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Romano Brothers & Co.

Winter 2009

A Message From Our President

Dear Clients:

Just like for so many of you, it has been a very busy holiday season here at Romano Brothers & Co. We recently completed our conversion to the Mesirow clearing system and our staff has worked extra hard to make this transition as seamless as possible from a client perspective. Still, we recognize that this has also required an adjustment on your part as we all get familiar with new statements, confirmations, and procedures. Rest assured, we are still fully independent and our ownership structure has not changed. Moreover, all of the same team members are in place to help you and answer any questions that may arise.

And of course, the world markets have kept up us extra busy particularly over the last quarter. Market movements that normally occur over months and years have been occurring in minutes and hours, as the pace of new company news or economic data coming to light, and policy makers' response to it, has been dizzying. Events were so dramatic that Doug Geisser and I even posted interim market commentary on our website (www.romanobrothers.org) at the beginning of November. That information is still available and if you haven't already, we hope you'll take a few minutes to review it, as much of it is still relevant to our current markets and outlook.

Because we issued commentary so close to the end of the year, we felt it would be more timely to move back our holiday newsletter slightly and combine it with a year end wrap up. Many comparisons have already been drawn between this market and those of 1973 and 1974, a time when Dick Romano was just a couple of years older than I am now and had been at the firm about the same length of time. Accordingly, Dick shares his thoughts on that market, as well as our current one, in this newsletter.

In closing, if there is one thing we've learned from the uncertainty of these markets it is how fortunate we are to have the constants of family and loved ones. It is in this spirit that we wish you and your family a happy (and belated) holiday season and the best of 2009.

Joseph Romano

The Impact of the Liquidity Crisis on Securities Markets

By Richard Romano
Chairman

The media have certainly made everyone well aware of the weakened state of the U.S. economy as well as the world economy and the effects on securities markets. However, we believe that there is an even stronger driving force moving our markets downward than the economy, and that is the almost insatiable need for liquidity by many financial institutions. Today, hedge funds and mutual funds are experiencing enormous liquidations by their investors and are being forced to sell portfolio investments to meet demands. Other institutions are struggling to raise cash either to fund prior investment commitments or to refinance maturing debt. All of this is on top of the general de-leveraging which is happening globally. Financial institutions of all types have become intoxicated with debt in attempting to enhance their investment returns through leverage. For the last several years, interest rates have been low and credit plentiful resulting in a huge lack of respect for risk, but this lack of respect is now being reversed.

It all began with easing of underwriting criteria for mortgages whereby borrowers whose ability to repay loans were being encouraged to take on more debt than they could afford.

Mortgages, both prime and *(continued on page 2)*

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subprime, were then pooled into marketable securities and sold to investors throughout the world. In many cases, institutions were borrowing short term funds at low interest rates to leverage the already weak credit instruments in their portfolios. When real estate prices started falling, foreclosures increased which lead to more foreclosures, still lower prices etc. In the process, the market value of the mortgage securities declined, the regulatory capital and the liquidity of financial institutions such as the major banks, the large brokerage firms and insurance companies became impaired (think Bear Stearns, Lehman Brothers, Washington Mutual, Wachovia, AIG, etc.). Critically short of liquidity, the U.S. Treasury stepped in to rescue the entire financial system.

As night follows day, one thing follows another. The declining market values of mortgage securities lead to declining market values for other security classes which resulted in a demand for more collateral to protect the loans which had been taken out to leverage these investments. In many cases, borrowers didn't have cash to post for the additional collateral, and therefore had to liquidate securities to raise cash. The result was a downward spiral in securities prices.

As prices fall, investors start to lose confidence in the markets and begin to sell in fear of further price declines and begin to sell their mutual funds, and hedge fund investors demand redemption of their stakes. At the same time, investors whom we don't normally consider to be leveraged such as university endowments are being pressed for liquidity and forced to sell investments. For example, the Harvard University endowment recently issued $3.6 billion in bonds to meet their liquidity needs.

As the demand for liquidity increases, the markets for certain asset classes become less liquid because potential buyers either don't have the cash or the confidence to buy. The markets for mortgage backed securities, commercial loans, real estate and other asset classes are moribund and not functioning well, and the primary markets where there is liquidity are the stock market and the bond market. While stock and bond prices are severely depressed, at least these markets are functioning normally and investors can sell securities there to raise needed cash. It is this persistent reliance on the stock and bond markets for liquidity that has, in our opinion, been a major driving force in lowering stock and bond prices.

