



To All:

The current bear market of 2008–2009 will probably be remembered as the worst investment period since the Great Depression bear market decline experienced between 1937–1942. “Bear Markets” are defined by decline of 20% or more in an equity index value (S&P 500). The negative 36.91% return in the S&P 500 would surely qualify, and incredibly, this return was one of the better performances in global markets for 2008.

Table I

Past Bear Markets					
Start	End	Start Price	End Price	Months	S&P 500 Pct. Change
03/06/37	04/29/42	18.68	7.47	62	-60.0%
05/29/46	06/14/49	19.25	13.55	37	-29.6%
08/02/56	10/22/57	49.64	38.98	15	-21.5%
12/12/61	06/27/62	72.64	52.32	6	-28.0%
02/09/66	10/07/66	94.06	73.20	8	-22.2%
11/29/68	05/26/70	108.37	69.29	18	-36.1%
01/11/73	10/03/74	120.24	62.28	21	-48.2%
11/28/80	08/12/82	140.52	102.42	20	-27.1%
08/25/87	12/04/87	336.77	223.92	3	-33.5%
07/16/90	10/11/90	368.95	295.46	3	-19.9%
03/24/00	10/09/02	1527.46	776.76	31	-49.1%
AVERAGE				20	-34.1%
10/09/07	11/20/08	1565.12	752.44	13	-51.9%

Source: Strategas Research Partners, LLC

What makes this bear market particularly severe is that the dramatic decline in equity prices occurred within a very short period of time. As you can see in Table I, the average period of decline was ~20 months. From high to low, the current decline has occurred in the last 13 months yet the overall percentage decline rivals that of the Great Depression (which occurred over a 62 month period).

Secondly, this bear market is **global** in scope; i.e. most international markets declined more than the S&P 500. Lastly, no sector within the equity markets went unscathed; i.e. everything went down. In essence, other than cash or cash-like instruments (Treasury Bills), there was no place to hide in the global equity markets.

As you can see from Table II, the data clearly underscores that virtually **all equity sectors declined dramatically** from their respective highs. The 200-day moving average is a technical indicator used to demonstrate the dramatic nature of the decline. A two standard deviation movement in price is considered abnormal (one would expect much less). In the table, the price movement for each sector breached the two standard deviation level. In absolute returns, the average decline for stocks in 2008 was approximately 38%–45%, depending on which index was used.

TABLE II

Percent Divergence from 200-Day Moving Average			
Index or Sector	Divergence from 200-Day MA	-2 Standard Deviations	-2 Std Dev Breach
Materials	-40.2%	-16.6%	YES
Industrials	-33.6%	-14.5%	YES
Energy	-30.0%	-13.2%	YES
Financials	-49.9%	-20.0%	YES
Utilities	-20.4%	-17.0%	YES
S&P 500	-29.4%	-13.4%	YES
Discretionary	-27.8%	-16.4%	YES
Dow 30	-25.3%	-11.7%	YES
Technology	-30.6%	-26.2%	YES
Telecom	-22.6%	-21.5%	YES
NASDAQ	-29.8%	-23.7%	YES
Dow Transports	-32.7%	-17.6%	YES
Russell 2000	-30.4%	-16.4%	YES
Health Care	-14.1%	-14.0%	YES
Staples	-14.8%	-10.6%	YES

Source: Strategas Research Partners, LLC

Overseas markets declined at a greater rate than U.S. markets. This decline reflected the delayed reaction by European governments to the economic crisis. Indeed, Europe has only recently moved to aggressively lower interest rates and stimulate the economy. Unfortunately, the delay has negatively impacted the equity markets as most are down significantly more than the U.S. Emerging markets (ex. Brazil, China, ...) are also down more than the U.S., partly due

to a normal decline from lofty valuations, and a reliance on commodity products which are in a general price decline.

In any case, **this is a global recession and its magnitude is considerable.** We believe two critical components need to improve before it becomes evident that the U.S. is likely to exit this severe recession. First, **the decline in home prices and overall housing demand must stabilize and improve.** If home values continue to spiral downward, it will put additional pressure on banks to write down more mortgage debt as foreclosures mount. As banks write down more securities, they are less inclined to lend which can exacerbate our current economic problems. The government is aggressively moving to bring mortgage rates down. We believe a rate of 4.5%-5.0% may be needed for conforming FHA approved financing. At these rates, there is a natural demand for homes as seen in the recent refinancing statistics. Currently, this rate is almost 5.5%.

