TRIVANT
CUSTOM PORTFOLIO GROUP, LLC

October 2008

quarterly INSIGHTS

Third Quarter 2008

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EXECUTIVE SUMMARY

Only One Bright Spot In A Poor Q3 2008

In the Third Quarter, the domestic S&P 500 Index fell 8.37% while the MSCI EAFE Index (foreign) fell 20.50%. Almost all global equity markets had negative performance in a range of 20% (the exception was the United States). The Consumer Staples sector was the lone "bright spot" regarding sector, market cap or style (growth versus value) performance.

The market continued to exhibit high volatility. All markets and sectors are now in negative territory year to date. Rapidly falling energy costs did little to calm investors. Investors remained nervous due to recession fears, housing market weakness and sub-prime mortgage woes. Areas of note include:

- Financials (-0.10%) held up relatively well versus the market for the first time this year
- Consumer Staples (+4.14%) was the only area of the market in positive territory
- Energy (-24.95%) was the worst-performing sector and is now negative year to date
- Materials (-22.93%) also fell badly and is now negative year to date
- US small cap stocks (-6.20%) relatively out-performed US large cap stocks (-8.98%)
- US growth stocks (-12.25%) lagged US value stocks (-5.45%)

Continued Emphasis on Large Cap US Stocks Despite Falling Energy Prices

Even though energy prices fell, we will maintain a large cap focus in the portfolio because large cap stocks offer a better risk/return tradeoff. We cannot pinpoint a logical reason to explain Third Quarter US small cap out-performance, other than to say we believe it was an anomaly. The larger companies should be better positioned to withstand the slowdown in the economy and consumer spending.

US stocks relatively out-performed those of Japan, the United Kingdom, the European Monetary Union (EMU) and Emerging Markets. The US Dollar considerably strengthened versus the Euro and Pound, and was stable versus the Yen. This was an important factor regarding relative US stock out-performance.

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EXECUTIVE SUMMARY

Continued from Page 1

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Fixed Income

There was no Fed interest rate cut in the Third Quarter as the Fed held steady its measures to stimulate economic growth. The Lehman Brothers Government/Corporate Bond Index, widely considered the broadest of the major US bond indices, fell 1.64% for the Third Quarter.

During the quarter, interest rates were steady. Highest safety Treasury bond prices rose (yields decreased) while corporate and municipal bond prices fell. This phenomenon was due to investors' "flight to safety" with respect to US Treasury bonds.

The yield curve, which compares the 2-Year Treasury rate (Constant Maturity) versus the 10-Year Treasury rate, became more "steep" as the fall of longer yields was less than the fall of shorter yields. Normally a steepening yield curve benefits banks because lending becomes more profitable.

Core inflation averaged 2.85% in 2007 and 5.40% through August, 2008.[1] With the recent fall of energy prices, inflation data should ease in future months. Still, the Fed Funds Rate is significantly below the inflation rate.

A decrease in anticipated inflation removes the immediate need for the Fed to consider an interest rate increase. With the recent credit flow crisis, the need to reduce interest rates became an emergency priority. The Fed cut interest rates by 0.50% in early October.

We anticipate the Fed will further cut interest rates in the near future (bond yields would fall and prices would rise) in order to stimulate flow of credit.

[1] Source: Bureau of Labor Statistics

TRIVANT CUSTOM PORTFOLIO GROUP, LLC Third Quarter 2008 Review

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented. Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.

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Equity Market Review

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Equity Index Performance

Index	Q3 2008	2008 Year-to-Date
S&P 500 (Domestic)	(8.37%)	(19.29%)
MSCI EAFE (Foreign)**	(20.50%)	(28.91%)
MSCI World	(15.15%)	(23.84%)
MSCI Emerging Markets	(26.86%)	(35.37%)
Russell 2000 (Small Cap)*	(1.46%)	(11.29%)
MSCI Japan	(17.60%)	(22.10%)
MSCI UK (United Kingdom)	(20.97%)	(29.84%)
MSCI EMU (European Monetary Union)	(21.18%)	(32.26%)

* Performance data does not include dividends ** Europe, Australia and the Far East

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Currency, Country, Sector & Market Cap Performance at a Glance

The US Dollar

The US Dollar appreciated considerably versus the Euro and British Pound in the Third Quarter, and slightly depreciated versus the Japanese Yen. The Federal Reserve Board Funds Rate remained stable at 2.00%. The European Central Bank (ECB) raised its rate from 4.00% to 4.25% on July 3. A significant Third Quarter decline in oil price (from a peak US $147 per barrel to US $96 per barrel), as well as relatively lower economic expectations for the European and British regions, likely contributed to the appreciation of the US Dollar.

U.S Dollar Appreciation vs. Foreign Currencies

Currency	Q3 2008	2008 YTD	2007	2006
US Dollar/Euro	11.50%	3.18%	(9.59%)	(11.79%)
US Dollar/Japanese Yen	(0.93%)	(5.73%)	(6.43%)	0.94%
US Dollar/British Pound	11.53%	11.10%	(1.01%)	(14.00%)
US DollarIndex*	9.25%	3.24%	(8.47%)	(8.25%)

* The Dollar compared with a weighted basket of currencies. Source: Telemet

In our previous report (Second Quarter 2008, The US Dollar, page 4), we stated the following:

"After two consecutive annual declines in the range of 10% versus the Euro, and a First Quarter decline of almost 8%, we believe the US Dollar is poised for a recovery over the next 12 months."

Year to date, the US Dollar has recovered versus the Euro and the British Pound. We anticipate that the US Dollar will stabilize in the short-term for the following reasons:

- Significantly reduced energy costs will lower inflation expectations. We expect energy costs will not surge going forward. Controlling inflation (by raising interest rates) will not likely be the primary concern of the Fed in the short term, nor will inflation be the primary concern of the European Central Bank (ECB) or Bank of England. Indeed, there was sufficient flexibility for all of these governing bodies to enact coordinated interest rate cuts earlier this month (October) in response to the credit crisis. The US Dollar should maintain stability with global rate cuts.
- In the midst of market turmoil, there has been a "flight to safety" through US Treasury purchases. This has stablized and should continue to stabilize the US Dollar in the short-term.
- Although the recent government package and other assistance will no doubt have a significant impact on the US deficit level, this impact will not be priced in to the exchange rate right away. The "flight to safety" towards US Treasuries dominates the US deficit impact short-term.

