THOMAS FINANCIAL

Third Quarter 2009

Quarterly Economic News

A light at the end of the tunnel: the Dow Jones Industrial Average had its best quarterly performance since 1998 and most major stock indices' year-to-date returns are now in positive territory by a large margin. Interest rates stayed low, as inflation has not yet been a mitigating factor. Despite economic contraction, the second quarter GDP was much improved compared to the two previous quarters. Other signs of economic improvement include increased merger activity, lowered cost of borrowing for banks down to pre-credit crisis levels, and increased activity in the national housing market. The short-lived, but popular, "Cash for Clunkers" incentive also spurred auto sales this summer. However, unemployment is still a major factor that threatens to hold back a solid recovery as the economy continues to shed jobs.

The Market's Extended Rise

The Dow rallied 16% for the quarter, extending its gains from the second quarter, and is now up 11% for the year. Gains were seen across all major equity indices, including small cap and international indices - the Russell 2000 small cap index was up 19% and the MSCI EAFE international index was up 19% for the quarter and 26% so far this year. The S&P 500's gain of 42% over the second and third quarter was its best two quarter rally since 1975, while the Dow's 34% gain was its best since 1986. Signs of economic improvement and an easing of the credit crisis, as well as investors' willingness to take on more risk, led to gains in equities. The following table shows returns for a select group of indices:

Index	3rd Qrt	1 Year	5 Year	10 Year
S&P 500	15.6%	-6.9%	1.0%	-0.2%
Russell 2000	19.2%	-9.6%	2.4%	4.9%
MSCI EAFE	18.9%	-6.3%	3.3%	0.3%
Barclays Agg. Bond	3.7%	10.6%	5.1%	6.3 %

Source: Wall Street Journal October 5, 2009

The S&P 500 is a commonly used measure of common stock total return performance.

The Russell 2000 is a commonly used measure of small capitalization stocks.

The MSCI EAFE is a commonly used measure of common stock total return performance of international markets.

The Barclay's Aggregate Bond Index (formerly Lehman Brothers' Aggregate Bond Index) is a commonly used measure of the bond market.

All referenced indices are unmanaged and not available for direct investment.

Past performance is not a guarantee of future results.

The yield on Treasury bonds dipped as signs of inflation did not materialize. The yield on the ten-year Treasury bond fell 0.21% and finished the quarter at 3.31%. The highlight in bond markets was not in Treasury bonds, but in the market's embrace of risk and the loosening of lending metrics. Investors bought corporate and high yield debt, taking advantage of higher yields. According to Merrill Lynch, the high yield market gained 15%

Cash for Clunkers

During the third quarter, the government unveiled a "Cash for Clunkers" program offering consumers up to $4,500 to swap older vehicles for more fuel-efficient vehicles. The program, created in part to spark auto sales, was wildly successful. Some auto showrooms could not process the paperwork fast enough and suffered inventory shortages on popular models as consumers rushed to take advantage of this incentive. Initially slated to last for three months, the program was terminated after approximately one month due to high consumer demand. Congress originally budgeted $1 billion for the "Cash for Clunkers" program, but its popularity led to the approval of an additional $2 billion to support the demand. This program provided automakers a much needed boost. Auto sales in July and August were estimated at an impressive 700,000 vehicles, but fell off in September when the program ended. Industry analysts feel that "Cash for Clunkers" left automakers in a better financial position even if future sales do not reach the levels achieved during the program. Many automakers were able to reduce their inventories and increase production, putting some idle employees back to work. The auto industry, which had shown signs of deterioration since the summer of 2007, now appears to be on the mend.

"Auto Sales Fall Back as Clunker Program Ends", Nick Bunkley, The New York Times, Oct. 2, 2009.

during the quarter and is up 48% for the year. In August 2007, as banks became more concerned about the creditworthiness of other banks, the overnight rate (rate that large banks use to borrow and lend from one another on the overnight market) increased. In October 2008, at the peak of the credit crisis, the overnight rate hit 3.64%, which halted most inter-bank financial activity. Today, the overnight rate has fallen to approximately 0.11%, which is below historical averages. This a clear sign that the credit crisis is losing momentum.

