FBB CAPITAL PARTNERS

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Dear Clients and Friends,

The beginning of 2010 finds the financial markets at a crossroads. Following the credit-based dislocations of 2008 and 2009, and while the economy is still in the midst of a fragile recovery, the markets are faced with the prospect that the Federal Reserve will soon begin removing liquidity from the system, first by allowing several temporary credit programs to expire as soon as next month, and then by raising short-term interest rates, possibly by mid-year.

Those programs had been put in place, and the Fed Funds rate dropped to near zero, as part of the Fed's efforts to fill the void which resulted from the credit market meltdown. Essentially, the Fed wildly expanded its own balance sheet in order to provide liquidity to a market that had become addicted to it, but which suddenly found it had no means to provide for itself. With respect to the economy's dependency on credit, we are reminded of a song lyric from rock band U2:

With or without you,
I can't live
With or without you.

The implied "Catch-22" is that the economy needs to leave its credit dependency behind, or at least work it down to a more manageable level, yet in the near term may be unable to do so without financial disruption. If the Fed is to achieve its goal of shrinking its own balance sheet, it must do so carefully so as not to send the economy and markets into a tailspin.

The gradual, deliberate deleveraging of the economy is one of the major headwinds that will likely constrain US economic growth for years to come. Moreover, rising taxes (in many forms) will cut into corporate and consumer spending, and persistent unemployment coupled with a "shadow inventory" of homes held by mortgage servicers will keep pressure on the housing recovery. These same headwinds should also serve to keep inflation in check, though a speculative push in commodities (notice $3.00 per gallon gasoline is but pennies away) and a recovery in other parts of the world could push prices higher.

While these factors temper our longer-term view of the economy, we find ourselves more constructive on the markets. As economist Milton Friedman once noted, the "market and economy are two different things." So while bond rates may begin moving up in anticipation of future Fed rate hikes, this will allow us to reinvest cash from maturing bonds at higher rates than have been available in the recent past.

Also, we believe stocks are reasonably priced in the context of normalized earnings power and cash flow, and are finding several opportunities in which to place new money. There may even be positive surprises this year, such as the reinstatement of dividends by prominent companies in the financial sector, and the potential for top-line growth for companies in the S&P 500, something which hasn't happened since the middle of 2007. Over time we will also be expanding our international holdings of both stocks and bonds, though we caution that a much longer investment horizon is warranted for such investments, given the unique risks posed by currency fluctuations.

We do want to bring up one administrative matter now that tax season approaches. In past years, our custodian firms have issued 1099s early in the cycle, only to later issue restated 1099s as additional information arrives. Further, some companies will issue K1s directly to unit holders; while we make efforts to confine K1 securities to tax-advantaged accounts such as IRAs, we have experienced situations where corporate restructuring can lead to unexpected K1s for taxable accounts. For these reasons, we suggest waiting until closer to the filing deadlines to submit your tax returns, simply to ensure you have the most up-to-date information and to help avoid the possibility of needing to file an amended return.

We thank you for your continued confidence in our ability to serve you, and we wish you all prosperity in the New Year.

Sincerely yours,

Mitch Schlesinger

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