

Capital Market Review • Third Quarter 2008

The top headlines this quarter were the failure or takeover of storied financial firms including Bear Sterns, Lehman Brothers, Merrill Lynch, AIG and Wachovia. In response, the US Government has passed wide sweeping bailout and guarantee programs to bolster confidence in the struggling financial system. A story that has been secondary to the headlines during the quarter is the decrease in the price of oil. The unprecedented rise in commodity prices, which were widely talked about during the earlier part of the year, also shifted directions. The leading concern is no longer inflation, but recession. The U.S. Dollar also shifted directions and strengthened against most major currencies for the quarter.

September was a repeat of June with the broad market selling off during the last month of the quarter. The S&P 500 Index fell 8.9% in September and 8.4% in June. Hardest hit for the month was EAFE, which was down 14.5% for the month, while small companies represented by the Russell 2000 fared a little better by being down only 8.0%. The losses in September resulted in losses for the third quarter of 2008. The negative result for the S&P 500 for the quarter makes the market negative for four straight quarters. The S&P 500 was down 8.4% for the quarter, 19.3% year to date and 22.0% for the trailing year, while the Dow was down 3.7%, 16.6% and 19.8%. The Russell 2000 was down 1.1% for the quarter, down 10.4% for nine months and down 14.5% for the twelve months. The EAFE declined 20.6% for the third quarter, 29.3% for the year-to-date and 30.5% for the year.

The Dow Jones Wilshire REIT Index fared the best for the month of September posting a 0.4% loss for the month. This

resulted in the index having stronger than market returns compared to the S&P 500 for the quarter with a 4.8% gain and with the strong first quarter numbers, keeps the year-to-date number ahead of the S&P 500 by 20.6% with a return of 1.3%

Things were mixed for bonds, as well. The Lehman Brothers Aggregate Bond Index, an index of the broad bond market, lost 0.5% for the quarter, the second straight quarterly loss, reducing the year-to-date return to 0.6%. The bond market fell on concerns of tight credit and a slowing economy. The index is still up 3.7% for the twelve month period. The Lehman Brothers US Corporate High Yield Index posted an 8.9% decrease for the quarter, showing evidence that the credit markets have been very tight. The Citigroup World Global Bond Index – Non US\$ was off 4.3% for the quarter reducing the year-to-date return to 1.2%. The municipal bond market, which has struggled in 2008, had a -3.2% return for the quarter and is off the same amount for the year-to-date period.

STOCK MARKET

The major averages saw steep losses during the third quarter, which were driven by the horrible September results. The S&P 500 Index, an index of large company stocks, gave up 8.4% and continued its downward slide from last quarter. The Russell 2000 Index, an index of small company stocks, did fair better only losing 1.1% for the quarter. The MSCI EAFE Index, an index representing international stocks, lost 20.6% in the quarter, its worst quarterly loss since September 1990. The Dow Jones Wilshire REIT Index, an index representing real estate companies, gained 4.8% in the quarter, the only index to post a gain.

The longer-term numbers have also gotten very weak. The S&P 500 Index is only up 3.1% annually for the past 10 years, which is below the T-Bill return of 3.5%. The 8 year return is negative 0.9%, which coincides more with the highs of the market. The six year return, which is more off the bottom of the last correction, is a decent 8.2%.

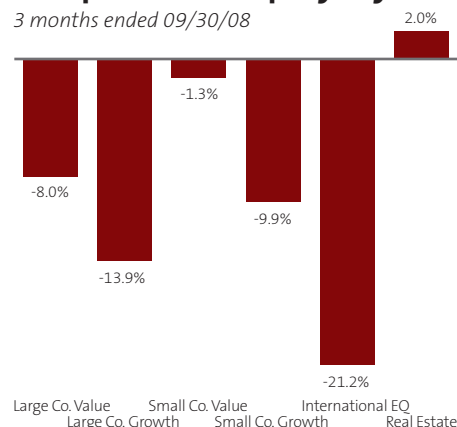
Market Returns

| | 3 months ended 9/30/08 | 12 months ended 9/30/08 |
|-----------------------------------|------------------------|-------------------------|
| T-Bills | 0.4% | 2.4% |
| Lehman Bros. Aggregate Bond Index | -0.5% | 3.7% |
| S&P 500 | -8.4% | -22.0% |
| Russell 2000 | -1.1% | -14.5% |
| EAFE | -20.6% | -30.5% |
| Wilshire REIT | 4.8% | -12.5% |

Equity Styles

Only the real estate category managed a gain returning 2.0%. Growth generally underperformed value for the quarter with Large Growth losing 13.9% versus Large Value losing 8.0%, which is a reversal from last quarter. Small Value lost 1.3% while Small Growth lost 9.9%. The average International Equity finished the quarter down 21.2%, the worst of all the categories.