"Dow, Up 15%, Has Best Quarter Since '98", Tom Lauricella, Wall Street Journal, Oct. 1, 2009.

"U.S. Stocks Fall, S&P 500 Trims Best Two Quarter Gain Since '75", Elizabeth Stanton, Bloomberg, Oct. 1, 2009.

"Treasury Buoys Credit Markets, but Junk is King", Serena Ng, Wall Street Journal, Oct. 1, 2009

"Treasuries Head for Weekly Gain Before Durable Goods Orders", Wes Goodman, Bloomberg, Sept. 25, 2009.

Housing Shows Signs of a Rebound

Many economists feel that the economy won't be restored to full health until the housing market stabilizes and home prices begin to rise. One widely monitored measure of the housing market's health, the S&P/Case-Shiller home price index, showed a 1.2% gain in July, its largest since October 2005. Below is a multi-year graph of the Case-Shiller index:

http://www.calculatedriskblog.com/2009/09/case-shiller-house-prices-increase-in.html

Nationwide, seventeen out of twenty metropolitan markets showed price increases in July. Low interest rates and tax incentives for first-time home buyers are boosting sales, along with a sense that prices have bottomed. People who were once waiting to buy are now taking advantage of low prices. However, as seen in the graph above, the upturn in prices is tenuous and there are still obstacles to a complete housing market recovery, including mortgage delinquencies and pending foreclosures. Economists are cautiously optimistic that gains in the housing market are sustainable and will benefit the economy.

"US Economy: Home Prices Increase by Most Since 2005", Bob Willis and Shobhana Chandra, Bloomberg, Sept. 29, 2009.

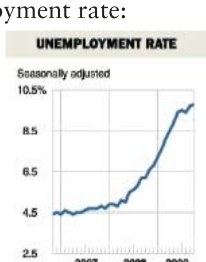
Merger Activity

A few large corporate mergers were announced in the third quarter: Disney bought Marvel Entertainment for $4 billion, Abbot Labs acquired a unit of Belgium's Solvay for $6 billion, and Xerox acquired Affiliated Computer for $6.4 billion. Mergers and acquisitions are a good sign of corporate confidence and a sign that the financial markets are stabilizing.

"Big Merger Deals Signal Restored Confidence", Andrew Ross Sorkin, New York Times, Sept. 28, 2009.

Rocky Recovery

In August, consumer spending reached its highest peak since 2001. The "Cash for Clunkers" program helped boost this number, but other retail areas benefited as well, indicating a broader consumer spending increase. Manufacturing is slowly expanding - the September numbers showed growth - but less than was expected. The second quarter GDP showed a decline of 0.70%, which was less contraction than expected. Economists are anticipating that the economy will have shown growth when the third quarter numbers are released. However, this optimism is being mitigated by weak employment. September's employment figures were below expectations: the national unemployment rate is now at 9.8%, the highest level since 1983. High unemployment will continue to temper consumer spending, a vital part of economic growth. The following table shows the most recent published unemployment rate:



http://online.wsj.com/mdc/public/page/2_3024-ecocharts.html?mod=topnav_2_3024

"U.S. Consumer Spending Jumps by the Most Since 2001", Shobhana Chandra, Bloomberg, Oct. 1, 2009.

"Signs of Upturn Fail to Brighten Jobs Outlook", Conor Dougherty, The Wall Street Journal, Oct. 3, 2009.

"GDP Shrank Less Than Expected in Quarter", Jack Healy, New York Times, Oct. 1, 2009.

Conclusion

Recent employment figures raised worries that the economic recovery may be undermined unless a decrease in unemployment is achieved. On a positive note, the stock market's continued rally in the third quarter has bolstered confidence. Investors sought riskier high yield bonds that became more attractive over the quarter due to low yields on government bonds and the easing of the credit crisis. Sectors of the economy showed signs of recovery, most notably the housing market. Increased merger activity reflects corporate confidence in future growth. There are still hurdles facing a complete recovery; however the economic decline seems to be leveling out.

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