WINFIELD
ASSOCIATES

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Customized Investment Portfolios and Private Wealth Advisory Services

MARKET COMMENTARY

The panic that ripped through the global financial system in 2008 began to fade in 2009 as investors returned to buying riskier assets. Money flowed out of US Treasuries and into equities, commodities and corporate bonds. The S&P 500 ended the year with a 67% gain from its low in March. Many emerging market economies never entered a recession during the crisis and benefited from the snapback in sentiment. For all of 2009, Brazil's Bovespa was up 82.7%, China's Shanghai Composite was up 79.9%, and India's Bombay Stock Exchange was up 98.8%. Oil climbed to $79.36 per barrel, up 78% from $44.60 at the end of 2008. Default rates on high yield bonds stabilized, providing junk bond investors with a total return of nearly 60% in 2009 alone. In sum, 2009 was a very good year across most asset classes.

Several factors point to continued expansion of the US economy and resilient equity markets in 2010. A recovery to more normal conditions, based largely on demographics and pent-up demand, should occur in numerous sectors. The total US population of 308 million is increasing about 3 million per year. Consumers should revert to normal spending habits as financial security improves. Eventually, a number of areas of the economy should return to normalized trends including:

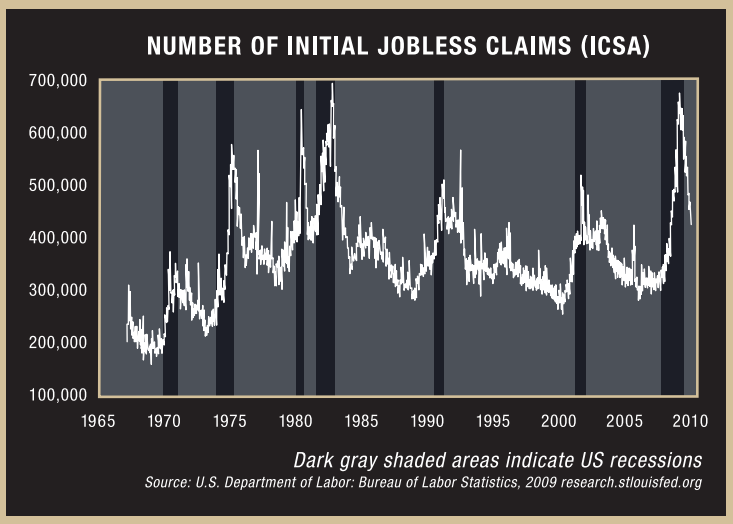
- *Auto production* - dipped to an 8 million unit annualized rate in 2008 and early 2009. The annual scrap rate is between 11 and 13 million units. For most of the past decade, production ranged between 15 and 18 million units yearly. By the end of this year, annualized production is expected to be 12 million units.

- *Housing prices* - are likely near the bottom and down -35% from the peak in 2006. Housing starts recently have been about 600,000 units compared to the historical trend of 1.7 million units annually. Housing affordability is at levels not seen since the 1970s.

- *Business inventories* - plunged during the Great Recession as companies cut costs to preserve profit margins and survive. We expect an upturn as companies restock to meet demand.

- *Capital spending* - lagged historical levels. Capital expenditures were less than total depreciation in 2009 for the first time since World War II. As a percentage of US GDP, capital expenditures have trended well above 7% historically and remain about 6%. A return to trend would see an 18% increase from current levels.

Perhaps one of the most important indicators of economic stabilization is employment. At the end of 2009, the US unemployment rate remained above 10%. However, in recent weeks, initial jobless claims showed some signs of improvement. In the graph below, weekly initial jobless claims fell to 434,000 during the week of January 2, down sharply from 665,000 during the week of December 5. As we mentioned in our October 2009 Market Commentary, improvements in economic activity should lead to GDP expansion followed by a fall in the unemployment rate. Initial jobless claims may provide a preview of this cycle.



