

EAST COAST

The logo for East Coast Asset Management features the words "EAST COAST" in a large, blue, serif font. Below this, a blue wavy line curves across the page. Underneath the wavy line, the words "ASSET MANAGEMENT" are written in a smaller, blue, serif font.

ASSET MANAGEMENT

To: East Coast Asset Management Clients and Interested Parties

From: Christopher Begg, CFA and Benjamin Favazza, CFP®

Date: July 20, 2009

Re: Second Quarter 2009 Update

Market Summary:

Since the lows of March 7th, the S&P 500 has recovered 35.89% through June 30, 2009. Year-to-date, the S&P 500 has had a total return of 3.16% with the second quarter registering a 15.93% total return. The price of crude oil has doubled from the February lows of \$34 closing the quarter at \$69.89. The price of a troy ounce of gold has rallied 34% to \$953 from the October 08 lows of \$715. The 30 year US Treasury bond began 2009 at 2.67% and is now yielding 4.55%.

So what's going on?

Judging by these indicators, one might think that the economy is not just recovering but flourishing. Our view, however, is quite the opposite. End demand for goods and services (GDP) continues to wane with -3% year-over-year readings and the US employment situation is the worst it has been in 27 years with unemployment recently registering 9.6% and expected to rise. The housing situation is horrible and we expect it to get worse. The key data point we follow to inform our views on the stabilization of housing prices is months-supply of inventory. This indicator has a flat-line trend at about 5.5 months going back 20 years and it is currently at 11 months (we believe that number could be as much as 20 months if you count shadow inventory-levels). We feel housing prices will continue to move in their downward trajectory until inventory levels normalize, which will take time. With regard to regional/national banks, the state of the housing and commercial real estate market will prove to be an on-going challenge as we fully expect additional rounds of dilutive capital raises to continue in order to bring their mandated coverage ratios in line.

We wrote in last quarter's update that there would be an inflection point from a period of deflationary pressures toward inflationary pressures that would be important to get right. From our last letter "In a deflationary cycle, cash is king. In an inflationary cycle, cash earns a negative real rate of return. The higher the rate of inflation, the greater the harm to the purchasing power of your accumulated wealth." Our view was that the inflationary forces being driven by a global policy response favoring reflationary strategies would eventually win that tug of war. As you can see from some of the numbers noted above, the effects of this response are showing up in asset prices and bond yields.

How are we looking to invest in this environment?

As always, we are relying on a good dose of common sense and a keen eye on the expected return of our investments to navigate through these fluid times. Warren Buffett's words "price is what you pay and value is what you get" couldn't ring more true in this environment. A primary theme with our equity investment strategy is to own the beneficiaries of the current reflationary policy and we have been favoring businesses, industry sectors and countries that have pricing power and/or control natural resources where the bar will be reset at a higher value. We continue to see strong tail-winds in the global sectors of Basic Materials and Energy. With regard to our international allocations, we are favoring those countries that are endowed with natural resources coupled with political/economic stability. The flip side is deselecting investments where there exists an intrinsically impaired ability to raise prices as input costs rise. We are wary of companies and industries with leveraged balance sheets that force them to rely on the "kindness of strangers" when they need to roll over long-term debt commitments. We are avoiding companies with large pension obligations at the same time as their pension assets have been cut in half by market performance. Finally, we foresee a long-term negative shift in demand for the US dollar as a store of value and perhaps as the world's reserve currency. When appropriate, we favor investments where non-dollar revenues repatriated may provide a couple additional percentage points of total return.

For our fixed-income allocation, we have chosen to keep some of our maturing bonds and our allocation that is ear-marked for bonds in very short-term maturities or money market investments. We fully expect yields to continue to climb and believe anything that looks interesting from a spread perspective today, with the quality attributes we require, will look like a relatively poor decision tomorrow once yields climb and better opportunities become available.

What do we expect for the remainder of the year?

Although our strategy is not dependent upon our ability to forecast the short-term zigs and zags of the market, we appreciate the fact that our clients often ask this of us so we offer the following musings. Our analysis suggests that the "elephant in the room" for global equity markets is a prolonged period of heightened inflation/asset-reflation that will continue to favor above-average returns over a secular period for many investments that are fundamentally sound and where valuations are attractive. We temper this bullish forecast with the caveat that some of this positive price move might be illusory in terms of real-return as underlying purchasing power is eroding at an above normal clip. Protection against inflation risk is critical. In the near-term, we fully expect that those looking for "green shoots" and a "v-shaped" economic recovery will be disappointed. We expect this disappointment to give us another opportunity to tactically increase positions at advantageous levels. We will continue to make sound investments that offer very attractive asymmetric characteristics: low probability of downside and a high expected compound rate of return from current prices. We do not make a habit of consulting the vagaries of the manic/depressive Mr. Market for inputs into how we should act. Mr. Market plays a critical role in providing us with a price to transact – otherwise the merits of the individual investment will trump the noise of the marketplace.

Organizational Update:

- **New Hire:** Beginning June 1st, Jack McManus joined East Coast as an Associate Portfolio Manager and Research Analyst. Jack has proven to be an invaluable member of

our team and has been with us since day one of our launch in the part-time role of Research Analyst. Jack graduated in May with an MBA from Boston College with a concentration in Asset Management, and was inducted into the Beta Gamma Sigma National Honor Society. Jack is a Chartered Financial Analyst (CFA) and came to East Coast with five years of previous investment experience. The decision to bring Jack on board full-time after graduation was the easiest pivotal firm decision we have made as he has been a vital part of our success to date. He is truly a team player and among his many talents is his ability to wear many hats, which we often ask him to do. Jack and his wife, who currently is a pediatric resident at MGH, live in Melrose and are expecting their first child in September.