The US Dollar: Portfolio Strategy Considerations

Assuming a stable US Dollar, we expect US stocks to out-perform the developed foreign markets. In the Third Quarter, we continued to reduce foreign exposure to the point where our current portfolio weighting is approximately 90% domestic exposure. This is as high a domestic exposure as we would ever want. The shift towards more domestic exposure benefited the portfolio in the Third Quarter.

Japan

The Japanese market was significantly down (17.60%) in the Third Quarter despite a Japanese Yen that slightly appreciated against the US Dollar. Japan had the best relative performance for developed markets through the first half of 2008, but this proved to be an anomaly versus a trend. Exports to

the US, Asia and the European Union (EU) are falling due to slowing global economies. Corporate profits are weak.

Japanese manufacturing will ultimately benefit from lower oil prices, but not enough at this time to bolster profits. The unemployment rate (4.0%) rose, there is no personal income growth, and private consumption has remained flat.

Japan: Portfolio Strategy Considerations

Until global economies improve, we are not enthusiastic regarding Japan. We further reduced our Japanese exposure in the Third Quarter and maintain a very small portfolio position.

Emerging Markets

Emerging markets were the worst-performing area (down 26.86%) in the Third Quarter, although there was large disparity in performance by region. Falling commodity and energy prices hurt many resource-rich regions.

Emerging Markets Performance

Country	Q3 2008	2008 Year-To-Date
Brazil	(37.87%)	(30.10%)
Russia	(45.26%)	(46.26%)
India	(13.93%)	(49.54%)
China	(25.22%)	(44.91%)

Source: Telemet

Emerging Markets: Portfolio Strategy Considerations

Emerging Markets performance is highly correlated to commodity and energy prices. We anticipated falling oil prices (Second Quarter 2008, Has Oil Peaked?, page 8) and sold our Emerging Markets position early in the Third Quarter. We continue to avoid this category.

Europe

Europe was significantly down (21.18%) for the quarter, and is the worst-performing developed market year to date. Optimism regarding European business prospects is clearly waning as evidenced by market performance. The Euro lost significant ground to the US Dollar, which under better economic conditions would help European exporters.

The dilemma facing the European Central Bank (ECB) continues. Inflation is rising and exports are falling. What is a greater priority, combating inflation (raising interest rates) or encouraging exports (lowering interest rates)? Due to the recent credit crisis, the ECB hand was forced with globally coordinated rate cuts in early October.

Europe: Portfolio Strategy Considerations

We will maintain our recently-lowered European exposure as we see no factors that point to out-performance.

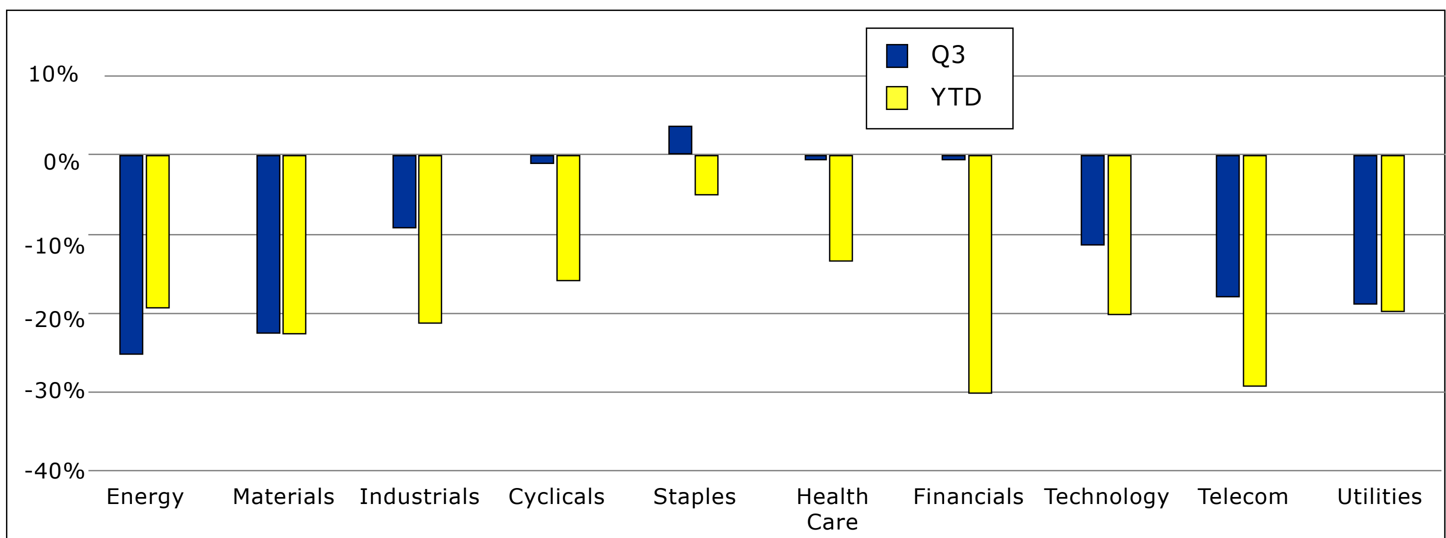
Sector Performance

Sector performance was mixed for the Third Quarter. Relatively neutral performance in Consumer Staples (+4.14%), Health Care (-0.01%), Financials (-0.10%), and Cyclicals (-1.04%) could not prevent a further fall in the S&P 500 Index (-8.37%). The index was most hurt by Energy (-24.95%) and Materials (-22.93%), as the impact of falling oil prices and a slowing global economy took effect.

Although the sub-prime mortgage crisis continued to carry over from previous quarters, Financials held up well versus the overall market. This performance is misleading. Stock selection proved critical for Financials. Some companies fared well and many fared poorly. The net average performance was a wash.

Technology (-12.11%) disappointed after showing signs of recovery in the Second Quarter (+2.29%). Health Care (-0.01%) out-performed the S&P 500 Index for the second consecutive quarter. This is a traditionally defensive sector, and should maintain relative market out-performance amidst economic concerns.

S&P 500 Index Sector Performance — Q3 2008



Source: Standard & Poor's

Sectors: Portfolio Strategy Considerations

Through the first three quarters of 2008, all sectors have negative performance. Only three sectors (Cyclicals, Staples, Health Care) have relatively out-performed the S&P 500 Index. In terms of relative benchmark performance, the two most critical portfolio decisions have been the weightings of Health Care and Financials (as compared to their index weightings). We under-weighted Financials and overweighted Health Care. These decisions aided portfolio performance.