Comparison of Equity Styles

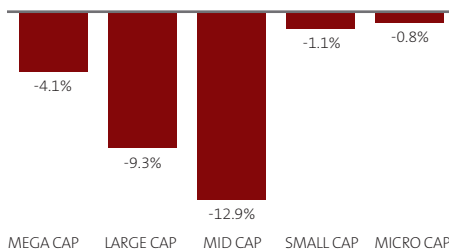


The nine month period was ugly for all styles, with international equity, the worst, losing 29.9%. Real Estate was the best with a loss of 6.0%. The difference between large value and large growth was 2.8%, while the difference between small value and small growth was 10.8%. Large value was down 20.1%, large growth 22.9%, small value 9.7%, small growth 20.5%, international 29.9% and real estate 6.0%.

The twelve month period, while all negative, varied less dramatically with large value losing 23.9%, large growth 23.2%, small value 15.7%, small growth 23.0%, international 31.1% and real estate 14.5%.

Return by Market Cap

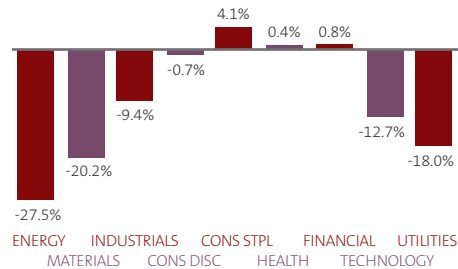
3 months ended 09/30/08



As mentioned earlier, the Russell 2000 posted a small loss of 1.1% for the quarter, which was outdone by the Russell Micro Cap, which was down 0.8%. Mid Caps, which was the best performing area last quarter, struggled by falling 12.9% during the quarter and making it the worst performing area. Mega Cap stocks were down 4.1% which was about half of what the overall market was down. Large Cap companies were off a little more than the overall market by falling 9.3%. For the nine months, mega caps are down 18.6%, large caps at 19.5%, mid caps at 19.5%, small caps at 10.4% and micro caps at 16.2%.

Stocks by Sector

3 months ended 09/30/08



Three of the ten sectors produced positive returns in the quarter, lead by Consumer Staples at 4.1%. Financial stocks, which up to this quarter were the largest decliner, posted a 0.8% gain followed by Healthcare at 0.4%. The three poorest performing sectors were the Energy sector, which had been posting the largest gains as oil prices moved up, made a strong reversal in the third quarter by declining 27.5%, Materials down 20.0%, and Utilities at 18.0%. Technology and Industrials trailed the overall market by returning a -12.7% and -9.4% losses for the quarter. Consumer Discretionary, which was down 0.7%, did beat the overall market.

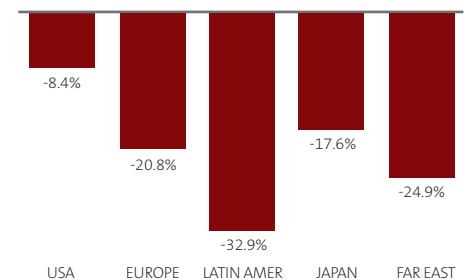
All ten of the sectors were negative for the nine months, with four outpacing the market and trailing the market. The Energy sector lost 18.7% for the nine months and 13.9% for the twelve months. Materials posted -19.4% and -19.6% returns over the nine and twelve month periods. Industrials lost 20.4% and 23.5% respectively for the nine and twelve months. The consumer and their spending have been a topic of discussion as the economy slows down led Consumer Discretionary down 13.8% versus -3.1% for Consumer Staples for the nine months and -22.4% versus a positive 0.3% for twelve months. Healthcare, which one would think is less sensitive to the overall economy, was down 12.5% for both nine and twelve months, which was better than market results. Financials continue to lead the

way down by dropping 29.1% and 39.2% due to lingering concerns of the amount of write offs that still need to be taken. Technology was down 25.0% and 25.7% for the nine and twelve month periods. Utilities were negative for the nine month period by being down 20.4% and a 14.4% loss for the twelve months.

A case for contrarian investing was made if you examine the energy and financial sectors. Energy, which lead the second quarter with a 19.4% return, became the worst with a -27.5% return this quarter. Financials, which were the worst in the second quarter with a -19.0% return, managed a small 0.8% gain this quarter. Sometimes it does come true that the last will be first and the first will be last.

Stocks by Region

3 months ended 09/30/08



All four regions underperformed the S&P 500 Index for the quarter with Latin America leading the way down with a -32.9% return followed by the Far East with a -24.9% return. The U.S., which was down 8.4% for the quarter, out-performed Europe and Japan, which were down 20.8% and 17.6% for the third quarter.

The USA led all the regions for the nine and twelve month periods also. Europe fell 30.6% for nine months and 30.9% for twelve months. Latin America, which is heavily influenced by the oil markets, had a 27.6% decline for nine months and 23.0% for twelve. Japan was the second best performing region for the year-to-

date period, but still produced a loss at 22.2%. For twelve months Japan was down 26.9%. The Far East region was the hardest hit for nine and twelve months by being down 39.4% and 40.5%.