- **Essex Office:** For those of you who have not recently visited our office in Essex, we are pleased to report that we have expanded. We doubled our space as of June 1st, which gave us the opportunity to build out a new conference room with full network/projection capability. While this serves as an important place to meet our clients, it also became mission critical as squeezing the 7+ members of our investment team into an office for our Monday investment meetings became increasingly difficult. We look forward to your next visit.
- **Summer Research Analysts:** As many of you know, we closely affiliate ourselves with local MBA programs in Boston. We typically offer full-time summer opportunities to candidates who have graduated or have just finished their first year. During the school term, we also offer part-time opportunities (25 hours a week) to candidates that are in their second year. Chris has now worked with over 20 MBA's in this capacity over the last 10 years which led to three strategic full-time hires. We have organized our research process to allow for four positions this summer. We work closely with the executive directors of the Investment Management curriculums at these schools (for example: Center of Investment Research and Management at Boston College and Hughey Center for Financial Services at Bentley College) as well as the recruiting offices to guide us in drafting the "best athletes." We could not be more pleased with the individuals we have working with us this summer. Their past career experience, work ethic, desire to add value, and teamwork have already made their mark on our research effort. Included are the bios for Anya, Scott, Greg and John for your interest and we hope that you have a chance to meet them in person.
- **Strategic Growth:** The opening line of Charles Dickens's novel A Tale of Two Cities begins: "It was the best of times, it was the worst of times." This could not be more appropriate to summarize the feeling we have had with regard to the timing of our launch. For the most part, we manage the majority of our client's accumulated wealth. Therefore, when we experience any period of dislocation like we had in 2008, where asset values are impaired and fear is rampant, we also feel that pain and can empathize with the perceived uncertainty it creates. Fortunately, we were able to bring in our largest grouping of client assets in the very early months and we were able to make shifts that helped mitigate some of the downside given our views of the true depth of the credit crisis. The silver lining in the timing of our launch is that we have had an abundance of opportunities created when the whole world essentially went "on sale" for 50% off. While some of those corrections were warranted, we believe that many were exaggerated.

Another positive opportunity for East Coast generated by this crisis is that we have been approached by many talented investment professionals who are interested in joining our team as principals. Some of these individuals have been most recently employed at leading bank trust departments and brokerage firms. They have long-standing relationships with their clients and are looking for a more transparent structure that is free from conflicts and bureaucracy. The critical element as we started these discussions with potential partners is that they completely buy into our vision of the firm we have built and continue to build. They have to be like-minded with regard to our investment philosophy, be a good match for our culture, possess strong character attributes, and be willing to implement our process as we want team players, not solo practitioners. We have engaged an executive recruiter to help with the initial phases of this process (initial interviews, background checks, reference checks, etc.) so as to minimize any distraction from our day-to-day focus. We have seen many quality candidates and we feel the environment has afforded us our pick of a champion litter.

As we build our firm, we are aware that it is sustained growth that will allow us to expand both our human and investment management resources, to the benefit of our clients. We have thought a lot about the quality and nature of that growth. We have structured our firm so that the right professional is positioned to maximize our client's satisfaction, which boils down to performance and service. You may have noticed that from the top of our structure we have differentiated Wealth Management and Investment Management. We have done this because we believe the two tasks are very different yet equally important. Cultivating best practices in both is our foremost objective. With full humility as to the task at hand, we expect to build the premiere investment-focused wealth management company for our target client demographic.

The majority of our clients are introduced to us from our existing clients and from our trusted referral sources. While we welcome any referrals our clients make, we also appreciate that we are providing a service that is private and many of you prefer to keep your financial affairs that way. We take this opportunity to thank those that have spoken of our firm in a positive light.

We continue to manage your capital with the utmost prudence and look forward to meeting or talking with you soon. We value greatly your support and trust.

"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change."

- Charles Darwin

Sincerely,



Christopher M. Begg, CFA
Chief Investment Officer



Benjamin S. Favazza, CFP®
Chief Wealth Management Officer

Research Analyst Biographies

Greg Harrison

Greg is a Research Analyst at East Coast. He is currently enrolled in the Master of Business Administration and Master of Science in Finance dual degree program at the Boston College Carroll School of Management. Greg earned a B.S. in Cell and Molecular Biology from the University of Washington and a B.S. in Finance from the University of Maryland University College. Prior to graduate school, he worked in the biotechnology industry as a validation engineering consultant. He is currently a CFA Level 2 Candidate. Greg speaks conversational German.

Scott Mensi

Scott is a Research Analyst and Marketing Officer at East Coast. He is currently enrolled in the Master of Business Administration and Master of Finance dual degree program at the Boston College Carroll School of Management. Scott earned his B.A. in Economics from Hamilton College. Prior to graduate school, Scott worked in the Client Management Group at State Street and more recently as a Marketing Associate at Numeric Investors.

John Rogers

John is a Research Analyst at East Coast. John graduated cum laude from Deerfield Academy in 2006, and is currently an honors student at the University of Pennsylvania. At Penn, John is a member of Wharton's undergraduate real estate club, volunteers for the NGO Power Up Gambia, and is the vice president of St Anthony Hall fraternity. He has prior experience as an analyst at both an investment bank and an asset management firm. John speaks conversational Spanish.

Anya Suvorov, MSF

Anya is a Research Analyst at East Coast. Anya received a Master of Science in Finance degree with high distinction from the McCallum Graduate School of Business at Bentley University. She attained her Bachelors in Finance from Northeastern University. Prior to joining East Coast, Anya interned at Aspen Technology as a Treasury Analyst, where she assisted the Treasurer with financial analysis, modeling and project management. Before graduate school, Anya worked at Brown Brothers Harriman as an Operations Specialist within Corporate Actions department. Anya is a native speaker of Russian.