Market Watch
2nd Quarter 2009

MOSAIC FINANCIAL PARTNERS, INC.
a Wealth Advisory firm

Summary

- This was an excellent quarter for the markets across the board, after six difficult ones.
- Large U.S. stocks (the S&P 500) rose 15.9% in the quarter.
- Small company stocks (Russell 2000) jumped 20.7% this quarter.
- The U.S. dollar weakened, helping overseas investments to gain value for American investors. Large non-U.S. companies gained 25.9% and smaller companies were up even more.
- REITs were up 8.9% this quarter.
- Emerging market stocks returned roughly 35% and were the winning sector for the quarter, once again.
- Alternative investments produced broadly positive results, with commodities up 15.5% and local market currencies up 15.8%
- Bonds generally enjoyed positive returns this quarter.

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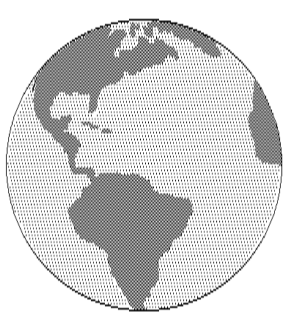


What a difference a quarter makes! After six consecutive quarters of negative returns, the market found a floor in March and bounced back. 'Green shoots' of economic recovery began to surface in several areas of the economy and the markets responded. While the investment landscape continues to be extraordinarily volatile, it appears that things in the economy are becoming 'less bad'. The direction of the markets will ultimately be determined by the direction of the economy.

Almost all asset classes did well this quarter. The S&P 500 finished up 15.9% for the second quarter and up 36.9% since the market low on March 9th. With that jump, that primary index for the U.S. markets is up 3.2% for the first half of the year. The Dow Jones Industrial Average and NASDAQ both finished up strongly for the quarter, rising 12.0% and 20.1%, respectively.

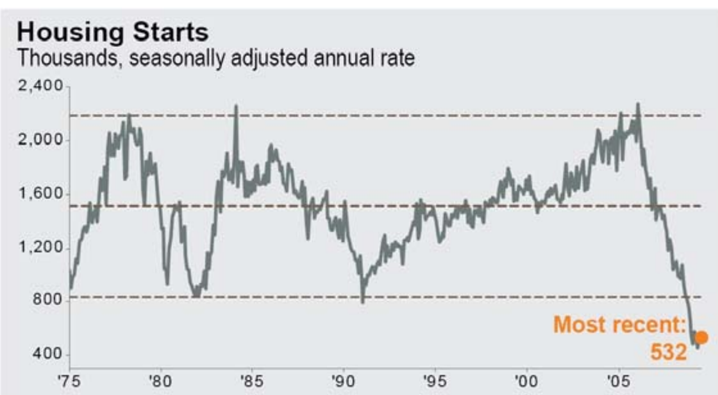
The jump in the markets reflected investor relief that the Armageddon many feared seems increasingly likely to be avoided. While economic signals were (and are) still weak, their rate of decline seems to be slowing. This has allowed everyone to start breathing again.

The current state of the economy:

- **The shrinking economy.** Real GDP (economic growth) shrank by an annualized rate of 5.5% in the first quarter of 2009, following a 6.3% decrease in the 4th quarter (Q2 numbers are not yet available). While the quarterly data was strongly negative, it was actually an improvement over the initially reported 6.1% decline. Much of the decline in the economy has been attributable to the weakness in two critical sectors: housing and autos. The Bureau of Economic Analysis estimated that these sectors subtracted 1.3% and 1.4%, respectively, from the reported GDP number.

- **Rising Unemployment.** Unemployment rose to 9.5% in June from 7.2% in December of 2008 and 4.9% in December of 2007. Earlier Administration estimates had 9.5% as a "worst case" level. More than 6.4 million jobs have been lost since the beginning of the recession, with nearly 3.4 million jobs lost just this year. Many are predicting that employment may hit or even exceed 11% before improving.

- **Housing prices continued to fall.** The Case-Shiller Housing index lost 0.9% in June as compared to May and is down 22.1% from a year earlier. While the greater Bay Area's prices have declined by 39.0% over the last year, the rate of decline in local prices appears to be slowing. Nationally, in a positive development, four of the major twenty regions actually experienced increases in June home prices as compared to May. New housing construction has slowed to levels not seen since World War II. With such low construction levels, eventually, the natural demand for housing that comes from population growth will absorb the existing supply (even given the expected continuation of foreclosure activity). As excess inventory is absorbed, prices will stabilize and ultimately begin to once again rise. Growing demand is also being supported by today's lower prices and by the Federal Reserve's efforts to keep interest rates low. Still, rising unemployment will likely keep default rates high in the near term and contribute to consumer caution about making large purchases, like housing (or autos).



