emerging markets have been able to continue to grow their economies, albeit at a slower rate. China, in particular, with its own \$500+ billion stimulus package, has continued to find ways to grow, while India has not been far behind.

After having to worry about deflation at the end of 2008, economists were happy to report inflation growing at 0.3% for January and 0.4% for February. However, longer term concerns about inflation abound as the US government continues to pump dollars into the economy. China, a large holder of US treasury bonds, was concerned enough about US inflation and how it might erode the purchasing power of their dollar denominated assets, to publicly question the United States' fiscal policy at the G20 Summit meeting. We believe inflation is likely to become a problem longer term, requiring explicit strategies in investment portfolios.

## Bonds

The Barclays Aggregate Bond Index continued to outperform its equity siblings (i.e., bonds did better than stocks). While equities saw investors continue to prefer more conservative stocks, fixed income saw an increased demand for some riskier bond asset classes. Emerging market debt, municipal bonds and high yield bonds all bounced back in the first quarter returning 4.8%, 4.2% and 6.0% respectively.

Corporate bonds unfortunately did not experience

a similar return of investor confidence as investors remained worried about companies' ability to repay debt. This left corporate debt spreads (the difference between corporate debt and treasury bonds) at historically very high levels, causing corporate debt to fall 1.9%.

Warren Buffett warned in his 2008 investor letter that last year (2008) would be known for not only its commodity bubble but also its treasury bubble. True to form, the safest of fixed income asset, treasuries, lost value in the quarter, declining 1.3%.

An important part of our bond approach includes Treasury Inflation Protected Securities (TIPS). These are specifically designed to protect investors against inflation and still provide a positive return. After generating negative returns in 2008 due to fears of deflation, TIPS performed well in Q1, returning 5.5%, as those fears diminished.

## Alternatives

As you will recall, we employ Alternative investments to provide positive long term returns but often not at the same time or for the same reasons as stocks and bonds. This provides a positive diversification effect. We didn't see this benefit in 2008, but Alternatives did help for the most part in the first quarter of 2009.

Though down considerably less than equities in general, commodities continued to decline as the Dow Jones-AIG commodity index lost 6.3%. This decline was moderated in most Mosaic portfolios as the PIMCo commodity real return fund lost only 0.9% in the first quarter (the fund benefited from using TIPS as the collateral for the commodities investing). We believe commodities are important long term component to our portfolios, given their significant diversification benefit and their ability to do well in periods of higher inflation.

Plum Creek Timber lost 23.4% in Q1 of 2009 as investors sold anything that had anything to do with home construction.

With minimal activity on the merger front, the Merger Fund returned +2.5%.

Exposure to emerging market debt and currencies (PIMCO Local Markets) had to fight against the rising value of the dollar to produce a return, and finished down 3.9%.

Lastly, the PowerShares currency long-short fund

provided a positive return of 5.7% for the 1<sup>st</sup> quarter.

**A Comment on Mosaic Investment Results**

As you know, Mosaic emphasizes a certain approach to investing. We emphasize globally diversified portfolios that are oriented toward smaller company stocks and a value style of investing. Over the last year, this orientation contributed to a underperformance relative to other choices we might have made. For sake of transparency and to help you understand our thought process, we thought it might be useful to review our approach, how this style of investing performed and what we think about it. We invite your questions should you like to know more.

Academic research has clearly established that over longer periods of time, value investing (buying things when they are out of favor and therefore “cheap”) produces better results than growth investing. Similarly, research suggests small company stocks have higher expected returns than stocks of large companies. We therefore seek to tilt our investment holdings toward value and smaller company stocks.

Along with our orientation to value and smaller companies, we believe that with the majority of the world’s market capitalization (55%) residing outside the U.S., over the long run, it is essential to have a global orientation in our portfolios. We believe having a rough balance between U.S. and non-U.S. investments (e.g., 50/50) will provide better diversification and better investment opportunities. Finally, we believe that investment real estate (which excludes your home) is an important contributor to portfolio diversification and growth, and needs to be a dedicated portion of your portfolio.

Any particular theme in the investing world will enjoy periods of excess success and other periods in which the alternative choice would have been better. Over the last 18 months, the way in which we orient our portfolios has led us to underperform on a relative

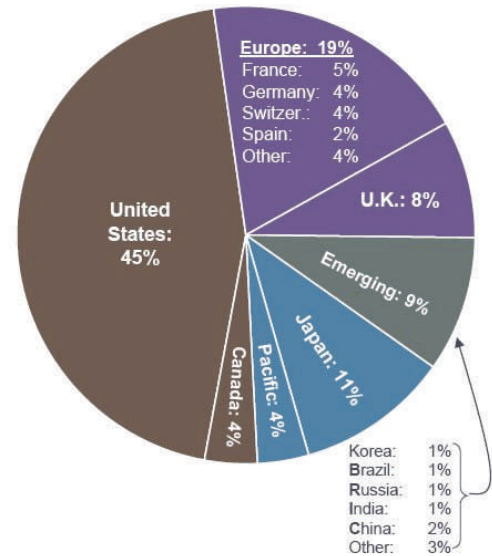
basis. That said, we continue to believe that our portfolios are strategically well positioned for the future.