We will maintain an under-weight to Energy since we believe oil prices will continue to be pressured. We slightly increased our Financials sector weighting because of a potential bounce off the bottom, recent government intervention and a positive and steepening yield curve (a steepened yield curve bodes well for bank profits).

We will maintain over-weights to Technology and Health Care. Businesses will turn to Technology in an effort to gain maximum efficiency with given resources. Upcoming election results may impact our strategy regarding Health Care. If there is a Democratic sweep, this would increase the likelihood of governmental intervention in the health care system. This could pressure sector profits.

Market Cap Performance

Small cap US stocks fared better than large cap US stocks in the Third Quarter. We are not interpreting this result as a momentum shift. The worst-hit stocks in the quarter were the large energy companies, and this likely skewed the market cap data.

We continue to anticipate large cap out-performance in most of 2008. The larger US companies are better positioned to withstand a slowdown in the economy and consumer spending. These companies also have stronger cash balances and balance sheets, and are less prone to potential credit flow issues.

Market Cap Performance

	Third Quarter 2008	2008 YTD
Large Cap Performance		
World	(15.15%)	(23.84%)
Foreign	(20.50%)	(28.91%)
USA	(8.98%)	(19.17%)
Small Cap Performance		
World	(14.83%)	(22.28%)
Foreign	(23.92%)	(31.68%)
USA	(6.20%)	(13.64%)

Source: MSCI

Market Cap: Portfolio Strategy Considerations

For the time being, we believe that large cap stocks are better positioned from a risk/reward standpoint and will maintain our large cap focus. Although energy prices have eased, we will likely delay a shift towards a smaller cap focus until historically high market volatility decreases. Small cap stocks tend to bounce more off a market bottom.

Style Performance

Growth stocks fared worse than value stocks in the Third Quarter. We are not interpreting this result as a momentum shift. The relative Third Quarter stability of Financials (-0.10%) weighed heavily on value stocks.

Style Performance

	Third Quarter 2008	2008 YTD
US Growth	(12.25%)	(18.98%)
US Value	(5.45%)	(19.50%)
Foreign Growth	(21.88%)	(28.01%)
Foreign Value	(19.07%)	(29.84%)

Source: MSCI

Style: Portfolio Strategy Considerations

In a slowing economic environment, we expect investors to seek large growth companies with strong balance sheets and solid historical earnings. We will maintain our growth bias due to our expectation of a slowing economic growth, attractive growth fundamentals, anticipated continuing fallout from the sub-prime mortgages, and the safety of significant cash on hand amidst credit flow issues.

Better Times Ahead

September Was An Historic Month

September will be remembered as one of the most unusual months ever witnessed on Wall Street. It was marked by the failure, seizure, bailout, and takeover of many financial icons.

It was also marked by an unprecedented level of Federal Government intervention. The historic events were as follows (listed in chronological order):

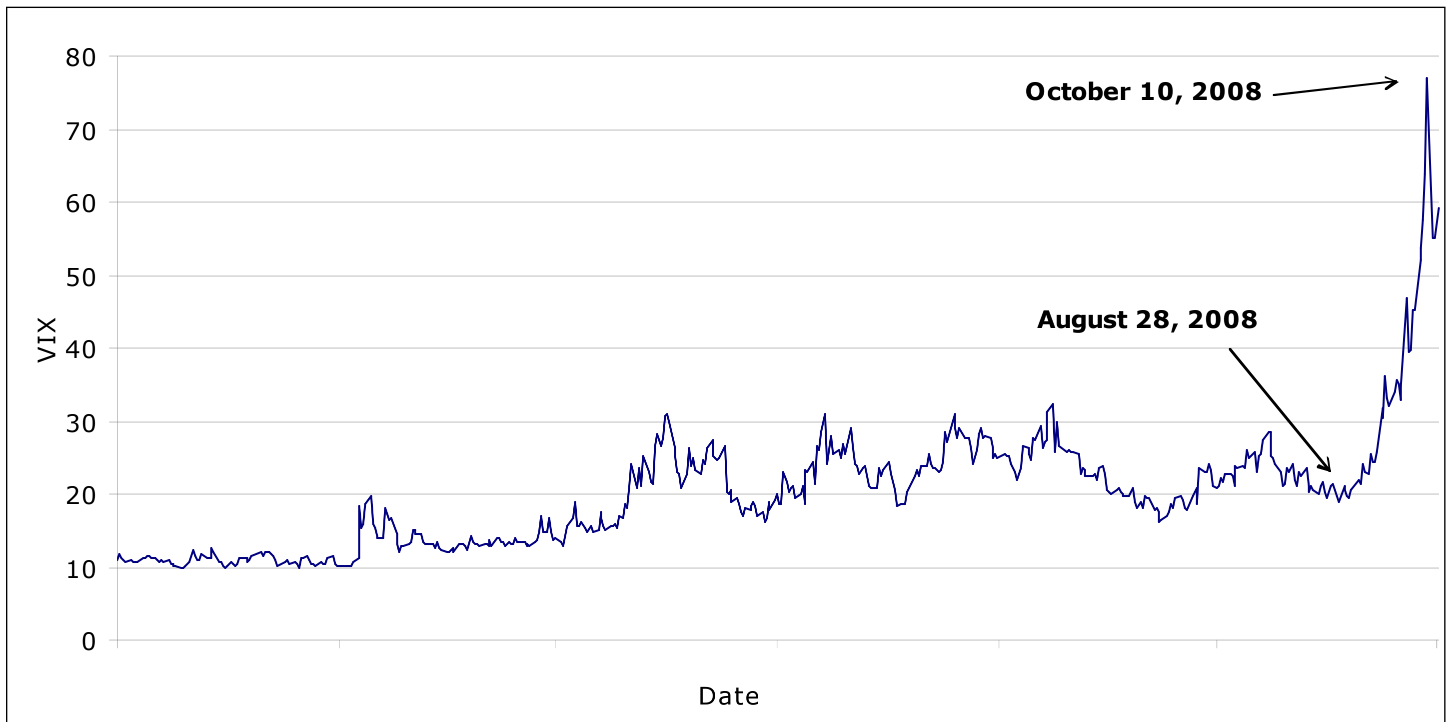
1. The Federal Government put mortgage giants Fannie Mae and Freddie Mac into conservatorship
2. Lehman Brothers, one of the oldest investment banks, was forced to file for bankruptcy
3. Bank of America executed a quick and unexpected $50 billion stock takeover of Merrill Lynch
4. The Federal Reserve expanded its lending facilities, taking a wider array of securities including equities, as collateral for its loans
5. The Federal Government orchestrated an $85 billion bailout of American International Group (AIG) due to its mortgage exposure and later increased it to over $120 billion
6. The Federal Government came forth with a $700 billion assistance package to acquire written-down assets from banks
7. Washington Mutual was seized by government regulators after a run on its insured bank deposits, marking the biggest bank failure in US history
8. Wells Fargo acquired the struggling Wachovia bank
9. The House rejected the proposed $700 billion assistance package and the stock market suffered its largest one-day drop since October, 1987 (the package was subsequently passed on October 3)