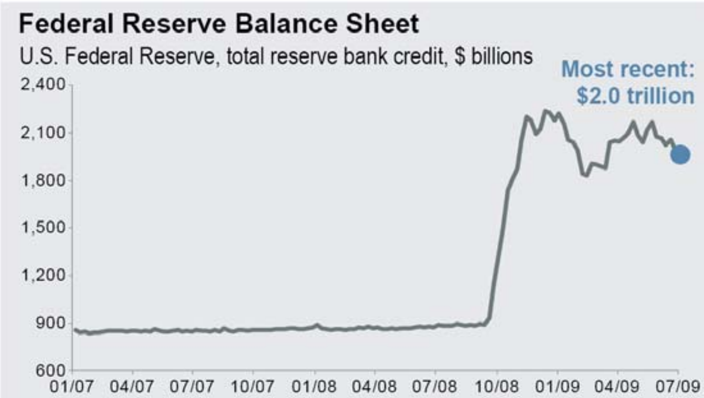
- **Corporate earnings are starting to show improvement.** The Bureau of Economic Analysis reported that corporate profits increased in the first quarter by $48.1 billion, an encouraging improvement over a disastrous fourth quarter of the prior year. Still, putting things in context, this was less than half of what earnings were two years earlier and approximately 39% lower than one year ago.

- **Consumer spending is down.** Consumer spending represents approximately two thirds of the U.S. economy and without such spending, the economy won't grow. With consumer spending down, the retail sector is suffering badly across the board. The silver lining to the steep reduction in consumer spending is that the personal savings rate in the U.S. jumped to 6.9% in May — the highest level in the past 15 years. An increased savings rate may slow recovery in the short term but should help in a number of ways in the long run, including adding to the liquidity of the markets and making the future growth in consumer spending more sustainable.

- **Low Inflation.** Although oil prices have doubled this year, most other commodity prices experienced minimal increases from January to June. After hitting a low of $33 per barrel earlier in the year, speculators and overall demand pushed the price of oil to just over $70 per barrel in late June. This contributed to a slight increase in overall inflation numbers.

- **Government Actions.** The Federal Reserve kept the Federal Funds rate at a target between zero and 0.25% during the 2nd quarter. Ben Bernanke, the chairman of the Federal Reserve, has repeatedly assured investors that the Fed will maintain this historically low rate as long as the economy remains under pressure. The Federal Reserve has also been active in purchasing treasuries to increase the supply of money in the economy and to lower yields. The Fed has actively targeted 30 year interest rates by buying up 30 year treasuries to encourage lower mortgage rates and hopefully help stimulate more housing purchases.

- **Borrowing demands are likely to push interest rates higher.** The U.S. government is projecting a deficit this year in the range of $1.5-2 trillion — not counting off-budget needs from programs like TARP or those directed toward state and municipal governments. Adding in the needs of other countries that also face severe shortages, global governmental borrowing alone is expected to reach unprecedented levels of as much as $5 trillion. Corporate financing



needs add to the potential demand for credit.

With the increased amount of government debt (in the U.S. and around the world), interest rates are likely to be forced higher in the next few years. Increased government borrowing increases the competition for funds, and therefore is likely to increase the cost of borrowing for everyone—consumers as well as local, state and yes, the federal government. As government debt rises, negative perceptions of U.S. financial strength are likely to grow as well. This could easily hurt the value of the dollar. China, the largest holder of US treasuries, has already expressed its own concerns about U.S. monetary policy. We don't see a problem in the short-run, but pressure has begun to build and the issue of U.S. debt will need to addressed. We need to get our country's financial house in order.

