KEATING INVESTMENT COUNSELORS, INC.
REGISTERED INVESTMENT ADVISORS FOR INDIVIDUALS, RETIREMENT PLANS, TRUSTS AND FOUNDATIONS

Investment Strategy
April 2009

Recessions and bear markets can be very trying times for all of us, giving rise to a number of strong emotions. Foremost are feelings of fear and regret, as the market values of all assets and investments, including homes, decrease. Your first instinct may be to liquidate and cut off further losses. However, if the assets are good quality and you don't need the cash, one should be loath to sell when prices are so severely depressed. Unfortunately, that is what the majority does most of the time, buy high and sell low. We are confident that this crisis will come to an end and that there will be a strong stock market recovery. While we do not know exactly when, we believe it is inevitable and is coming sooner than commonly expected.

There is one thing we do know for sure: it is essential to stay invested, especially at this point in the cycle. Market timing, selling at the top and buying at the bottom, is extremely difficult to implement. In fact, we don't know anyone who has consistently been able to do it. Great fortunes have come from owning great businesses, not trading them. Most importantly, the opportunity costs of being wrong can be immense. Stock rallies tend to occur in short, sharp bursts. As demonstrated in a recent study of market data by Janus, keeping your money on the sidelines for just a few days over the past 20 years translated into dramatically lower wealth.

Value of $1,000 Invested in the S&P 500® Index From 1988-2008

Source: Janus market study utilizing FactSet Research Systems, Inc., data from 12/31/88 to 12/31/08.
This hypothetical example does not represent the returns of any particular investment and includes the reinvestment of dividends.

For example, $1,000 invested in the S&P 500 Index over the twenty-year period ending on December 31, 2008 would have grown to $5,043. However, an emotional investor who liquidated based on fears and only missed the market's ten best performing days, ended the same twenty year period with only $2,594, 48% less! That is just 10 days out of 7,300 days over twenty years. Although these sharp bursts most often come within 30 days of major market declines, they are nearly impossible to predict. Yet, missing out on these unexpected market rallies can have a dramatic effect on long-term wealth. By keeping a long-term perspective and overcoming short-term emotions, investors may be handsomely rewarded in the end. Have we already experienced one of those "best" days on March 23 when the S&P 500 rallied 7.1%?

While the market's recovery can be dramatic, as we stated above, we don't know exactly when it will occur or how long it will last. It is likely the effects of the recession will be felt for

much of 2009. Equity markets will remain volatile, unemployment will certainly continue rising, and we are likely to see some additional corporate bankruptcies. We will be monitoring closely for signs the economy is stabilizing and forming the foundation for the eventual recovery. Encouraging signs would include corporate earnings exceeding expectations, housing prices stabilizing, increasing consumer spending, improved investor confidence, and more liquid credit markets. Improvements in these areas will be needed to sustain the current market rally. However, we anticipate that employment numbers will continue to be negative for a while, even after the economic recovery takes root. With the U.S. economy in the midst of its sharpest downturn since 1982, companies will be reluctant to begin hiring until they are certain that the economy is well into recovery.

There are early signs of improvement as the normal resilience of our economy and the many recent government programs are finally starting to kick-in. New home sales increased 4.7% in February, the first month-to-month increase since July. Durable-goods orders unexpectedly climbed 3.4% in February. Consumer spending increased 0.2% in February after a 1.0% increase in January, two successive months of improvement after a 4.3% decline in the fourth quarter of 2008. Consumer sentiment also increased slightly from 50.5 to 53.5, according to the latest Consumer Confidence Survey. There are also signs of stabilization in the financial sector. The interbank lending rate (LIBOR) has come down from the extremes after the Lehman bankruptcy and there has been a dramatic increase in successful corporate bond offerings. In fact, the first quarter set a record for corporate bond issuance with $824 billion completed. We have even seen major banks such as Bank of America, Wells Fargo, and JP Morgan announcing they were profitable for the first two months of 2009 and now have the ability to begin paying back government capital supplied under the Troubled Asset Relief Program (TARP).

Another positive sign is the increase in merger and acquisition activity, notably in the healthcare sector, but with signs of activity emerging in other sectors. Several of the companies we own have been active including: Johnson & Johnson which recently acquired both Mentor Corporation, a leading medical aesthetic products supplier, and Omrix Biopharmaceuticals Inc., which makes sealants used to control bleeding during surgery. Eli Lilly purchased ImClone, known for its highly successful cancer drug, Erbitux. Medtronic purchased CoreValve and Ventor Technologies, both of which specialize in minimally invasive heart valve procedures. Abbott Labs initiated a $2.8 billion cash tender offer for Advanced Medical Optics, a leader in contact lens solutions and devices used in Lasik eye surgery. Pfizer announced the $68 billion acquisition of Wyeth, a move that will create the world's largest pharmaceutical company. There are also confirmed stories of IBM negotiating an acquisition of Sun Microsystems and Microsoft seems to be looking once again at Yahoo!.

Armed with the knowledge that the stock market typically begins a new bull market about five months before the economic low point and about eight months before the peak in unemployment, we are now switching from playing defense and are re-positioning portfolios to take advantage of the upside potential in the recovery. The strongest companies will be poised for

rapid growth during the recovery phase and it is important to position portfolios in anticipation of that growth. You can be sure that our proven strategy of value investing based on thorough fundamental analysis has not changed. We believe in being fully invested toward client objectives and in owning the highest quality, dividend paying companies in the world.

Where income is important, we have been moving more toward high quality corporate bonds to replace reduced income from early redemptions of government agency securities and the effects of some unexpected reductions in dividend payments. Investment grade corporate bonds from companies such as General Electric, Reynolds American, and Nordstrom, to name a few, have been selling at significant discounts to their par value at maturity. We believe the combination of high yields along with the potential for capital gains make these offerings a compelling value.

On the equity side, we continue to actively evaluate portfolio holdings to take advantage of opportunities to upgrade positions at current bargain prices and to maintain and enhance the substantial upside potential in the coming recovery. As we have mentioned before, it is essential to focus on the strongest companies with the best management teams during the downturn. Many of these companies have been accumulating cash and preserving capital while improving their processes and cutting costs. Meanwhile, their competition grows weaker through lack of re-investment in their businesses as they focus more on survival. This positions the stronger companies to take advantage of strategic opportunities as competitors disappear through acquisition or failure. Some of the leading companies we have been buying, like Abbott Laboratories, Bristol-Myers, Coca-Cola, Disney, IBM, Johnson & Johnson, Lilly, Medtronic, and Philip Morris, have the financial ability and foresight to stay on the offensive during difficult times and will be positioned for robust growth and above average returns over the next decade.

While the soon-to-end first decade of the 21st century will likely be the worst for stock returns in modern financial history, it follows the 1990's, the best decade in history. Rational investors will realize that this is no coincidence. After the historic, unsustainable run of 18.2% per year during the 1990s it now seems obvious that the current decade would likely yield a below average return. In fact, with the stock market selling for 33 times earnings at the end of 1999, the average market return for the subsequent period has been -1.4% annually. Likewise, the current poor results will likely lead to above average returns over the next decade. With the market currently priced at 10-11 times earnings, we expect returns for the next ten years to be near or above the long-term average annual equity return of 9.4%. The U.S. has faced many difficult challenges before and has always overcome them. We believe this will be the case once again and we remain quite confident in the long-term prospects for the U.S. stock market.

Truly yours,

Keating Investment Counselors, Inc.