At the end of September, we thought we were in the final stage of a normal bear market. In fact, we had just taken the initial steps to reposition the portfolio for a potential "bounce off a market bottom". Unfortunately, our timing was off. We did not anticipate the sudden speed and ferocity of the subsequent market decline through the first 10 days of October. Despite the recent market direction, we believe that better times are ahead.

Recent Market Volatility Is Unprecedented

The stock market has seen record breaking volatility in September and early October. We would be surprised if you are not concerned. The CBOE Market Volatility Index (VIX) measures the level of market volatility. The index set an all-time record of 76.94 on October 10, a meteoric rise from a level of 19.43 on August 28.

The CBOE Market Volatility Index (VIX) — October 2006 Through October 2008



Source: Telemet

We believe that a normal bear market has been hit by a panic. And when panic hits, investors act in an irrational manner.

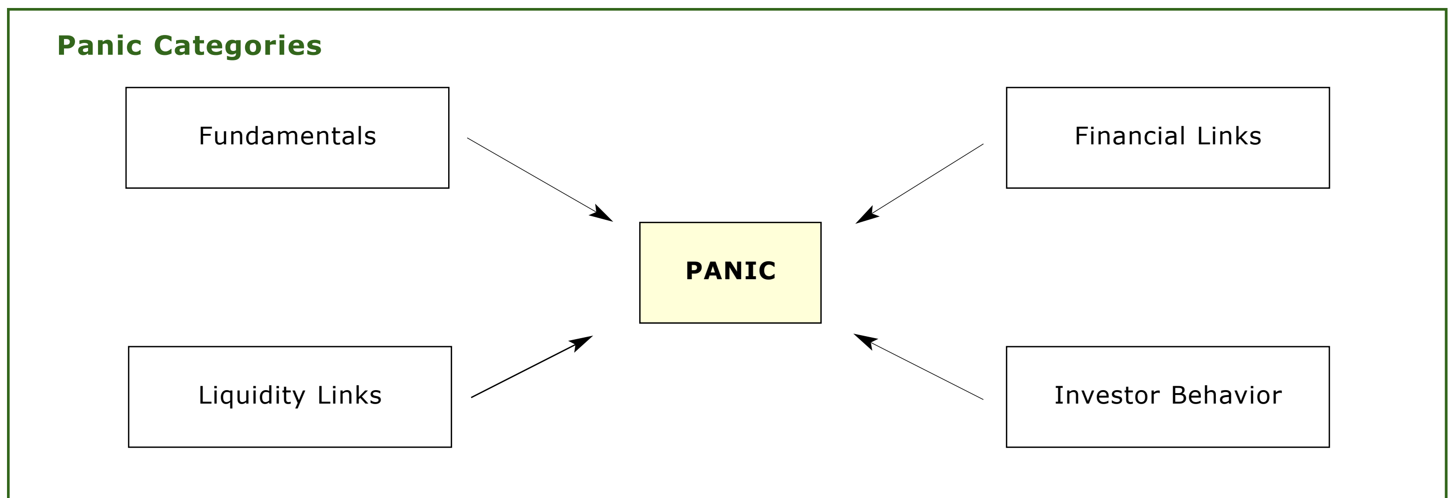
What Led To Investor Panic?

Media attention has contributed to investor panic. For successive weeks, President Bush, Fed Chairman Bernanke and Secretary of the Treasury Paulson appeared almost daily on national television to call for "immediate action to a financial crisis". The Presidential candidates and many congressional leaders also directed attention to gloomy economic prospects and various emergency plans of action. Economic fear is the leading discussion on television, radio, newspapers and the Internet. Panic has resulted.

Panics are very rare in financial history. The 1987 stock market crash was the only panic experienced by most of us. Panics are theoretically caused by negative feedback loops which spiral out of control.

Consider the current panic and how it illustrates a negative feedback loop. Bad mortgage loans lead to bank losses, which lead to fewer mortgages, which lead to less housing demand, which drives housing prices lower, which leads to more bank losses, and so on. Banks then become unwilling or unable (due to capital rate requirements) to lend money to any borrowers no matter how strong.

Panic can be caused by up to four categories: fundamentals, financial links, liquidity links, and investor behavior. Fundamentals include unemployment, GDP growth and inflation. Financial links are the bank derivatives and loans that tie many banks together. Liquidity links are the connection between the mortgage securities and credit availability. Investor behavior is the resulting action of investors to how they view the first three factors.



Why Investor Panic Should Subside

1. Fundamentals

Unemployment, GDP growth and inflation all currently remain in a normal range. We do not believe that fundamentals are a factor regarding panic.

2. Financial Links

Many banks are tied together through bank derivative products and inter-bank loans. If a bank fails, it can leave its participating partners "holding the bag". This is the main reason that the Fed has taken such aggressive measures to prevent the failure of any banks deemed to be significantly intertwined with others. We believe that financial links was a panic factor, but that this panic factor should subside due to the seizure, bailout or takeover of the troubled major institutions.

3. Liquidity Links

Credit markets stalled recently. The fear of a credit freeze has heavily contributed to panic. We also anticipate this component of panic will subside when the market recognizes improved credit flow.

Governments worldwide have taken aggressive steps to restore the flow of credit. There is evidence that the banks are gaining confidence to lend to each other. The overnight bank-to-bank lending rate, known as LIBOR (London Interbank Offered Rate), was as high as 5.09% on October 9. By October 14, with the benefit of government actions, LIBOR fell to 2.14%.

4. Investor Behavior

Factors regarding financial links and liquidity links have driven investors to liquidate stock portfolios, which in turn has driven down the market. There are two main psychological drivers for recent investor behavior, Prospect Theory and Emotional Herding.

