

October 23, 2008

Dear Valued Investor:

Equity markets around the world continue to experience high volatility as investors deal with a great deal of uncertainty about just about everything. Although we still face a long list of unanswered questions, volatile markets, and yes, a recession, some of the right answers are starting to come in.

The ongoing list of unknowns is daunting: Are we in a global recession? How deep will it be? Are government and central bank actions sufficient to deal with the banking crisis? Is OPEC likely to stick us with an oil production cut in an attempt to push oil prices back up again? And so on. Yuck.

Here in the United States, the Dow gave back all of Monday's gain on Tuesday and Wednesday, but managed to close above the closing low set on Friday, October 10 and then closed up 172 points on Thursday—roughly flat. International markets fared as badly, or worse, pretty much across the board. It looks to me as though developed country equity markets are moving up and down trying to decide whether we've seen the bottom yet or not. Also, while energy and materials stock prices took the immediate negative impact of the sizable drops in oil and commodity prices, the positive net effects of lower prices for the economy will take a while to show up in other stock prices.

Now that, in my opinion, we are in a global recession, I expect mostly negative economic news for the next three to nine months. Consumers are tightening up, adjusting down spending in response to the economic uncertainty and lost net worth in housing and financial markets. In aggregate, the tax rebates in May, June and July from the Economic Stimulus Act of 2008 did not deliver the desired impact on spending. While consumer spending stayed relatively flat, personal saving increased by quite a bit more than the tax rebate, leading to a record decline in consumer installment credit in July. I am actually happy to see that; it is a rational response to tough times. However, I think that response does point to a fairly sharp downturn in consumer spending starting this quarter and extending into the first half of next year. Home construction is already at deep recession lows, and banking is in recession. But U.S. exports are booming, and I do continue to think that in aggregate U.S. non-financial corporations are pretty well positioned to weather a recession with well contained costs, low inventories, and capital spending programs under pretty tight control. These companies' biggest problem continues to be the decline in prices of goods and services sold. So much for fears of inflation. So, while there is legitimate uncertainty over the magnitude of the recession, I still believe it will not be a deep one.

There are some positives. The dollar exchange rate, while still low, has been moving sharply higher, and the price of crude oil, while still high at about \$68 a barrel today, is down sharply from that horrible peak of about

\$146 we hit in mid-July. The high energy prices earlier this year took a while to damage the global economy, and lower prices now will, with a similar lag, help repair the economy. It sure is nice to see gasoline prices below \$3 a gallon again.

I continue to believe that the Federal Reserve, the Treasury and other federal agencies are headed in the right direction to repair the damage done by the meltdown in banking. For example, bank reserves, which normally total about \$44 billion, now total \$180 billion and are likely to increase far more under announced programs. And over the last four weeks, as non-bank borrowers exercised their revolving credit lines, bank lending has increased by about \$300 billion, double the previous record four week gain. So, it looks as though both bank and non-bank companies are awash with cash. And households are piling up personal savings again. In the short-run all these positives don't help the economy or financial markets as everybody sits on this cash, but longer-term they should begin to ease the credit crunch and restart economic growth.

It's clear to me that consumers, businesses, and investors alike are now tightening their belts and that we are entering a recession. There is plenty of pain in recessions; even a short and shallow recession means that some people will lose their jobs and some businesses will not survive. Once consumers and businesses are assured that the economic stimulus programs put in place are making real progress to their goals and can see positive results, the magnitude and the duration of the recession will become clearer and confidence should improve. Meanwhile, we will continue to see very volatile markets as investors react to every positive and negative indicator. As always, please call your financial advisor with any questions or concerns.

Sincerely,



Lincoln Anderson
Managing Director, Chief Investment Officer

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