So how long does this phenomenon persist? One would hope to see some easing of this liquidity crisis in the beginning of 2009 with the trillions of dollars spent or pledged by the Treasury starting to work through the financial system, the year end hedge fund redemptions completed, tax loss selling ended and hopefully some stabilization of security prices. Indications are that the economy will continue to slide in 2009, but historically, security prices have bottomed before the economy.

I have experienced market upheavals several times in my 46 years at Romano Brothers, and each event has had its own set of circumstances surrounding it. The severe market collapse of 1973-74 was characterized by long gas lines, 12 percent inflation, high interest rates and the Watergate episode. In the 1980's and early 90's, we suffered the failure of almost the entire savings and loan industry. In 1998 the implosion of Long Term Capital wracked the financial system and the markets. And in 2000, there was the bursting of the internet bubble followed by the horrible events of 9/11 in 2001. Following each of these declines, the markets have recovered and gone on to new highs reflecting the growth of our economy. Though I can't say where the market bottom is nor when the recovery will begin, I do have every confidence that in spite of all the pain and angst of these times, this great country will not be denied and this too shall pass.

Erica Kiser and Doug Geisser

Kiser Joins Romano Brothers & Co.

We are pleased to announce that **Erica Kiser** has joined our firm in the Fixed Income Sales & Trading and Client Services capacity. Erica started in August after moving back to the mid-west from Los Angeles where she was working in the Institutional Sales department at Wedbush Morgan Securities. She is a University of Wisconsin-Madison graduate and is currently enrolled in the MBA program at the University Of Chicago Booth School Of Business. Erica will be working with Douglas Geisser, managing fixed income bid-wanteds and trading inventories as well as assisting in the management of client portfolios.

WCE Unveils Cornerstone Founder Plaque

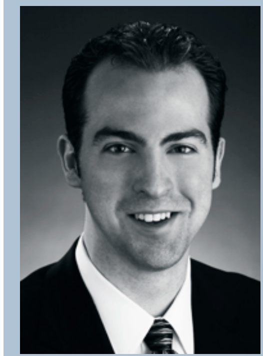
This past spring, the Woman's Club of Evanston officially unveiled a cornerstone plaque in recognition of the three Cornerstone Circle founding members: Romano Brothers & Co., North Shore Vascular Associates, and Abbott Laboratories Fund.

When the WCE approached Romano Brothers & Co. to become a founding member of the WCE Cornerstone Circle two years ago, the firm responded wholeheartedly.

"Acting as the investment managers of WCE Foundation, we understood the importance of contributing to their capital campaign which helps maintain the historic clubhouse, a vital meeting place in Evanston," said Joe Romano, President.

Left to right: Loreen Mershimer, The Abbott Fund; Richard Romano, Joseph Romano, Terry Dason, WCE President; Wendy Irwin, Capital Campaign Manager; Vickie Burke, WCE Capital Campaign Co Chair.

This $1 million capital campaign will enable the WCE to renovate and restore the building in which more than 5,000 volunteer hours and over $100,000 are contributed every year to local non-profits.



Knorr Earns CFP®

Romano Brothers & Co. is pleased to announce that Associate Portfolio Manager Christopher Knorr recently passed the CFP® Certification Examination. Chris joined the firm in 2006 and works on Joe Romano's investment team. His responsibilities include financial planning and portfolio management. Chris received his B.A. in Economics from Hamilton College, Clinton, NY.

ESO Christmas Concert Makes All Merry

The annual Evanston Symphony Orchestra Christmas Concert generously supported by Romano Brothers & Co., once again delighted all who attended the early December concert.

Maestro Lawrence Eckerling led the 80 piece orchestra that played holiday favorites while the Evanston Dance Ensemble danced to selections of Tchaikovsky's "The Nutcracker." Everyone joined in the fun singing along with the Evanston Festival Chorus. A joyous time was had by all!

Back Row (left to right) David Davenport, Richard Hemwall, Jac Cerney, Doug Geisser. Front row (left to right) Deborah Cross, Joe Romano, Harry Porterfield, Lawrence Eckerling, ESO Music Director; Cheryl Haack, ESO President; Dick Romano, and members of Evanston Dance Ensemble.

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Wishing All Our Clients the Best in 2009!

Evanston Dance Ensemble performed at the ESO Christmas Concert sponsored by Romano Brothers & Co.