LEGACY
ASSET MANAGEMENT, INC.

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About Legacy

Legacy Asset Management, Inc. is an independent Registered Investment Advisory firm, committed to providing the best solutions for our clients' success.

We offer professional money management and sound objective advice throughout a full range of investment and Qualified Retirement Plan consulting services for the institutional and high net worth client.

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The Rebound

Chicken Anyone?

In 2009, investors unknowingly played the ultimate game of chicken. After suffering gut wrenching equity losses in 2008, the year began with losses compounding on losses. By the end of January, all of the major indices were down almost 10%. In February, the Dow and the S&P 500 lost yet another 10%. With investment accounts down almost 50% over 14 months, retail and institutional investors began questioning whether they had the guts and stamina to remain in equities or whether they should reduce their exposure in favor of risk-free assets, such as Treasury and CD securities. Those investors that stayed true to their investment philosophy and asset allocation throughout the market meltdown were rewarded as the equity markets came roaring back.

There was little to get excited about in March until several large money center banks indicated that zero interest rates were helping their bread and butter business of making loans. Indeed, borrowing money from the government for free and lending to high quality customers for 5% sure did help build up net interest margin. By April, the effects of government goodies (home buyer's tax credit) and low interest rates started to trickle down to consumers and magically, the housing market started to show signs of life. Housing prices stopped declining and the supply of houses for sale fell from 13 months to less than 8 months. As other aspects of the economy bottomed in the spring the stock market began to stabilize and gain momentum. By the middle of the summer there was actual evidence that the economy was beginning to improve. "Less worse" became the popular catch phrase for economists and Wall Street gurus trying to justify the rise in the equity markets. Indeed, in July, 73% of S&P 500 companies reported earnings that were better than the gloomy predictions earlier in the year. As the leaves began to change colors, companies continued to produce earnings that were generally better than expected due to cost cutting, high productivity and for multinationals, a falling dollar. The U.S. dollar, relative to the Euro, started to fall in April and continued to slide through November before staging a rebound in the final month of the year. Dollar weakness helps support sales and earnings for multinational companies that sell U.S. products overseas and commodity based stocks like gold, oil and copper. Equity prices continued to move higher throughout autumn as optimism grew that the economy would continue to improve, and corporate earnings would continue to gain momentum through the first half of 2010. When all was said and done, the Dow, the S&P 500 and the NASDAQ had their best year since 2003, with gains of 20%, 25% and 45%, respectively. What is more remarkable is that from the market low set on March 9, the Dow rebounded **61%**, the S&P 500 shot up **67%** and the NASDAQ exploded **81%** higher.

A Historic Decade

America, the great land of opportunity, may seem to be more of a myth than a reality after the recent financial crisis. The depth and breadth of the effects of the collapsing global economy took its toll on both corporations and individuals. The magnitude of the losses helped turn the first decade of the century into the worst in 70 years. Indeed, the last 10 years were tough on Americans as employment opportunities diminished under the weight of two recessions and the credit crisis. Even as the total U.S. population grew by 35 million people, the economy only managed to create 464,000 net jobs over the course of the decade. Weak employment contributed to only a modest increase of 5.3% in personal income from December 1999 through October 2009. This is the smallest increase in six decades. Furthermore, the collapse of the housing market and losses in

401k and other investment accounts help explain why the average net worth of Americans declined 13% from the fourth quarter 1999. This is the first decade that Americans have actually lost wealth since the 1930's.

The millennium started with such promise. Economic cycles were deemed non-existent, net earnings did not matter and the tech revolution was in full force. Unfortunately, it did not last long. The tech bubble burst in March of 2000 followed closely by the decade's first recession. By the time the World Trade Center towers fell, the economy was, at best, limping along. The Bush tax cuts and low interest and mortgage rates helped revive economic activity but growth was uneven. With little debt, strong balance sheets and cheap money, corporate managers elected to pursue mergers and acquisitions rather than investing in research and development. Stocks responded positively to the strategy as the S&P 500 rose for five straight years from 2003 to 2007. All the while, consumers were leveraging-up on their mortgages to support their audacious appetites for iPhones, Xboxes, and Wii's. The Internet, Google, YouTube, blogging and reality TV became popular outlets for household entertainment as newspapers and traditional forms of news media became less influential.

