

November 7, 2008

Dear Valued Investor:

Well, it is pretty clear that we are now in the thick of a recession. The November 7 U.S. employment report for October showed a rise in the unemployment rate from 6.1% to 6.5% and a 240,000 decline in payroll employment in October. Also, there was a big downward revision of the September figure to a 284,000 decline. Previous to September, the employment declines over the prior eight months had been moderate, averaging about 84,000 a month. So I would date the recession as beginning in September, and cite as the driving forces the delayed impact of the huge oil price spike over the first half of the year, which increased our imported oil bill by about \$400 billion compared to 2000, and the global collapse in credit markets that hit after Lehman and AIG failed in mid-September.

With the election behind us, we can now concentrate on sorting out this mess and limiting the damage to the economy and financial markets. President elect Obama is already hard at work assembling his fiscal policy team, and President Bush has promised full coordination with that team on maintaining and expanding the operations of the Treasury, FDIC, Federal Reserve (Fed) and other agencies to solve the credit crisis and to limit the damage as much as possible. And over the last two months the actions taken have been very large. I will not go through the laundry list, but the Federal Reserve has, in particular, conducted an incredibly expansive monetary policy, increasing what is called “the monetary base” (total bank reserves plus currency in circulation) by about \$400 billion or nearly 50% over the last two months! And they have been busy in other areas as well; they made purchases totaling \$243 billion in the commercial paper funding facility over the last two weeks alone. And they have cut the fed funds rate to near zero. Other central banks are cutting rates as well.

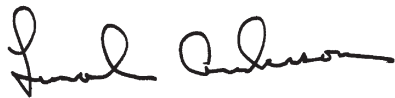
Meanwhile, Congressional leaders are considering a lame duck session of Congress before yearend to pass further fiscal stimulus measures and then to consider additional action when the new Congress convenes next year. Hopefully, given that the Democrats did not achieve a filibuster-proof majority, both sides of the aisle will bring their best ideas to the table and the resulting legislation will reap the benefit. All of these actions will, in my opinion, act to limit size and scope of the recession, but given the unprecedented nature and speed of the global collapse of credit markets, it will be awhile before we have any certainty on this score.

Is there good news? Well yes there is: credit markets appear to be healing—interbank lending rates are lower, and U.S. commercial banks are, despite headlines to the contrary, continuing to lend. Total bank loans are up nearly 10% over the last 52 weeks. That said, bank cash assets, which typically total about \$300 billion, have exploded up to nearly \$550 billion. So there is still plenty of cash on the sidelines. The decline in oil prices is a big help, amounting to a \$200 billion tax cut. That said, I do now expect a raft of pretty poor recession-related economic reports over the next six to nine months.

What does this outlook mean for investing? We are experiencing extreme volatility at present. For example, the Dow stock prices index experienced one-day drops of more than seven percent twice in October and also had two one-day rises of about eleven percent! But when the dust settled, the Dow was down about 14% over October. Does this mean all the bad news and potential bad news is “priced in”? You never know until well after the fact. We may have seen the low in late October, or we may “re-test” that low sometime soon. But I think we are near the bottom, and those 11% up days we saw twice in October lead me to think that this is no time to go to cash. Some market valuation metrics point to undervaluation of many “risky” securities, including the stock prices of companies I view as sound and the bond prices of states that I am confident will not default, among others. By my calculation, at today’s prices the stock market value of all U.S. non-financial corporations is about 44% of the net worth of these companies. Also, it is important to remember the stock market usually bottomed four to six months before the recessions ended, and the stock market bottom often came at about the same time as past fiscal and monetary policy actions to combat the recession (which pale compared to current actions) took hold.

I certainly expect continued volatility, given all the extraordinary developments, conditions and policy actions, and I expect more big up and down days. Like most investors, I want to see the up days start to outnumber the down days once again. As always and even more so now, please call your financial advisor with questions or concerns.

Sincerely,



Lincoln Anderson
Managing Director, Chief Investment Officer

* There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

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