LPL Financial

9785 Towne Centre Drive
San Diego, CA 92121-1968

One Beacon Street, 22nd Floor
Boston, MA 02108-3106

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Dear Valued Investor:

Well, we got through a lot of data on the economy and a slew of company earnings over the last two weeks. And the stock market also stabilized with the S&P 500 Index unchanged! Looking at the data, the "glass is half empty" crowd note the rise to a 5.7% unemployment rate in July, the seventh month in a row of declines, albeit small declines, in payroll employment, revisions that now show a 0.2% decline in fourth quarter 2007 GDP, and a "weaker than expected" rise of 1.9% in second quarter GDP. Looking at the same data, the "glass is half full" crowd note that the unemployment rate is still, historically speaking, fairly low, that the modest declines in payroll employment are consistent with continued measured adjustment by business to slower growth, that the tiny dip in Q4 GDP was nowhere near recession territory, and that the GDP increases in the quarters since—up 0.9% and up 1.9%—indicate an economy regaining its footing. Same story on inflation—the inflation worrywarts continue to say a big surge is in the offing, but the broadest measure of inflation, the GDP price index, rose at an annual rate of only 1.1% in Q2 and is up only 2% over the last four quarters.

This week is the final peak week in Q2 company earnings season, with 68 companies reporting. So far, 373 of the 500 S&P 500 companies have reported, and once again you can take the numbers either way. Adding actual reports with estimates for the remaining 127 companies, total earnings are down about 20% from Q2 2007. This decline is more than accounted for by another round of huge write-downs at the big banks and sizable losses in the auto sector. (GM lost $15 billion!) Setting those two sectors aside, company earnings are likely to come in with double digit gains for Q2. These companies have been generally well managed with good cost control, and very good prospects in exports behind the weak US dollar. I think most of the bank write-downs are behind us, so I, along with the analyst "consensus", expect that the rebound in aggregate earnings starts this quarter.

One, in my opinion, very big positive over the last three weeks has been the drop in oil prices. The price of crude oil has fallen about $25 from a top of about $146 a barrel to about $121 today. That is a nice sized decline, but it only takes us back to the price on May 5. We have experienced a huge run-up over a very short time. For those worried about tax increases next year, bear in mind that compared to 2000, we are now spending $375 billion more per annum on imported petroleum and products. That is a pure tax on the American economy. An additional fall to about $63 a barrel would get rid of about half that tax, would in my opinion do wonders for the economy and financial markets, and would help offset tax hikes next year. I know that $63 sounds outlandish, but that was the price just over a year ago. I hope we are in the midst of a sustained drop; if prices turn back up again, the chance of a recession beginning in the second half rises sharply.

This mix of bad and good news and conflicting interpretations leaves financial markets in the same jumbled up state—down year-to-date, but above the July 15 low, which the S&P 500 hit two days after oil prices started to tumble. And the dollar exchange rate also hit bottom and began to recover on July 15. Both oil (down) and the dollar (up) have a long way to go to get back anywhere near historic norms. If they do continue returning to normal, it should be good news for U.S. financial markets. I think the odds favor these outcomes, so I am in the "half filled" camp. As always, please call your financial advisor with any questions or concerns.

Sincerely,

Lincoln Anderson
Managing Director, Chief Investment Officer