FAYEZ SAROFIM & CO.

Investment Counsellors

A Consistent Discipline for Fifty Years | **3RD QUARTER 2009**

ECONOMIC & MARKET UPDATE*

The collapse of Lehman Brothers in September 2008 sent tremors reverberating through economies worldwide and intensified the downturn already underway into the worst global recession since the 1930s. With a sense of urgency, policymakers around the world responded aggressively, enacting collectively more than 700 measures to stabilize financial systems and stimulate economic activity. Now, a year later, the unprecedented policy response appears to be gaining traction and helping to reverse the negative feedback loops that so exacerbated the global recession on the downside. Signs of recovery are unevenly distributed among the world's major economies, but a nascent global upturn appears to be gathering strength.

Emerging Asian economies led by China are recovering the fastest, with several registering second quarter growth rates of more than 10% annualized. Even Japan's output rose at an annual pace of 3.7%. Activity likewise picked up in the key European economies of Germany and France. Progress towards recovery has been slower in the US, where GDP contracted modestly in the second quarter. However, the third quarter GDP report, which is released in late October, is widely expected to show that growth has resumed. The index of US leading indicators has risen for five consecutive months through August, a trend that historically has consistently and correctly signaled recovery. Greater economic strength abroad is expected to reinforce the domestic improvements currently underway and provide a lift to US exports and the overseas earnings of US multinationals. Near-term prospects should also get a boost from a favorable swing in the inventory cycle, an intensifying impact of federal fiscal stimulus and greater stability in the housing market.

> ***The transition from recession to recovery is still in an early stage and vulnerable to setbacks.***

While the majority of US economic releases over the last three months have surprised on the upside, a few disappointing reports in the final weeks of the quarter serve as a reminder that the transition from recession to recovery is still in an early stage and vulnerable to setbacks. There are valid concerns about the ability of this recovery to become self-sustaining in 2010 given the persistent weakness in the labor market, the ongoing deleveraging in the household and financial sectors and the eventual curtailment of policy stimulus. These factors are expected to make the recovery in the US quite moderate by historical standards.

The rally in equity markets from early March through September has both anticipated and reinforced the improvement in the near-term economic outlook. Importantly, appreciation in stock portfolios along with modest increases in home equity led to an uptick in consumer net worth in the second quarter, the first such increase since the third quarter of 2007. Continued increases in net worth can help set the stage for a mild pickup in consumer spending even as thrift remains firmly entrenched and unemployment elevated.

Improved capital market conditions and greater business confidence have also supported a pickup in debt and equity offerings. Issuance, which was initially concentrated in the financial sector as banks recapitalized, became more widespread in the third quarter. With nonfinancial corporate balance sheets flush with cash, merger and acquisition activity has likewise revived. Deals are being completed at significant premiums to market prices, underscoring the undervaluation of many public enterprises. An assessment by corporate managers that opportunities for organic revenue growth will be more limited in a slow growth environment may also be contributing to the increased activity. In any case, managements have been quite aggressive in cutting operating costs and paring back capital expenditures in this downturn. The financial flexibility and strength of most large nonfinancial companies are the best they have ever been, and operating leverage on even a tepid uptick in final demand could be significant.

With interest rates low and on hold, inflation muted, economic prospects improving and earnings estimates being revised upward, the backdrop for stocks remains constructive. However, in 2010, as the impact of stimulus fades and the Fed begins to withdraw liquidity, concerns about growth and earnings are expected to intensify. New leadership with fundamental strengths will likely be required to take the market indexes higher. So far the market rebound has been driven by the revival of the low quality, riskier issues that were abandoned by investors in the wake of the financial crisis. For the first nine months of 2009, the highest rated A+ and A stocks in the S&P 500 are up only 4% and 18%, respectively, while B-rated stocks have appreciated almost 33% and C-rated issues some 55%. This performance divergence has compressed valuation distinctions among higher and lower quality issues. Going forward, we believe the stocks of high quality industry leaders are positioned to reclaim a premium valuation and resume market outperformance. These dominant businesses that are the focus of our strategy are distinguished by strong franchises, global market opportunities, and ample financial resources. They are well-equipped to sustain superior earnings and dividend growth in a low nominal growth environment.

