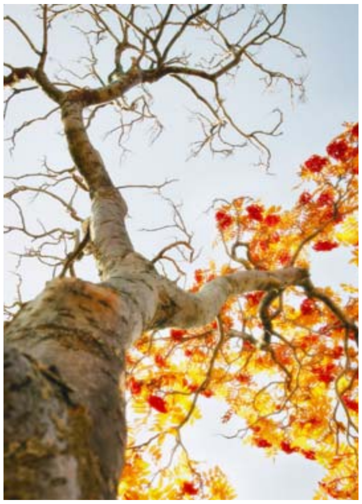

PARTICIPANT NEWS

SPECIAL REPORT

NOVEMBER 2009

Featured Articles:

Commentary on Recent Market Events

Commentary on Recent Market Events

It has been one year since the demise of Lehman Brothers and Merrill Lynch; one year since the deep freeze in the credit markets; and well over a year since Bear Sterns was knocked off its pedestal. At the end of the third quarter in 2008, the future looked quite bleak, but at the end of 2009's third quarter, the United States has left the ICU and regained some of its strength. Unfortunately, America is still a patient at the hospital being nourished by stimulus and aid programs. Over the last quarter, this nourishment has helped the market continue its run from the depths, but many are wondering, how long can it last? Improvements in some economic indicators have fueled the rally but there are still concerns about the health of the economy. Many agencies have taken the past year to gather information on the causes of the recent recession. Every day we are getting closer (or further away) to finding out what new rules and regulations are going to govern our markets. We have come a long way from a year ago and during this past quarter we saw some good progress, but we still have a long haul in front of us.

Over the past three months, the market continued to rise significantly. The S&P 500, a broad measure for the 500 largest U.S. companies, increased by 15.61%, which was closely matched by the Dow Jones Industrial Average, a condensed measure of the 30 largest U.S. stocks, which gained 15.82%. In the equity markets, value companies performed the strongest over the period which was a reversal from the beginning of the year when we saw growth stocks leading the way. This performance was mainly due to the surge in financials. Similarly, Real Estate and High Yield securities had yet another stellar quarter. A common denominator between all of these securities is risk. Increased risk taking can also be one explanation for the steady decline in the dollar. In general, risky assets have outperformed high quality assets by about 20% this year, reversing the trend we saw in the last 6 months of 2008 and the first quarter of 2009. In other words, when investors are scared they tend to invest in high quality stocks and government bonds, and when they feel more confident they invest in riskier assets in the hopes of getting a higher return.

While we have just experienced one of the best 6 month periods of performance in stock market history, in our opinion all is not rosy with the economy. Bank lending has really been a tale of two cities. Investment grade borrowers, who have little or no debt on their balance sheets and lots of cash are still able to borrow money at attractive rates. High risk borrowers; however, are finding it almost impossible to borrow money because banks have curbed any sort of risky lending. This can partly be attributed to the fact that banks continue to fail at increased levels. The Federal Deposit Insurance Corporation's (FDIC) watch list grew from 117 banks at the end of March to 416 by the middle of August. Along with bank failures, the unemployment rate is still increasing, approaching 10%. Over the course of the recession, the United States has lost about the same number of jobs that were created during the last bull market, approximately 7.2 million. Small businesses are the main creator of these jobs but they are also the majority of risky borrowers. A bounce back in lending, especially lending that involves more risk, will be a good indicator as to when the job market will start to improve.

Another factor that will have consequences on the economy, albeit unknown, will be the proposed increase in regulation of the financial markets. As of right now, many agencies are performing a substantial amount of research so they can get a grasp on what they are exactly dealing with. Healthcare is at the forefront. President Obama

continued

Cornerstone
A SUBSIDIARY OF HARLEYSVILLE NATIONAL BANK

CORNERSTONE ADVISORS ASSET MANAGEMENT, INC.

74 WEST BROAD STREET, SUITE 340
BETHLEHEM, PA 18018

PHONE: 610-694-0900

made it clear during his address to Congress that the completion of this bill was expected. The healthcare industry is going to change, but how, is anyone's guess. The Senate is also conducting an inquiry into the rating agencies. There are many that blame these agencies for giving certain securities such a high rating when the loans backing the instruments might not have warranted that rating. Trading overseers, like the Commodities Futures Trading Commission (CFTC), are also jumping into the action by looking into the regulation of oil futures trading. The CFTC is mostly concerned with limiting the effect of speculators in the market place. With all of these new rules and regulations, there are many unknowns and we have to wait for the details to see how it will affect the markets.

So what does the future hold? It is very difficult to forecast the direction of the market or the economy in today's dynamic environment, but there are a few items that have our attention. Despite the better than expected earnings numbers, companies were not able to post any sort of sales growth. Most of the outperformance during the second quarter came from cost cutting (mainly layoffs). Third quarter numbers could be boosted by inventory restocking and fourth quarter numbers are going to be compared against very low standards from last year. But in order for earnings to grow through 2010, sales, driven by the consumer, will need to increase. The economy is certainly in better shape this year than it was last year; however, we are still cautious.

In managing portfolios, we have been increasing the amount of money allocated to international equities to take advantage of the declining value of the dollar while simultaneously decreasing the amount allocated to US stocks. We have also reduced the amount invested in high yield bonds since they have returned almost 50% this year and re-allocated it towards a core income strategy since we feel the high yield bonds are now overvalued. We also continue to have a bias towards higher quality stocks and bonds since we feel that risky assets have moved to far too quickly and are more susceptible to downturns in the market. We continue to remain more concerned about protecting money than maximizing return (by taking more risk.)

If you have any questions about your account, please feel free to call Sean Lyons, Chris Lakatosh, or Michelle Johnson at Cornerstone at 1-800-923-0900.