FERGUSON ASSET MANAGEMENT, INC.

Investment Counseling & Asset Management for Individuals & Institutions

Quarterly Financial Report and Commentary

July 2009

Information in this report includes:

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Hand holding commentary

The Second Quarter

The second quarter was positive for nearly every sector and asset class in the equity markets. (Equities are stocks and fixed income is primarily bonds). The Dow Jones 30 Industrials gained about 11.5 percent. Unfortunately, it is still down about 3% for the year. The S & P 500 did somewhat better on both counts, up 14% for the quarter and up 1.7% for the year.

Technology, financial and international stocks all had a banner quarter. The emerging markets and the domestic small cap stocks were uptrend leaders, and the Bombay and Taiwan indexes soared. The gold index gained only 3% for the quarter, but it is still up 13% for the year. Money has historically flown into gold in deteriorating economic times, and out as the perceived problems improve.

The "safe" investments haven't done so well this year. The utility index is off 2 ½ % and 6-month Treasury Bills are yielding 0.35, while one-year CD rates range from 1.40 to 1.85. The two-year Treasury notes were yielding 1.05% at the end of June, which is not much to support a fixed income couple in their old age!

Your portfolio information is attached to this report. The higher your allocation to equities, the higher your quarterly returns are. If you have any questions about your portfolio or the asset allocation, and we haven't spoken with you recently, please feel free to give us a call. We expect to have touched base with each of you before this quarter is over.

We don't know just what the Obama massive stimulus packages will do to our economy. There is very little history regarding this approach. The Japanese provided massive fiscal stimulus to their economy in the early 1930's, and by 1933 they were out of the Great Depression. The only problem was they were spending money on war material. We wouldn't do that, would we?

Big change for your IRA account?

IRA account withdrawals are taxable. They are also included in your estate. They are subject to double taxation. They are taxed once if they are included in your estate (if your estate is large enough), and they are always taxed when funds are withdrawn.

Roth IRA account withdrawals are not taxable. The funds were taxed as ordinary income, but were allowed to be saved and grow tax-free. There are contribution limits for higher income earners.

The withdrawal may be by you, your spouse, or your heirs. Nevertheless, no matter who withdraws, they must include the amount as ordinary income and pay income tax on it.

(An insidious point you may not have known is as follows: You have an estate which is one million dollars above the exempted estate amount. That amount was in your home and business. The million is in your IRA. The estate tax on the million is currently 47%. Your heirs pay $470,000 on the tax on your IRA. They argue among themselves and don't want to sell the house or the business so they liquidate the IRA to pay the $470K. Now they have an IRA distribution which is ordinary income. They are in the 30% tax bracket. They owe $300,000 in ordinary income tax. What was left of your million that your kids inherited after they paid the various taxes due? Yes, only $230,000!)

You may have a terrific opportunity in 2010. This is a one time only, one year only situation. Congress has eliminated income limits or restrictions for individuals converting from a traditional IRA to a Roth IRA. Not everyone is currently allowed to open a Roth IRA. There are income limits. Moreover, taxpayers with adjusted gross incomes over $100,000 have been unable to convert to a Roth.

The year 2010 is different. There are NO income limits for transferring from a traditional IRA to a Roth IRA. When you do convert, the ordinary income tax is due. Again, a gift. We can pay that tax over two years. Whoopee-do you might say, but this is a big deal.

The Roth IRA assets grow tax-free. How old is your youngest grandchild? Just think of all those tax-free years of money compounding for them.

The withdrawals are tax-free.

There is no required minimum distribution once you turn 70 ½.

This year you should contribute the maximum allowed into your traditional IRA. Next year you complete a Roth IRA conversion. Another plus to think about is that the administration has already said income tax rates (and capital gains rates) are going higher.

This year we will be speaking with you about the conversion and, for many of you, discussing our analysis and plans with your CPA.

Fidelity

At one time or another during the past thirty years, we domiciled client assets at a variety of brokerage firms. We used Prudential, Schwab, Merrill, Oppenheimer, Smith Barney, and Fidelity. Fidelity impressed us with their order execution service, lower commission charges, no hidden fees, no self-serving promotions, and superior back office services for independent registered investment advisors, such as Ferguson Asset Management, Inc.