**The views expressed herein are those of Fayez Sarofim & Co.'s investment professionals at the time the comments were made and may not be reflective of their current opinions and are subject to change without prior notice. Neither the information contained herein nor any opinion expressed shall be construed to constitute investment advice or an offer to sell or a solicitation of an offer to buy any securities mentioned herein.*

PORTFOLIO COMMENTARY

3rd Quarter Attribution*

The recent three-month period was the strongest third quarter for the S&P 500 in nearly four decades. The quarterly gain, which added to similarly strong returns in the second quarter, was achieved against a backdrop of improving economic and credit markets conditions. Smaller, lower quality issues in the more cyclical sectors continued to lead the market. The beleaguered financial sector, which registered the steepest decline in 2008 and early 2009, was the top-performing sector of the Index in the third quarter followed by industrials, materials and consumer discretionary. The portfolio logged a double-digit gain in the quarter but trailed the Index primarily due to its strategic focus on higher quality companies with steadier businesses. In particular, the emphasis on consumer staples issues impeded relative returns as did the limited representations in the outperforming financial and consumer discretionary sectors. The overweighted allocation to energy also detracted from relative results. These factors were partially offset by strength in key holdings in health care and industrials, the underweighted exposure in utilities and the void in telecom. Leading issues in the portfolio for the quarter included Intuitive Surgical, Caterpillar, American Express, General Electric, HSBC Holdings, Prudential Financial, News Corp. and Halliburton. The high quality multinationals in the portfolio have the fundamental strengths that we believe will be required to drive the market higher from current levels. In our opinion, these globally focused industry leaders are particularly well positioned to maintain superior earnings growth if, as we anticipate, the economic recovery in the US after the initial cyclical snapback proves to be subpar.

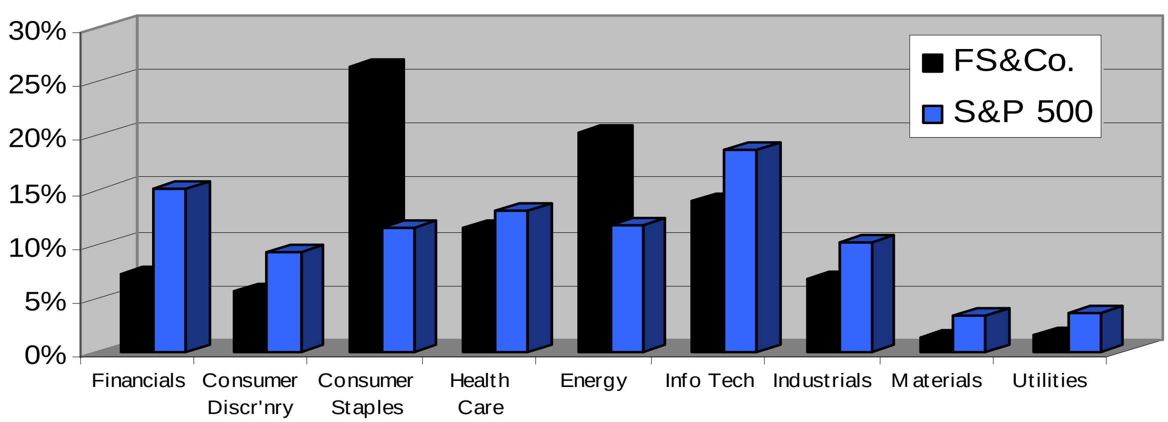
Top Ten Holdings*

Exxon Mobil Corp.
Philip Morris Intl Inc.
Coca-Cola
Procter & Gamble
Johnson & Johnson
Chevron Corp.
Nestle Sponsored ADR
PepsiCo Inc.
Intel Corporation
Abbott Laboratories

Portfolio Characteristics*

Avg. # of Holdings:	50-70
Avg. Mkt. Cap:	$109 B
Median Mkt. Cap:	$44 B
5-Yr. EPS Growth:	19.7%
Dividend Yield:	2.6%
P/E (2010E):	13.4x
ROE:	28.3%
Debt to Total Cap:	27.3%

Sector Weightings



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**Based on a target model portfolio. The specific securities identified and described herein do not represent all of the securities purchased, sold or recommended for the portfolio, and it should not be assumed that investments in the securities identified were or will be profitable. We will, upon request, furnish a listing of all investments made during the prior one-year period. Data as September 30, 2009.*