Value vs. Growth. In most of our portfolios, we weight most sectors 60%

value and 40% growth. The first three months of 2009 have not been kind to value investors. As the economy began to experience difficulty, value stocks began to be viewed as distressed rather than desirable (and in some cases this is a fair assessment– think autos and financials). Over the last year, the Russell 1000 Growth index outperformed its value counterpart by 8.1%. Over longer time periods however, value has outperformed: Over the last 10 years value outperformed growth by an annualized rate of 4.6%. Over 20 years, value has been better by 0.2%.

Why do we believe that value will continue to outperform growth over time? Simply stated, high growth companies are rarely able to sustain such growth rates over extended periods. The high prices that investors pay for the promise of growth often goes unrewarded. In contrast, value stocks are often those that are distressed and out of favor. On an individual basis, a value company may indeed fail. But taken as a group, study after study has demonstrated that with reasonable consistency, these distressed and out of favor companies do pull through and reward investors

Weights in MSCI All Country World Index

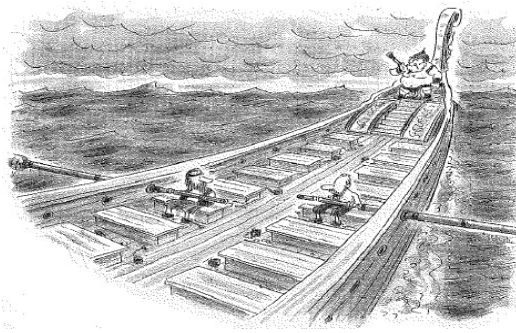


with returns greater than those generated by their growth stock brethren. While relative performance does not always favor value (e.g., 2008) we do expect this long term relationship favoring value to continue.

	Q1 2009	1 year	10 Year	20 Year	30 Year
Russell 1000 Growth TR USD	-4.12	-34.28	-5.26	6.85	9.3
Russell 1000 Value TR USD	-16.77	-42.42	-0.62	7.68	10.8
S&P 500 TR	-11.01	-38.09	-3	7.43	10.32
S&P SmallCap 600 TR	-16.84	-38.06	4.24	7.85	N/A
MSCI EAFE GR USD	-13.85	-46.2	-0.47	2.7	8.77
FTSE NAREIT Equity REITs TR	-31.87	-58.16	3.89	6.8	10.09

**Small vs. Large:** Along with a value orientation, we have also oriented our portfolios toward smaller company stocks. Although small company stocks are more volatile (risky), over longer periods of time this asset class has achieved higher returns than larger company stocks. Investment risk and return are linked. Investors do demand higher expected returns if they are going to take on more investment risk. Smaller companies are in greater danger of having insurmountable problems than larger companies—they are at greater risk of failure. As a result, traditionally smaller company stocks offer the chance for a higher rate of growth. But they are also more volatile than larger companies because they are less able to deflect the impact of economic movements. Small stocks (in the chart on the prior page, the “S&P SmallCap 600”) underperformed large company stocks (the S&P 500) in the first quarter of 2009, but slightly outperformed against larger stocks over the last 1-20 years. Going as far back as data is available, small stock returns average about 2% greater than large stock returns. It didn’t happen in Q1, but we believe that trend has a good rationale behind it and will return.

**International.** Mosaic does not fully weight international equities to their 55% global allocation, but we do invest in them more than most other advisors. At the end of 2008, the US stock market’s capitalization as a percentage of the world market was 45%. In our portfolios, we recommend an equal weighting of US and international equities. Over the last year international investment fell more severely than US holdings - not because international companies underperformed, but because of the relative strength of the dollar. Relative strength in currency ebbs and flows. In the late 1990s, the dollar was strong. For most of the current decade, it has been relatively weak. We believe that once the current crisis has passed, this “natural” ebb and flow will resume and exposure to international companies will benefit our portfolios. In addition, while it doesn’t always work this way, a truly global portfolio generally provides increased diversification and thus lowers portfolio volatility.



*“At this point, I’m just happy to still have a job.”*

**Real Estate:** Finally, Mosaic also recommends a meaningful allocation to publicly traded real estate (Real Estate Investment Trusts). Real estate as an investment class has historically provided significant diversification in a portfolio. Over many time periods, REITs have served to moderate the volatility of stocks while providing positive long term returns (for example, in the market downturn of 2000 – 2002, REITs generated meaningful positive returns that helped buffer the losses experienced in U.S. equities). Although the last 18 months have tested our resolve, we continue to believe real estate will be a positive contributor to our portfolios over time.

While Mosaic portfolios underperformed on a relative basis over the last 15 months, this is largely attributable to the allocation choices we have employed and we believe is only a temporary disadvantage. We believe the orientation we’ve built into our portfolios is strategically sound and will contribute to positive portfolio growth in the years ahead.

### Looking into the Future

Forecasting is always fraught with danger. That said, we think certain themes are likely to occur over the next few years. In

no particular order:

- As U.S. government spending continues to exceed revenues, inflation will become a more significant problem.
- If U.S. inflation rises, it is likely that the relative value of the U.S. dollar will decline.
- With markets at their former high levels, stocks were unlikely to see attractive returns for several years. As a result of the substantially lower price levels today, the potential for attractive stock returns has improved substantially.
- Once past the current crisis, emerging market countries are the most likely to see high rates of future economic growth.

Thank you for allowing us to serve you.

Mosaic Team