Daniel Kahneman and Amos Tversky won a Nobel Prize in 1979 for developing Prospect Theory. In turbulent times, investors over-weight low probability events such as the possibility of a depression. We have observed this phenomenon as of late. Recent polling indicated that 6 out of 10 Americans thought the country was entering a prolonged depression. The prospect of a depression, though remote

(at least in our opinion), has likely driven many investors out of the market.

Emotional Herding describes the recent scenario where a large group of investors have similar negative expectations at the same time regarding future prices and returns. Pervasive feelings dominate rational thought. Investors have moved lockstep to get out of the market.

We anticipate that investors will soon downplay the possibility of a depression and will begin to have positive expectations regarding future prices and returns. Panic will subside.

Why We Are Not Headed To A Depression

There are two possibilities at this time:

1. We are headed towards a depression where the credit crunch leads to unstoppable negative feedback loops, or
2. We have a generational opportunity to buy world class companies at fire sale prices

The similarities of the depression in the 1930's and today's economy are limited to a few areas. In the 1930's a crisis in confidence led to dramatic runs on banks as depositors moved quickly to pull out their money. Today, a crisis in confidence is causing a credit crunch as banks are afraid to make loans to banks or healthy borrowers for fear of not being paid back.

In the 1930's countries responded to the crisis by simultaneously increasing tariffs and killing off trade, which exacerbated the problem. Government action in the form of regulations eventually helped the country to get out of the depression, but the response was delayed for years.

The benefit of historical knowledge is driving governments to take action before the economy unravels. Remember that GDP growth, a measure of the strength of an economy has actually accelerated over the last two quarters (2.8% growth in most recent release) and unemployment is 6.1%, higher than it was, but still not at abnormally high levels. We have seen unprecedented action with globally coordinated rate cuts to deal with the problems. This is why we are not headed to a depression.

The 1930s Depression versus Today

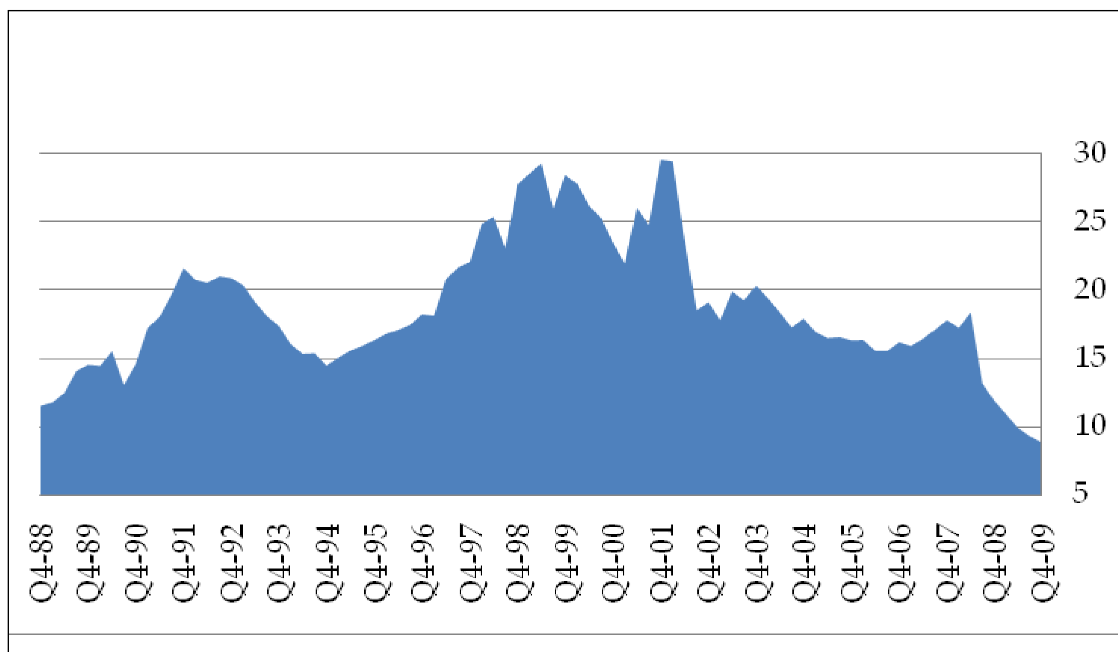
Factor	1930's Depression	Today
Crisis In Confidence	Run on banks	Credit crunch
Trade Policy Response	Increased tariffs (lower trade)	Global trade continues
Unemployment Level	Abnormally high	Not abnormally high
Government Response	Very slow (years)	Immediate
Global Coordination of Efforts	No	Yes

We See Opportunity

While we believe that there is evidence of an economic slowdown, we strongly believe that there is a generational opportunity to own great companies at prices that may never be seen again. In other words, stocks are cheap.

The cheapest level for stocks in recent memory was in the recession of 1982, where slow growth and record high interest rates pushed stock values under 10X's earnings. Right now, operating earnings multiples are at historic lows. Although market valuations are at about the same level as 1982, lower interest rates make current valuations more attractive. One of the strongest periods in market history was initiated in 1982: an 18-year bull market which averaged over 20% annualized returns.

Operating Earnings Multiple for the S&P 500 Index



Source: Standard and Poor's

Bounces Off Bear Market Bottoms Are Substantial

Although it may appear counter-intuitive in the midst of recent market turmoil, we believe that the end of the bear market is near. Markets historically bounce off the bottom when the market outlook appears bleak, investors are nervous and media coverage is negative. We believe the September events were characteristic of a market bottom. There are better times ahead.

A bear market is defined as a stock market decline that exceeds 20% over a given time frame. Given this definition, we have been in a bear market that started last October (12 months ago). Post World War II bear markets have averaged 13 months, so we are fast approaching the average bear market duration. Additionally, a new Administration could inspire the market after the election date (November 4).

When bear markets end, market upside is tremendous. For the last 10 bear markets, the average S&P 500 Index 12-month bounce off the bottom has averaged over 30%.