We believe investment opportunities remain in 2010. Valuation of equities in general seems reasonable. The price to earnings ratio of the S&P 500 is 17x 2009 estimated earnings and 14x 2010 estimated earnings. In light of historically low interest rates and accelerating earnings, equity indexes could move higher on a valuation basis. We also continue to invest in high yield bonds as defaults will likely be 12-14% in 2009, much less than the 25% the market predicted early last year. A return to a more normal default rate of 5-7% should produce further junk bond gains in 2010.

Of particular interest to investors is the outlook for emerging markets. Despite precipitous drops of -60% to -80% in 2008, the equity markets of Brazil, Russia, India and China (BRIC) far outpaced most developed market indices in 2009 and for most of the past decade. The question of whether these countries have come too far remains at the forefront of market strategists' concerns. While strategists predict the US GDP growth rate around 3.5% for 2010, consensus GDP growth rates are 9% for China, 8% for India and 5% for Brazil.

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Most Asian countries (ex-Japan) with much smaller GDPs such as South Korea, Indonesia and Singapore are also expected to post growth rates above 5%. Importantly, many emerging markets stand on firmer financial ground than in previous business cycles. Non-Japan Asian countries are expected to hold a relatively low level of government debt by 2014 (34% of GDP compared to 118% of developed countries). Emerging market equity valuations also remain attractive on a relative basis. The price to earnings ratios for many emerging market equity indexes is similar to developed market indexes even though most emerging economies are growing 2x-3x faster. Barring another significant financial crisis and accepting greater volatility, we expect emerging markets to outperform again in 2010.

MACROECONOMIC OUTLOOK

	October 2009	January 2010
US GDP	Positive	Positive
Inflation	Neutral	Neutral
Employment	Negative	**Neutral**
Productivity	Positive	Positive
Corporate Profits	Positive	Positive
Consumer Debt	Negative	Negative
International Growth	Positive	Positive

We are changing our view of Employment from Negative to Neutral. As we discussed in our Market Commentary, we are beginning to see moderate improvements in employment, particularly in initial jobless claims filings. Of note, the US Census Bureau will hire hundreds of thousands of temporary employees in the coming months to take a snapshot of our population. Whether the temporary hires lead to a trend reversal in the unemployment rate has yet to be determined. Nonetheless, we expect the combination of government hires and a slowdown in jobless claims to lead to an unemployment rate below 10%.

ROTH IRA CONVERSION PRESENTATION

On January 1, the federal government permanently eliminated the $100,000 income limit for Roth IRA conversions. On Wednesday, March 3, Winfield will host a presentation at Westwood Country Club in Rocky River, Ohio to review the tax and estate planning issues surrounding Roth conversions. Please watch for details on our website to attend, participate real-time via the internet or listen to the replay.

ROTH IRA LIMITS

While higher income earners can now convert traditional IRAs to Roth IRAs, limits on contributions to Roth IRAs will continue to apply. For 2009, contributions are not available to joint filers who have an AGI of $176,000 or more; $120,000 for single filers. If you qualify, you have until April 15, 2010, to make a maximum Roth IRA contribution of up to $5,000 for the 2009 tax year ($6,000 if you're age 50 or older).

MARKET PERFORMANCE

	4Q 2009	2009
Dow Jones	8.09%	22.60%
S&P 500	6.01%	26.50%
Nasdaq	6.91%	43.89%
Russell 2000	3.49%	25.22%
MSCI EAFE	1.80%	27.55%
Barclays Agg	0.20%	5.93%

WHEN TO WORK WITH WINFIELD

PRIVATE INDIVIDUAL INVESTORS

- Manage accumulated wealth, inheritances and settlements to meet investment objectives

ENDOWMENTS AND FOUNDATIONS

- Manage assets with a long-term growth strategy while meeting investment policy requirements

BUSINESS OWNERS

- Customize investment portfolios to meet investment objectives and lessen risk of concentrated assets
- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to meet investment objectives and lessen risk of concentrated assets

RETIREES

- Customize investment portfolios to meet investment objectives with the option of drawing income
- Management of IRAs, trusts and taxable accounts

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