Summary. We think there may be another shoe or two to drop before we reach a real point of stabilization in the economy. While only 10% of the Obama stimulus package has yet gone out the door (and therefore has hardly had any chance to create a positive effect) there continue to be several unsolved problems on the horizon. Consumer spending is likely to remain anemic as Americans worry about their jobs and seek to reduce their excessive debt burden. High unemployment will likely keep consumer loan default rates high for some time yet. This in turn may cause banks to refrain from aggressively lending (despite encouragement from the federal government). Weak consumer spending combined with constrained lending will hamper business growth and thus, significant improvement in unemployment (and economic growth) will take time. With governmental debt rising to unprecedented levels, it is very possible that interest rates will rise, putting an additional crimp in the ability to move out of the recession. While corporate earnings are expected to continue their recent improvement, they'll be held back if consumer spending doesn't increase and if interest rates rise to a point at which borrowing becomes prohibitively expensive. We are cautiously hopeful that we've seen the bottom of this recession, but getting back to a growth economy could take a long time.

Performance This Quarter

Overview: It was an outstanding quarter. Equities across the board performed well. Small stocks outperformed large stocks, both domestically and outside the U.S. International significantly outperformed the U.S., helped in part by the generally weaker dollar. Emerging markets were the outstanding performer. Real Estate, which had been beaten up so badly the last two quarters, enjoyed quarterly returns of almost 30% and commodities also produced attractive returns. Bonds showed positive returns.

Domestic Equities. The Russell 2000 (small stocks) returned 20.7% besting its large stock companion, the S&P 500 (up 15.9%), by 4.8%. Value stocks were helped by gains in the financial sector–the best performing sector of the quarter – and thus beat growth stocks for both small and large stocks. For example, the Russell 1000 (large companies) value and its growth counterpart returned 16.7% and 16.3%, respectively, for the quarter.

Foreign Markets: The 'Great Recession' has hurt many foreign economies even more than the U.S. Japan's and Germany's most recent GDP numbers both experienced drops in excess of 14%, substantially worse than the dip in the U.S. economy. While production is down considerably, their unemployment numbers have been less severe than the US as a result of their broader social safety nets. For instance even with the substantial contraction in the Japanese economy, their unemployment rate was recently only

5.2%.

The pendulum of investor emotion and expectations seems to have over-exaggerated the negative impact of the recession internationally, and this quarter could be seen, in part, as an effort to undo the excess selling of the prior few months. This quarter the MSCI Emerging Market (the developing world) and EAFE (the developed, non-U.S. world) indexes respectively returned 34.8% and 25.9% for US investors. During 2008 frightened foreign investors flocked to the dollar for its perceived safety; most or all of that move has been undone so far this year and the dollar has weakened against most major currencies. The dollar experienced notable losses this quarter against the Euro (losing 5.7%), the Canadian dollar (an 8.4% drop) and the British Pound (a 15.0% plunge). The investment impact of this switch resulted in improved returns for American investors in non-U.S. investments.

Emerging markets performed especially well this quarter, averaging a rise of almost 35%. As the developed world struggled to recover from the recession, it appeared increasingly likely that the emerging markets would be the new drivers of growth for the world economy. China's stock market, even with their considerable social unrest, finished up 35.8%. Brazil's currency, the Real, gained strongly against the dollar, leading to a 41.0% return for US investors. Investments in India experienced a 59.8% rise, including 17% on the day after a new moderate Indian president was elected.

Real Estate Investment Trusts: Real estate stocks represented by the FTSE NAREIT Index and investing in all kinds of commercial real estate (not homes) had a spectacular April, after an especially tough fourth and first quarters. During just April REITs jumped 31.0%. Real Estate Investment Trust (REITs) remained relatively flat for the remainder of the quarter and finished up 28.9%. In the last half of 2008, REITs were discounted as worries arose that they would be unable to refinance their considerable debts. The current concern is less that and more a question of whether their tenants will be able to maintain their rental payments. Business earnings have broadly fallen, some have entered bankruptcy and most have fewer employees that a year or two ago, all of which is likely to reduce demand for commercial space. The resulting lower rental revenues could weaken the future earning power of many REITs.

Fixed Income: As the stock markets improved, investors moved their money from the safety of bonds to riskier and higher-returning stocks. The Barclays Aggregate Bond Index, the broadest index of bonds showed average returns for bonds during the quarter of 1.8%. Short-term bonds averaged 1.43% during the quarter while Intermediate bonds averaged 1.67%. Treasury bills, the safest of investments, lost 2.2% as the level of fear felt by investors around the world abated. At the same time, high yield (junk) debt, the riskiest type of bonds, gained 23.1% in the second quarter.