Market Bounces Off The Bottom

Bear Market Start	Bear Market End	Duration of Bear Market	Next 12 Months (S&P 500 Index)
6/15/1948	6/13/1949	12 Months	+42.07%
8/2/1956	10/22/1957	15 Months	+31.02%
12/12/1961	6/26/1962	7 Months	+32.66%
2/9/1966	10/7/1966	8 Months	+33.06%
11/29/1968	5/26/1970	18 Months	+43.73%
1/11/1973	10/3/1974	21 Months	+37.96%
11/28/1980	8/12/1982	21 Months	+59.40%
8/25/1987	12/4/1987	3 Months	+22.40%
3/24/2000	9/21/2001	18 Months	-12.50%
1/4/2002	7/23/2002	7 Months	+17.94%
10/9/2007	10/10/2008?	To Be Determined	To Be Determined
		13 Months	**+30.77%**

Source: Schafer Cullen Capital Management

Since it impossible to know (except in hindsight) when a bear market bottom occurs, it is important to maintain a disciplined investment approach. As many managers say, "it is not timing the market, but time in the market that counts." It is important not to miss the bounce off the bottom.

Our philosophy is that if your asset allocation is correct, your portfolio is properly diversified, and all possible measures are taken to achieve tax efficiency, patience is the only remaining component for success.

Why We Believe the Bear Market Will End Soon

Reasons we believe the end of the bear market is near include the following:

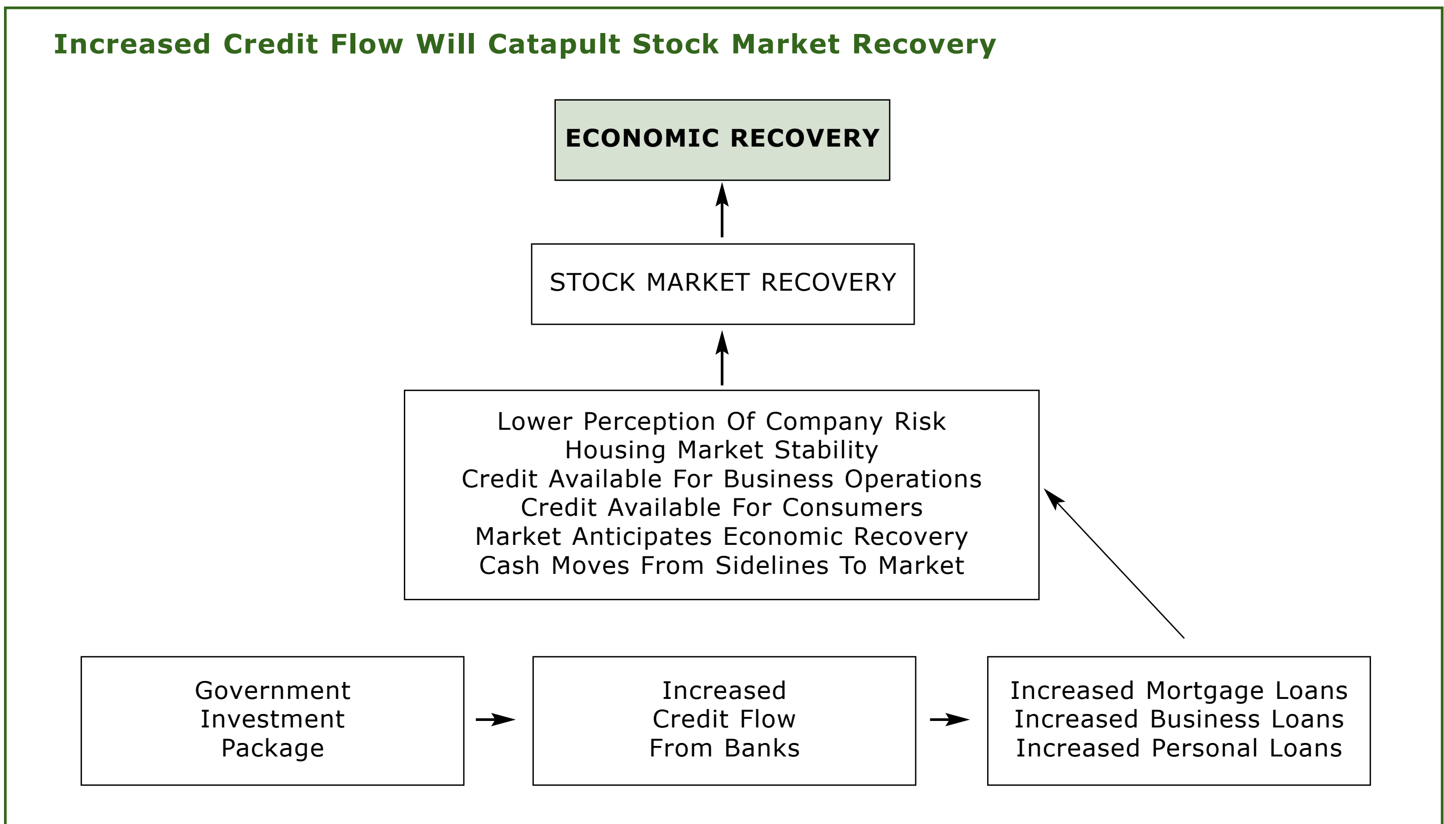
1. The Government Has Taken Aggressive Steps To Restore The Flow Of Credit

To increase credit available to the marketplace, the Fed announced plans to loosen its lending restrictions to the banking industry. The Fed said it would expand its short-term lending to banks by starting to take additional forms of collateral, instead of just Treasuries and other high-grade securities.

In its boldest move, the Federal Government came forth with a $700 billion investment package to acquire written-down mortgage assets from banks. The media and most onlookers have called this package a "Wall Street Bailout". We believe this is misleading. Government funds will be used to purchase depreciated bank assets at a determined "market rate", and these assets will be held by the Government and subsequently sold at a later point in time.

In a perfect world, the Government investment package will ultimately be profitable to taxpayers because the market price of the assets is quite attractive by historical pricing standards. In a realistic world (the assumption we will make), it is impossible to know whether the package will make or lose money. Regardless, it is reasonable to assume that a good portion of the invested funds will be recovered in the long term. The ultimate cost of the package (if indeed the investments are not profitable) will be much less than the announced dollar value of the package.

Why is this government investment package so critical? Credit markets have stalled. With loads of troubled assets on their balance sheets, banks are hesitant or unable to take on more loans if the risk of default is high. Furthermore, when banks need to write down those assets, they have less cash on hand to issue loans. This causes businesses and consumers to pay more for loans, if indeed they can get loans at all. The removal of risky assets from the banks will ease balance sheets and restore the flow of credit. We believe this will catapult a stock market recovery, which in turn will foreshadow an economic recovery.



2. The Housing Market Should Stabilize

New home sales recently hit a 17-year low despite housing price declines. Total housing inventory as of August, 2008 is 10.9 months.[2] There continues to be a mismatch of housing supply (too high) and demand (too low).