By 2007, the cracks in the dikes began to show as problems in the housing market came to light. The financial landscape changed dramatically in 2008 as a century of financial history disappeared as investment stalwarts Bear Stearns, Lehman Brothers and Merrill Lynch were forced to close their doors. The government became the "broker of big business," deciding what bank and business would succeed and fail. Never before had bureaucrats taken such control over the capitalist system. Government spending on the war and social programs ballooned and debt expanded 65% in the decade, to $11.9 trillion. By the end of the decade, the deficit had reached $2 trillion.

The future will certainly be challenging and investment mangers will have to be on their "A" game! There will be many twists and turns throughout the next decade as the potential impact of higher interest rates and taxes unfolds. In addition, investors will have to keep a watchful eye on developments in Washington regarding government regulation, support for the dollar, deficit and debt reduction and geopolitical issues. The good news is that we have never had two decades back to back where equity returns were negative.

A Year To Buy And Hold

It is psychologically difficult for investors to react rationally in irrational situations. When the financial markets are moving in the wrong direction investors tend to act in ways that are opposite of what the situation dictates. A buy and hold strategy usually outperforms a short-term or trading philosophy in a trendless market. Based on the magnitude of both the decline and the recovery, one could easily say that taken together, the last two years have basically been trendless even though the Dow and the S&P are down about 10% from the pre-Lehman bankruptcy levels. This includes the big declines from the middle of September 2008 through March 9, 2009 and the big recovery in the latter part of 2009. Anticipating and capitalizing on such violent trend changes is almost impossible to do. Therefore, investors that stayed invested throughout the entire cycle should have survived the recent volatility in relatively decent shape, depending on their asset allocation. Unfortunately, too many investors asked to be taken out of equities near or at the bottom and did not have the conviction to get back into the market as it rallied upward. Therefore, they did not benefit from the market rebound and have losses that may take years or decades to recapture.

At Legacy Asset Management, not only did we weather the economic storm, but also successfully navigated the turbulent equity markets. Client equity portfolios delivered positive returns of 20% versus a decline of 9% for the S&P 500 index, over the decade. Our disciplined process focuses on identifying companies with compelling long-term strategic plans and valuations that are attractive relative to broad-based economic realities. We are not afraid to use cash as an asset allocation tool. If we see volatility impacting a specific sector or the economy as a whole, we will make both tactical and strategic decisions to increase the cash positions in client portfolios in order to preserve capital and limit risk exposure. Our defensive move into cash in 2008 served our clients well as did our conservative, value based approach to stock selection. We continue to adhere to our discipline which has helped clients successfully maintain their capital through two complete business and investment cycles.

4th Quarter Market Review

Although the equity markets could not duplicate the double digit gains of the previous two quarters, they did manage to extend the positive upward momentum on the back of stronger than expected earnings. Almost 80% of the companies in the S&P 500 beat analysts' expectations in the quarter. The majority of the improvement resulted from cost cutting, margin expansion as well as moderate revenue growth. This positive development could be a precursor to more permanent improvements in general business conditions.

Stocks sold off in the latter part of October as investors asked rhetorically "what's next"? Concerns centering around the sustainability of the recovery, potential softness in the upcoming holiday shopping season, and the expiration of the housing rebate program took center stage. This correction proved to be short-lived as stocks resumed their upward trajectory in mid-November after a string of positive economic releases around durable goods, factory orders, housing and jobless claims. Furthermore, Mergers & Acquisitions activity picked up and had its most active quarter since the summer of 2008, with Warren Buffett stepping up to buy Burlington Northern, Exxon Mobil's purchase of XTO Energy, and the merger of Stanley Works with Black and Decker pointing to increased CEO and Board of Director confidence.

