



**The Ben
834 Chestnut Street, Suite 315
Philadelphia, PA 19107
215.875.8666 • 215.701.8745 FAX**

Financial markets continue to be jittery in December, with all sorts of gloom and doom over the subprime mortgage problems. Given all the bearish sentiment, it is surprising that the Dow, the S&P 500 and the NASDAQ stock price indices are about flat so far this month. It has been a busy time in financial markets, with big write-downs at some money center banks and other financial institutions and continued worries over credit markets. The Federal Reserve responded by cutting their target rate – the federal funds rate by another 25 basis points to 4.25% on December 11, cutting the bank borrowing rate, known as the discount rate by 25 basis points to 4.75%, and establishing a set of special borrowing facilities for the banks on December 12.

Mortgage markets are getting back to normal. It looks like these overly risky subprime mortgage loans have stopped and the rest of the mortgage market is still in business. The Mortgage Bankers Association reported that over the last two weeks mortgage applications jumped to the highest levels since 2005 with both purchase and refinancing applications up sharply. Also, fixed-rate mortgage rates are down, with, for example, a national average 6.07% contract rate on 80% loan-to-value 30-year mortgages. This is back down around the near-term rate lows we saw at the end of 2006. Hopefully, these improvements will be reflected in better home prices and sales next year.

Meanwhile, the economic news has been mixed. On the minus side, inflation surged in November due to rising oil and gasoline prices last month. And, so far in December, energy prices are up, not down as I had hoped for. I still see potential for lower prices. The International Energy Agency's monthly report released today cut their estimate of global oil demand and increased their estimate of supply. On the plus side, employment continues to chug along with the unemployment rate stable at 4.7% and a rise in payroll employment of 94,000 in November. Retail sales were okay in November, very strong at first blush, but adjusted for surging gasoline prices, the gain was normal. Industrial production has continued to chug along, rising 0.3% in November, recovering from a fall in October. Adding it up, I expect another small upward revision to Q3 Real GDP growth to 5% or so, and then a subdued Q4 with GDP growth at about 2%. I think the economy will reaccelerate over 2008 as we put these housing problems behind us and move ahead with business spending and export led growth.

I wish you a very happy holiday and a great year ahead. I look forward to sharing my thoughts and analysis with you on the markets and economy throughout 2008. As always, please call me with any questions or concerns. Again, happy holidays!

Sincerely,

David Waters

David S. Waters, CFP, CLU, ChFC, RHU
Vice President
Professional Planning Associates, Inc.
Phone: 215-875-8666
Fax: 215-875-8745
www.proplanners.org

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