The recent steady decline of housing prices has given little motivation for buyers to enter the market. There is no incentive to buy a house if one thinks the price will be lower in the near future. A change in expectations from declining to stable housing prices, combined with increased credit availability to borrowers, should foster future housing demand.

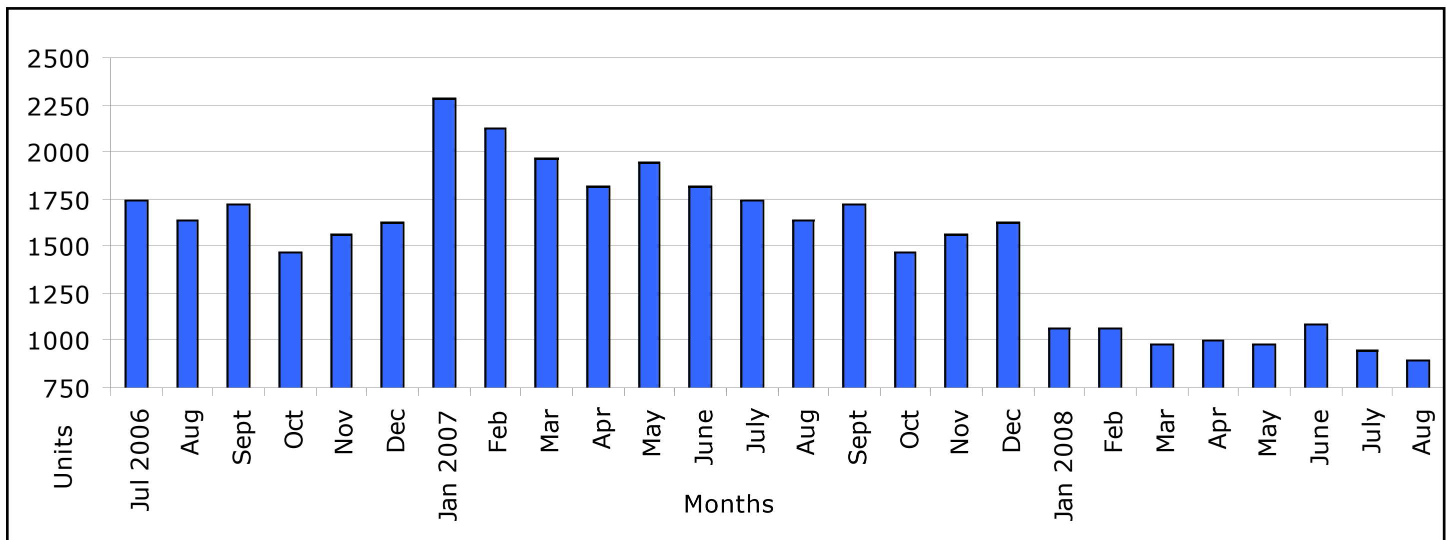
The Federal Government plan to put Fannie Mae and Freddie Mac into conservatorship should help to increase liquidity in the mortgage markets and restore confidence in global financial markets. Fannie Mae and Freddie Mac are set to greatly increase their purchases of prime mortgages, which should push mortgage rates lower. This will add future support to home demand and prices.

Housing prices are beginning to stabilize. The Standard & Poor's/Case-Shiller 20-city housing price index fell a record 16.3% in July from a year earlier. However, the pace of monthly declines is slowing. Between May and July, home prices fell at a cumulative rate of 2.2%, less than half the cumulative rate experienced between February and April.

There are signs of increased housing demand. The National Association of Realtors reported that pending home sales increased 7.4% from July to August, its highest level since June 2007.

Future housing supply should decrease. US building permits have declined 33% between August, 2007 and August 2008. Housing starts continue to fall, and will fall further in the future due to the rapid drop in housing permits.

US Housing Starts — Seasonally Adjusted Annual Rates (Units in Thousands)



Source: National Association of Home Builders

A trend of higher housing demand and lower housing supply should eventually reduce current housing inventory (10.9 months) to a normal level (6.0 months) and stabilize prices.

[2] Source: National Association of Home Builders

3. More Credit Will Be Available For Businesses And Consumers

The removal of troubled assets from bank balance sheets via the government investment package, coupled with a stabilized housing market, will restore the flow of credit to businesses and individuals. Businesses will have the credit to expand operations, and individuals will have the credit needed for consumer spending. This will foster an economic recovery.

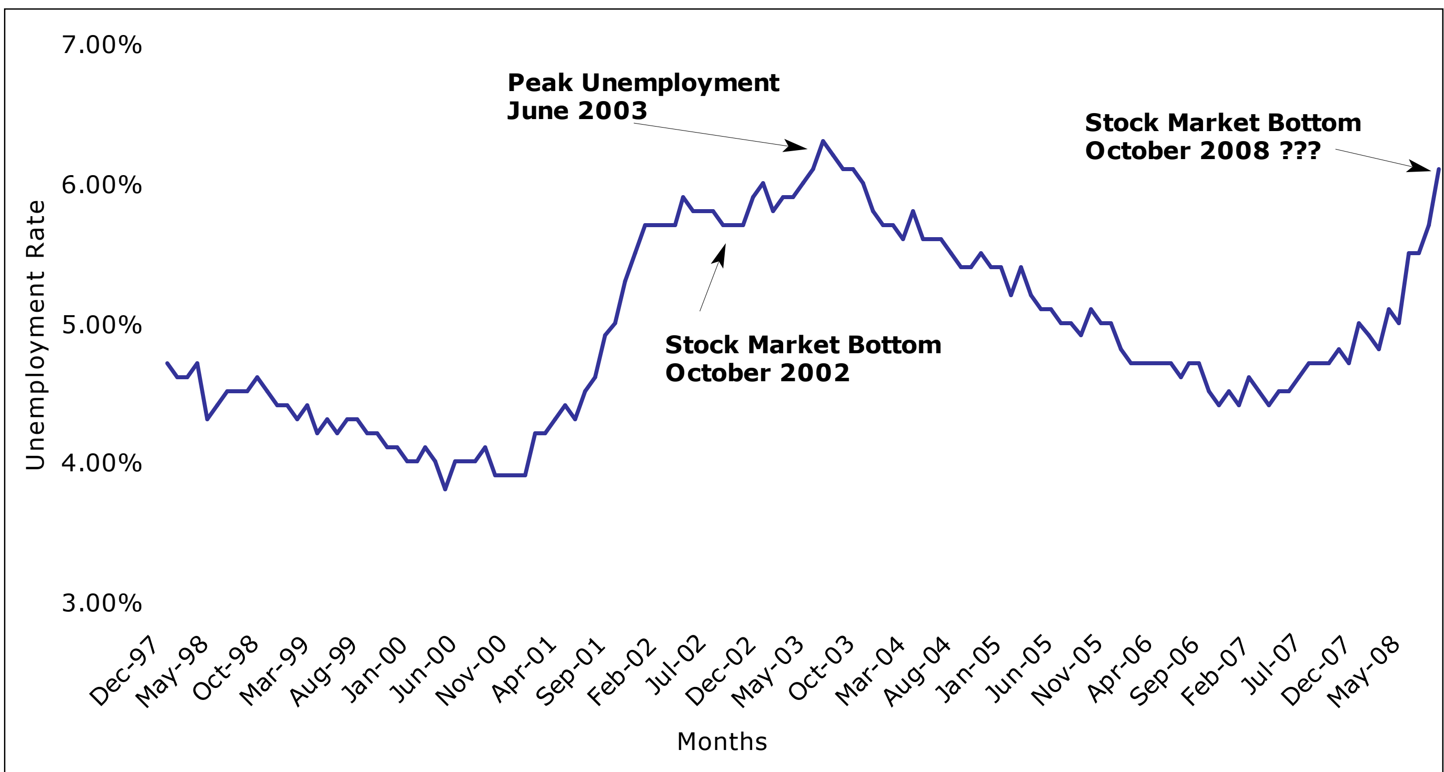
Lower energy prices will also help an economic recovery. Oil prices fell from $147 to $96 per barrel in the Third Quarter. This should dampen inflation and encourage consumer spending. In addition, lower energy costs should bolster corporate earnings.