Secondly, **we need the U.S. Government to implement a program to remove the poor performing loans from the major banks.** These loans, generally associated with sub-prime or Alt-A mortgages, were provided to individuals who normally would not qualify for home ownership. As the economy and employment picture deteriorated, the underlying mortgages were not paid and had to be written down or classified as non-performing assets (i.e. taken as a loss by the bank). Once the government implements this program, banks are likely to start to lend more aggressively. This seems a likely outcome as the government is about to reveal its new rescue plan. The new plan is likely to commit the balance of the Congressionally approved TARP (Troubled Asset Relief Program) funds in conjunction with additional programs aimed at helping to restore bank liquidity. For all of us, **it is imperative that the U.S. banking system return to normal** and for the credit markets to become more liquid as a precursor to a lasting economic recovery.

How did this current crisis occur? The origins were probably rooted in the late 1990s and continued into the early 2000 period as the Federal Reserve moved interest rates lower and lower. This, in turn, stimulated a boom in housing as more and more people began owning or speculating in residential real estate. With money so cheap (unusually low interest rates), banks became increasingly lax on credit standards partly because various government programs were also aimed at promoting increased home ownership. Real estate appreciation also fueled a massive refinancing boom as homeowners increased their overall mortgage dollars at lower interest rates. This helped create the current bankruptcy problem of mortgages larger than the declining value of existing homes.

At the same time, the financial community began introducing derivative securities to leverage the booming mortgage market. Unfortunately, in the fall of 2007, housing demand began to decline which set the stage for our current financial crisis. What is apparent now is that huge financial leverage was added to a mortgage market that was already a bubble by itself. Interestingly enough, this underscores how poorly understood the risks were by so many “smart” people. Even our Federal Reserve was still forecasting GDP growth (3+ %) as late as the spring of 2008.

For 2009, we believe corporate profits could decline ~30% or more while unemployment could rise to 8 ½-9 ½ %. However, we also expect to see some positive developments emerge in the

short-term. The new administration and Congress seem committed to passing a \$900 billion to \$1 trillion, 2-year stimulus package shortly. This is in addition to the \$700 billion in the Troubled Asset Relief Program (TARP) already approved. Similar programs are also being developed and implemented on a global basis by many central banks (European Union, Australia, Canada, ...). Secondly, there is a discussion of implementing a “Good Bank–Bad Bank” program to be administered by the FDIC. This program will be designed to remove the bad assets from the banks to promote further lending.

Additionally, commodity costs, which acted as a drag on the global economy throughout 2008, are now substantially lower. As such, this acts as an overall stimulus as less money is needed for the purchase of gasoline and food products. Finally, global equity prices have declined approximately 40%–65% on average and may now fully reflect the current economic problems in 2008 and 2009. On balance, we think that some recovery in our economy is likely before the end of the year.

We want to emphasize that our core portfolio remains very attractive. The vast bulk of our equity exposure is in stocks that have largely weathered this economic storm. Once the economic turn comes, it will be these companies that are likely to capture greater market share and emerge more streamlined and more profitable. This should set the stage for considerable earnings growth in the future.

Our investment approach remains cautious but also opportunistic. We have maintained significant cash positions in most accounts and are beginning to utilize some of this cash by purchasing high-grade corporate bonds. Yields on these bonds are in excess of 7% and should offer strong appreciation potential as the credit crisis recedes. Indeed, there are early signs that the credit markets are moving in the right direction. We intend to remain patient and wait for signs of recovery before more actively committing additional cash to equities. We continue to actively review our core equity positions to ensure that our investments can achieve our long-term appreciation objectives.

We realize that a lot of damage has occurred in the economy and the financial markets. Recovery is not likely to be easy or quick. We remain focused on capital preservation in this difficult time.

Sincerely,

Jack Salzman

Jeff Bates

Steven McGinty, CFA