HUSIC CAPITAL MANAGEMENT

INVESTMENT OUTLOOK Q2 2009

Emerging Markets Lead The Economic Recovery

Recent market activity continues to reinforce our belief that the most important economic trend of this period is the industrialization of the emerging world. Contrary to the prior economic growth cycle, this time we expect emerging countries to be the engine of growth and pull developed countries into positive territory. As you can see in the table below, real GDP in some emerging economies actually was positive in the second quarter.

Real GDP – Second Quarter 2009

Country	Real GDP Year-over-year % Q2 2009	Country	Real GDP Year-over-year % Q2 2009
China	7.9%	France	-2.9%
India	6.1% (est.)	Singapore	-3.5%
Indonesia	4.0%	Spain	-4.1%
Australia	1.0% (est.)	U.K.	-5.6%
U.S.	-1.0%*	Germany	-5.8%
Brazil	-1.8% (est.)	Italy	-6.0%
South Korea	-2.5%	Japan	-6.5%

* Quarter-over-quarter % annual rate. Source: Bloomberg, ISI

Manufacturing purchasing manager surveys improved again in June and are now above 50% in India, China and Turkey, indicating growth. Manufacturers are stockpiling commodities, believing this recovery has durability. A consequence of this scenario will be a revaluation of emerging countries' currencies versus the dollar and euro. This will bolster the buying power of consumers in places such as China and will have widespread ramifications. We will develop more on this in the future.

The U.S. market has strengthened and we believe it will continue to catch up with the emerging markets. Of particular note has been the breadth of the rally. Though still down versus last year, we did a study on how well stocks have performed this calendar year. We found that almost all the sectors are at their highest levels of 2009. Our take away is that this is a high quality rally evidenced by broad participation.

Following a strong market rally, pullbacks of 5 to 10% can come at any time for any reason. The surprise has been that, despite how much pessimism has been thrown at this market, it has continually shown a resistance to decline. President Obama's efforts to "reregulate" Wall Street, his attempts to overhaul health care, earnings concerns and substantial capital raises are just a few worries nervous investors felt would derail the rally. Corrections, though shallow to date, have helped rebuild the proverbial "wall of worry."

Despite this pessimism, fundamentals are improving. For the first time since mid-2007, reported earnings in the first quarter of 2009 exceeded estimates. Investors held or added to their stock portfolio post-earnings, which is a response correlated to bull markets. The markets consolidated, then moved higher again as second quarter earnings reporting season turned out to be better than expected. We expect this beat-estimates-and-raise-guidance cycle to continue.

The earnings recovery and its impact on stock performance have been interesting. First, the market collapsed in the second half of 2008 as investors feared the worst. Then, in the first quarter of 2009, companies needed to show they quickly reacted to the downturn and cut expenses. In the second quarter, though expense focus continued to be the theme, revenue stabilization was important as was an improved outlook for the future. Going forward, it will be important to show revenue growth. We look forward to our companies reporting improved year-over-year comparisons as they lap last year's weakness.

Case-Shiller home price indexes rose for the second month in a row in June and for the first quarter in three years. Consumer confidence has continued to rise. Credit markets have improved substantially. High yield bond spreads that peaked at 1800 basis points (bps) last year, versus 1100 bps peaks in 1990 and 2002, have improved to 800 bps. The Treasury versus Eurodollar bills (TED) spread is back to normal ranges, indicating decreasing risk.

In addition, U.S. leading economic indicators have been strong, rising for three consecutive months for the first time in five years. Excellent at forecasting economic recoveries, these indicate an economic turnaround during the second half of 2009. Real GDP estimates continue to rise and our V-shaped recovery thesis will drive 4% growth for each of the third and fourth quarters of this year and for the year 2010.

Sentiment has declined to neutral as investment newsletter writers became more bullish as the rally continued. Copper and oil prices remain strong, which supports economic growth and equity markets. BRIC market rallies remain intact.

Though some make comparisons of our economy to Japan's following their 1989 market collapse, we find few similarities. Monetary and fiscal policy failed in Japan. First, they kept short rates above the structural growth rate, which allowed debt servicing costs to destroy the bank capital, which led to deflation. Then they failed to inject money into their banking system which was collapsing. Next, the yield curve was never steepened enough to allow the banks to grow their way back to profitability. And last, they raised taxes.

The U.S. monetary and fiscal policy has been vastly different. The Federal Reserve cut rates virtually to zero with the quantitative easing program. Then vast amounts of capital flooded the system on both a systematic and targeted approach. As in the early 1990s U.S. banking crisis, the Federal Reserve engineered a steeply-pitched yield curve. Finally, increased taxes were postponed to the future. Investor confidence that this response will be successful has resulted in a dramatic rally from the lows.

We think there is more capital appreciation potential for the banks. First, the capital markets have been quite receptive for them to raise capital to shore up their balance sheets. Second, the steep yield curve drives them back to strong profitability. Third, there is less competition as weak institutions are swallowed by the strong. Fourth, as the housing market recovery continues, the banks are large owners of properties that are now appreciating in value.

Outlook

We remain constructive on equity markets. Following poor long-term equity market results, strong rebounds have historically occurred. With pension funds woefully under-funded, asset allocators will need to increase exposure to equity markets. This will provide a floor to the markets. The economic recovery will provide the upside potential.

From a technical perspective, the markets have broken out from a nine-month inverse head-and-shoulder consolidation pattern. If the market moved back to September 2008 levels that would imply a 20-30% return for the S&P 500 index.

As we expected, perceptions about prospects of financial services companies are changing dramatically. As happened in the early 1990s, the Federal Reserve has engineered a steeply-pitched yield curve that is restoring health to financial company balance sheets, gradually at first. We expect the rate of improvement to accelerate into 2010. We see new positive analyst recommendations on financial services companies occurring daily.

In addition to financial services, another strong performer has been the technology sector. There have been numerous sub-themes within the overall sector. One in particular is the demand for ubiquitous internet services. This is generating a need to rebuild, fortify and advance the power of networks. In turn, this is revitalizing the semiconductor and telecom systems components companies. The shift toward richer content on the internet in the form of audio and video is also driving the need to significantly upgrade networks.

Our time-tested hurdles strategy will position the portfolio to take advantage of these opportunities.

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