4. The Market Discounts An Economic Recovery Several Months In Advance

The key to an economic recovery and ensuing stock market recovery - increased credit flow from banks - has been initiated by the government investment package. We do not expect the problems in the market to be resolved overnight. However, we do anticipate signs of improved credit flow shortly. In a relatively quick fashion, we expect the perception of company risk to be reduced when the government package starts to be implemented.

Future expectations drive the stock market. The market should theoretically bounce off the bottom 6-9 months in advance of the point where an economic recovery is expected. By removing the risk of a financial meltdown, the government package should restore confidence and put the economy on track for a normal cyclical recovery sometime next year.

Expect negative headlines regarding economic conditions to persist for several months into a stock market recovery. It is not unusual for unemployment to peak in the midst of a stock market recovery.



5. Some Uncertainty Has Already Been Removed From The Market

Some market uncertainty has been removed with the clarified status of Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch, American International Group (AIG), Washington Mutual and Wachovia. Additional market uncertainty has been removed with the passing of the government investment package legislation. Markets hate uncertainty.

6. Cash Will Move In From The Sidelines

The inflation rate (5.4% as of August, 2008) comfortably exceeds the small yields for conservative bonds and cash. Put another way, the real rate of return on bonds and cash is negative.

Market uncertainty has chased trillions of dollars to the sidelines. There will be a point, perhaps very soon, where investors will grow wary of negative real rates of return. At the first sign of positive future economic data, we believe funds will quickly shift to stocks.

Portfolio Strategy Considerations

For the last few years, we have maintained a large cap focus in the portfolio because we believed it offered a better risk/return tradeoff in difficult markets. We have started to adjust the portfolio to be better positioned for a potential market rebound, and will keep you apprised of these adjustments.

Bond Market Review

There was no Fed interest rate cut in the Third Quarter as the Fed held steady its measures to stimulate economic growth. The Lehman Brothers Government/Corporate Bond Index, widely considered the broadest of the major US bond indices, fell 1.64% for the Third Quarter.

Key US Interest Rates

	30 September 2008	30 June 2008	Change
Federal Reserve Board Funds Rate	2.00%	2.00%	0 basis points
2-Year Treasury (Constant Maturity)	1.96%	2.62%	-66 basis points
5-Year Treasury (Constant Maturity)	2.98%	3.33%	-35 basis points
10-Year Treasury (Constant Maturity)	3.82%	3.97%	-15 basis points

Note: 100 basis points (bp) = 1.00% Source: Bloomberg

During the quarter, interest rates were steady. Highest safety Treasury bond prices rose (yields decreased) while corporate and municipal bond prices fell. This phenomenon was due to investors' "flight to safety" with respect to US Treasury bonds.

The yield curve, which compares the 2-year Treasury rate (Constant Maturity) versus the 10-year Treasury rate, became more "steep" as the fall of longer yields was less than the fall of shorter yields. Normally a steepening yield curve benefits banks because lending becomes more profitable.

Core inflation averaged 2.85% in 2007 and 5.40% through August, 2008.[3] With the recent fall of energy prices, inflation data should ease in future months. Still, the Fed Funds Rate is significantly below the inflation rate.

A decrease in anticipated inflation removes the immediate need for the Fed to consider an interest rate increase. With the recent credit flow crisis, the need to reduce interest rates became an emergency priority. The Fed cut interest rates by 0.50% in early October.

We anticipate the Fed will further cut interest rates in the near future (bond yields would fall and prices would rise) in order to stimulate flow of credit.

Bond Market: Portfolio Strategy Considerations

We continue to maintain our fixed income portfolio position in shorter term maturity bonds (average duration of less than 4.0 years) and Treasury Inflation Protected Securities (TIPS). The recent rise in Treasury bond prices presents an opportunity to sell these bonds at favorable prices. We will keep you apprised of any portfolio adjustments.

Inflation is now a smaller risk than it was when oil peaked at $147 per barrel. However, we continue to hold TIPS as part of a diversified bond portfolio. TIPS offer protection in the event inflation becomes more prominent. This can be especially important for investors who require portfolio income.

[3] Source: Bureau of Labor Statistics

Closing Thoughts

The Third Quarter continued to test the patience of investors. The first 10 days of the Fourth Quarter drove many investors out of the market.

We advocate our clients stay the course regarding their appropriate asset allocation. During hard times, it is tough to remain disciplined, but pulling out of the market creates a pattern of buying high and selling low.

It is our belief that there are better times ahead. We see no reason to immediately deviate from our current portfolio strategy, but will likely make adjustments before the end of the year.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

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"Bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price."

Warren Buffett, "Buy American. I Am."
New York Times, October 16, 2008

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