About a dozen years ago, we switched all clients to Fidelity and never regretted that choice. We do not receive any fees, kickbacks, hidden services, or rewards from Fidelity. We have worked closely with them and have been fortunate enough to beta test some of the new software they were evaluating. This past May I was invited to their leadership conference and tremendously enjoyed the Fidelity presentations and interactions with other leadership advisors.

Now, after several years of planning and testing, and expenditures expected to reach fifty million dollars, Fidelity is rolling out their Wealth Management Program for independent advisors.

This is a state-of-the-art integration of portfolio record keeping, allocation analysis, graphic analysis, and client presentations that are integrated with the most extensive new client relationship management (CRM) program. Fidelity has teamed up with Advent (the leading portfolio record keeping system and the one which we have been using for over twenty years) to expand the portfolio record keeping and analysis programs used by us in asset allocation.

They have partnered with Oracle and Siebel Systems for the CRM program and, important for us, the seamless integration of both the CRM with Advent. We are in training and have online, one-on-one instruction from very competent teachers. This is my first working experience with Oracle, and now I know why they are such a successful dynamic company. Their service is extraordinary.

Our Cloud Computing

It will take us about two months to be fully on course with the new Fidelity platform.
What you will eventually see are more graphics in our reports and presentations. Each of us will have access to your work-in-progress files, such as fund transfers, requests, deposits, and pending actions for your behalf. We will have access to this information from Fidelity's secure servers almost anywhere on the planet. The information is available to us because of the Fidelity

platform, the integrated infrastructure, and the software services. This is known as “cloud computing.”

We also spent and are spending a fair amount of money on this new Wealth Management Program. (A heck of a lot less than fifty million). The benefits are for you, our clients. We are excited about the opportunity that this “cloud” provides.

My goodness, there is a lot going on!

Sometimes we just need to have someone hold our hand and reassure us that everything is going to be alright.

Health care reform, the Afghanistan war, TARP funds, business bailouts, bankrupt states, and government web sites rendered dysfunctional are some of today’s relevant issues. We now have eleven czars, including car, energy, and drug czars. Two-year Treasury notes have a yield of 1.05, income and capital gains taxes are expected to increase next year, and real estate taxes already have. Unemployment continues to head higher and, if like any prior recessions, will continue to do so for a couple of quarters into a recovery.

Speaking of recovering, are we? Again, if history is a guide, we should know if we are recovering now by sometime in 2011. It takes a while to gather and analyze all that data with outdated government computer systems that we were belatedly informed are prone to regular hacking disruption. However, we now have an InfoTech Czar to solve the situation and their target is 2012.

These are just the mundane, business as usual, routine crisis of the day sort of things. The juicy parts involve forbidden love, billion dollar fraud(s), and celebrity deaths. These also now appear to be routine.

I bring these items up to point out that nothing is really ever new. The names of today’s calamities are different than Vietnam, the gas shortages of the seventies, the double-digit unemployment of the early eighties, and the stock market 22% one day meltdown of October 19, 1987. Tino De Angelis rocked over 20 big banks, broke two brokerage firms, and nearly ruined American Express with his soybean oil fraud of the sixties. The largest US bank failure in May 1984 was the collapse of Continental Illinois National Bank.

There is a difference this time, in that those prior problems were spread out over decades. Now it seems that it is all happening at once. We do not know if the positive returns from last quarter were a blip in a bear market or the beginnings of a subdued recovery. Some factory orders are picking up, the technology sector is stabilizing, home sales show mixed geographic specific improvement, inventories are down and will eventually have to be rebuilt, and we are saving more money in the coffers for eventual capital or discretionary spending.

We are not gamblers, and betting on the next direction of the stock market(s) is not our cup of tea. Prudent asset allocation has, and will continue to win out in the long run. What that allocation is for you may be entirely different from the next individual. We have clients that we have positioned mostly in fixed income, and others who are primarily in diversified stock holdings. Each client has different needs, risk tolerances, time horizons, and goals. We never adopted the cookie cutter approach to investing.

Patience will be rewarded. We are not risking your retirement. Enjoy your family and this summer. Plan something positive for yourself. Best wishes from all of us to you. JPF