TIPS as an indicator of Inflation or Deflation. During the Great Depression of the 1930's, a deflationary environment was created by government actions which exacerbated the already difficult economic problems. During the current 'Great Recession', the Federal Reserve has pumped trillions of dollars into the economy, intending to avoid the mistakes of the earlier period. Being still in the midst of the unresolved economic troubles, the question remains—will the injection of all the fiscal and monetary stimulus in fact counter the deflationary pressure? (Deflation is a situation in which as prices start to fall, buyers respond by deferring purchases, which worsens the economy, which causes more deflation—it is a particularly vicious cycle and nearly impossible to escape without serious damage.) If the stimulus is successful, it is not yet clear if it will result in inflation or even hyper inflation. While we don't have the answers to these questions, we believe the best vehicles to address these concerns are TIPS (government bonds known also as "Treasury Inflation Protected Securities"). TIPS adjust their principal value semi-annually to reflect the inflation rate, and yet make no adjustments below zero in a deflationary environment. Most Mosaic portfolios hold a 50% position in TIPS within the intermediate bond allocation as well as collateralizing our commodities position.

Alternatives: Our alternative investments all provided positive returns during the second quarter and returned to their normal low correlations with the S&P 500. The PowerShares DB G10 Currency Harvest (DBV), which takes advantage of currency dislocations, returned 10.8% through the first half of the year and 4.8% for the second quarter. The PIMCO Developing Local Markets (PLMIX), which invests in currencies of, or in fixed income instruments denominated in the currencies of developing or emerging markets, rebounded nicely as the strength of these currencies relative to the dollar boosted returns to 15.8% for the second quarter. Plum Creek Timber (PCL) returned 3.7% during the second quarter. Analysts at Moody's warned that PCL was trading at an unsustainable multiple to one of its earnings measures, causing its stock price to drop toward the end of the quarter. Other analysts have countered that Plum Creek's strong dividend payout and ample cash reserves signal a higher fundamental price. We continue to believe it is a good long-term position to hold. The Merger Fund (MERVX) returned 2.2% in the second quarter. PIMCO Commodity Real Return (PCRIX) is our primary exposure to commodities and is backed up by TIPS, which influence its returns, helping it to grow 15.5% in the second quarter.

Looking into the Future

Forecasting is always fraught with danger.

The Bottom line—how did we do?

While the markets were exceptionally difficult for the prior six quarters, this quarter produced unusually good returns. While some of our strategies worked against us in 2008, most added to client returns this last quarter, putting most of our portfolios nicely above benchmark.

- Our bias toward Value versus Growth produced a small benefit domestically, but a substantial one overseas.

- Our overweighting of small companies relative to large boosted returns domestically (4.76%) and even more so overseas (8.69%).

- Our greater emphasis on international equities (50-50) than most advisors enhanced returns this quarter as non-U.S. large stocks outperformed their U.S. benchmark by nearly 10% while the differential for small stocks was nearly 14%.

- Our belief that emerging markets warrant an important allocation was tested last year as these markets dropped dramatically, but just this quarter they rose nearly 35%.

- While REITs worsened our losses last year, this quarter they added to our gains, rising 28.85%, more than the broader markets.

- Commodities were a difficult drag on returns last year and our selected holdings did even worse. This quarter our primary fund rose 15.5% while the commodities benchmark rose only 11.7%.

A word of caution. After a great quarter, some caution is called for. It is not yet time to relax. Ben Bernanke told Congress, "Economists are extremely bad at predicting turning points, and we don't pretend to be any better." So as people begin to predict a market bottom, vigilance and skepticism are needed.

Market optimism can be fleeting as we've experienced at the end of last year — the market rose 23% from its November lows, and then fell again to new depths. The historical definition of a "Bull" or "Bear" market is that the market rises or falls 20% or more, respectively, from its prior peak or trough. These usually happen once every few years. As shown on the chart below, in the last year alone, it occurred four times! It has been a period of extraordinary volatility.

While we do not predict a fall below March levels, we have created long-term strategies tailored to your goals. Reacting emotionally to the trend of the moment is natural but to come out ahead in the long run, focusing on your goals and sticking to your long-term strategy is likely to serve you best.

If you would like to speak with your advisor about your portfolio, please do hesitate to call. Thank you for allowing us to serve you.

Your Mosaic Team

Date	S&P 500 Level	Fall/Rise
Start: July 1, 2008	1280	
Low: November 19 2009	752.44	Down 41.2%
High: January 2, 2009	931.80	Up 23.4%
Low: March 9, 2009	676.53	Down 27.4%
High: June 11, 2009	944.89	Up 39.7%