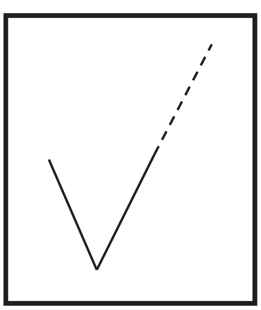
Overall, the Dow, S&P 500 and NASDAQ posted gains of 7.4%, 5.5%, and 6.9% respectively for the quarter. Technology stocks were the best performers, delivering gains of 10.5% driven by strong earnings resulting from the restocking of inventories and margin expansion. Consumer discretionary and healthcare stocks were also solid, gaining 8.6% and 8.5%. Retail discretionary stocks rose on expectations for a good 4^{th} quarter relative to the abysmal holiday 2008 season. Leaner inventories and modest discounting should have helped profit margins. Healthcare stocks as a whole enjoyed a valuation shift upward as the specter of healthcare reform became a reality. This "sell the rumor, buy the news" dynamic is reflective of the idea that the actual reform passed will be less onerous than that which the stocks had discounted. All other sectors of the market posted positive absolute returns this quarter except for the financial sector, which logged a 3.7% loss. This is likely a result of profit taking from the earlier torrential returns we have seen in this space coupled with a lack of true fundamental improvement in the companies' businesses.

In terms of style and characteristics, growth handily outperformed value stocks across all capitalization sizes. However, according to the Russell Indexes, the widest deviation in returns occurred between large-cap growth (7.94%) and value (4.22%). The return of growth over value this quarter can largely be attributed to the aforementioned outperformance of technology stocks along with the significant underperformance of the more value focused financial stocks. The spread in performance between value and growth was considerably smaller among mid and small-cap companies. Large-cap returns beat those of their small and mid-cap counterparts as the risk trade abated in the quarter. In the second and third quarter, small and mid-cap stocks led the markets higher as investors sought outsized returns from risky or low quality stocks. As the economic recovery unfolds, large-cap stocks tend to out perform small and mid-cap stocks.

Where is the Alpha?

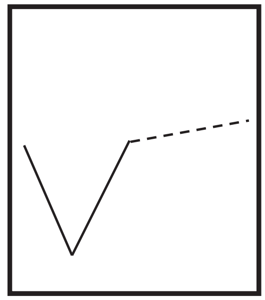
We find ourselves at an inflection point where the equity markets will move in one of three possible directions based on the likely scenarios of economic recovery. With a belief that a picture is worth a thousand words, we have created three diagrams to help explain our thesis for the economy and the financial markets. In all three diagrams, the solid "V" is meant to represent what has actually occurred with the meltdown of '08 and early '09 and the subsequent recovery this year. The dashed line represents our forecast for each scenario.

The "V" Shaped Recovery



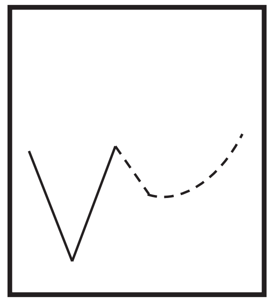
The first scenario is the most bullish (and in our opinion, unlikely to occur) case where both the short and long term economic outlook reflects continued growth in a somewhat linear fashion with few bumps or pullbacks. It factors in a rather robust economic recovery, a return of consumer spending to prior levels, steady monetary and fiscal policies, and consistent and compelling data around improvements in housing and credit availability.

The "Square Root Shaped Recovery"



The "square root" shaped recovery, (a possible scenario) represents a slow and stagnant recovery which will stall both GDP growth and stock prices for the long-term. It assumes that a vicious cycle will develop where chronically high unemployment will cause protracted saving by consumers. Over the long-term, the high level of personal savings will undermine the effectiveness of any stimulus plan and will create larger deficits, leading to higher interest rates and lower corporate activity.

The "Modified Nike Swoosh" Recovery



The third (and most likely, in our opinion) scenario represents a short-term market pull back of some of the gains achieved in 2009. We believe that there has been some amount of the economic recovery that was front-end loaded due to stimulus programs like "Cash for Clunkers" and the home equity rebate program. In addition, equity investors with cash sitting on the sidelines earning no interest have already come back into the markets. Third, the equity markets do not look to be especially cheap trading at a multiple of 15X 2010 expected earnings. Finally, we look for the dollar to regain some strength in the near-term which can lead to a market pullback.

Long-term, we are bullish and believe that the recovery will continue after this initial correction. Our assumptions center on the premise that corporate profits will carry the day in lieu of a weak consumer. Inventories should continue to rebound from multi-decade lows and stronger profitability will enable companies to increase their capital spending. As corporate profits resume, we see the employment picture brightening in the latter part of 2010 with a related up-tick in consumer spending and confidence. We also believe that the dollar and interest rates will remain low by historical standards, providing further fuel for stock and economic gains.

Quarterly Activity

Legacy initiated positions in the following companies:

V.F. Corp (VFC) We added this diversified manufacturer and retailer in the quarter due to its attractive valuation, strong management team and its competitive position within its industry. With superior lifestyle and core brands such as Lee and Wrangler Jeans, Vans, Reef, Nautica, and the North Face, the company has diversified its portfolio of offerings and lowered its fashion risk. This multinational company generates approximately 30% of company sales outside the U.S. and should continue to benefit from weakness in the dollar. We believe gross margins will expand as management continues to focus on "lifestyle" brands which have higher margins relative to its core jeans franchise. We believe that V.F. Corp. is attractively valued. It typically trades at a premium to its retail peers due to its higher margins and strong profitability. However, relative to its peer group, it's valued at an unusual 12% discount. In addition, V.F. Corp is using its excess cash flow to buy back shares, while its dividend is currently 15% higher than its 10 year average.

Forest Labs (FRX) Legacy initiated a position in Forest Labs, a specialty pharmaceuticals company best known for its therapeutic focus on mental health disorders such as depression and Alzheimer's disease. The company's key drug, Lexapro, has been a key driver of the company's success, but is scheduled to go off patent in 2013. Investors' concerns about how the company will fill this "patent hole" has driven the shares' valuations down to extremely attractive levels, with the stock trading at a P/E of 8.7X projected 2010 earnings. Excluding the cash on its balance sheet, FRX is trading at 6X estimated 2010 earnings. Our investment thesis centers on the view that the market is not giving credit for its late stage drugs and a credible pipeline which looks to hold promise. In addition, its balance sheet is very robust with a cash balance of approximately $3 billion and no debt. We believe management has a successful track record of prudently deploying cash in order to support its pharmaceutical pipeline.

Legacy liquidated positions in the following companies:

Amgen (AMGN) Legacy eliminated positions in Amgen this quarter after the company released its third quarter results. While, financially speaking, AMGN hit all metrics, the investment thesis become more uncertain due to FDA concerns over the effectiveness of its key pipeline drug Prolia. This trend has become all too familiar at Amgen which is dealing with dramatically lower sales than projected for its high profile franchise drug, Aranesp which had an additional clinical setback due the increase of risk of stroke for people using the drug for cancer. We were also disappointed by the company's failure to repurchase shares given the low relative valuation and high free cash flow yield of the stock with no commensurate dividend yield. While we will continue to monitor the progress of the company's pipeline we feel the fundamental risks to the clinical process and pipeline outweigh the benefits of a cheap valuation and near term results.

XTO Energy (XTO) We sold our holdings in XTO on December 15th after Exxon announced its intention to acquire the company in an all stock deal worth $31 billion. Since our clients already hold a large position of Exxon, we did not feel that it was necessary to add to the position. Therefore, we elected to sell all positions and lock in gains.

United States Oil ETF (USO) We sold part of our client positions in this Exchange Traded Fund that is linked to the price of West Texas intermediate crude. With rising oil prices, the ETF had increased in value almost 60%. With outsized gains and an increasing position within the portfolio, we decided to reduce our holdings. Although we reduced our exposure in USO, we still believe there continue to be opportunities within the energy sector. We will continue to hold USO as a small position to leverage our exposure to energy.