Please note that these returns are in U.S. Dollar terms and the change in currencies will have an effect on the return

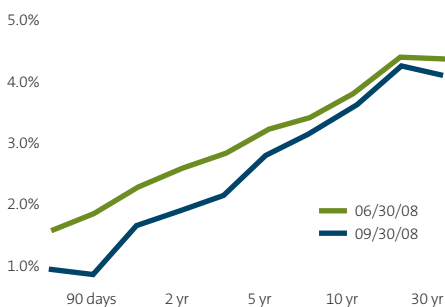
BOND MARKET

The bond market generally experienced a tough quarter even though interest rates on Treasuries decreased for the quarter. Spreads on non-Treasury bonds widen for the quarter as concerns over the stability of the credit markets and the ability of borrowers to repay their debt came into question.

The yield on the 2 year Treasury went from 2.6% to 2.0% during the quarter. Likewise, the yield on the 5 year went from 3.3% to 3.0%, the 10 year from 4.0% to 3.9% and the 30 year from 4.5% to 4.3%. This resulted in price gains in US Treasuries. However, the returns in the spread markets were generally negative

Yield Curve

3 months ended 09/30/08

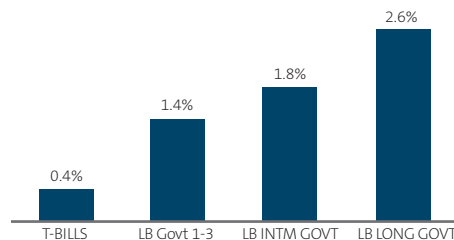


There was a growing consensus that the Fed will raise the Discount rate sooner than later to combat higher inflation three months ago. This consensus shifted directions and by the end of the third quarter the market was anticipating a rate cut, which it got in October. Generally, the Fed does not like to move

rates before a Presidential election, but with tremendous anxiousness in the credit markets, it left the Fed little choice.

Bonds by Maturity

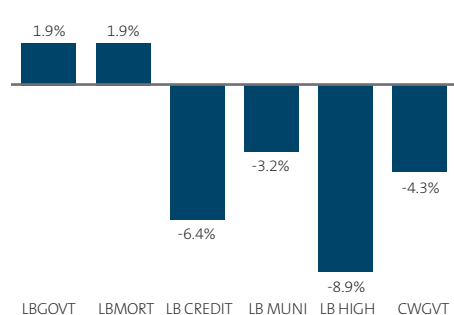
3 months ended 09/30/08



The Lehman Brothers Long Government Index led all maturities last quarter due to the falling yield curve with a return of 2.6%. The Index was up 4.0% for nine months and a strong 9.8% for the year. The return of 0.4% for T-Bills was the only lowest return across the maturity spectrum. T-Bills were also the weakest for the nine and twelve months with a 1.4% and 2.4% return. The Lehman Brothers 1-3 Year Index returned 1.8% in the quarter, 3.5% for nine months and ended the twelve months with a 5.9% return. The Lehman Brothers Intermediate Government Index was up 1.8% for the quarter, 4.0% for nine months and 7.5% for the twelve months.

Bonds by Sector

3 months ended 09/30/08



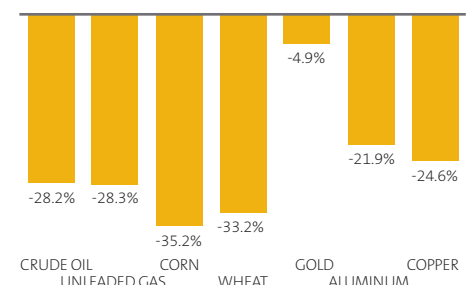
Bonds by sector tell a very different tale than bonds by maturity. With the exception of the Lehman Brothers

Government Index and the Lehman Brothers Mortgage Index, which were both up 1.9% for the quarter, all other sectors produced negative results in the quarter. The Lehman Brothers Credit Index, an index of investment grade companies, was not able to stay in positive territory losing 6.4% for the quarter. Municipals, which are generally perceived as second in safety to the US Government, lost 3.2%. High Yield bonds, of below investment grade companies, performed the worst by being down 8.9% for the quarter. World Government bonds also produced disappointing results and foreign currencies generally fell against the US Dollar by falling 4.3%.

The same pattern of returns, with the exception of World Government bonds, held true for the nine and twelve months. High Yield bonds are off 10.1% for the nine months and 11.2% for the year, while investment grade Credits are off 6.8% and 4.8%. Municipals are down 3.2% and 1.9%. US Governments are up 4.0% and 7.9%, with Mortgages trailing slightly at 3.8% and 7.0%. World Governments are up 1.2% and 5.2%.

COMMODITIES MARKET

3 months ended 09/30/08



The Dow Jones AIG Commodity Index had a very difficult quarter by losing 27.7% in the third quarter. The concerns of a slowing economy and the realization that the US economy and the rest of the world's economies are not decoupled as many speculated. The index now

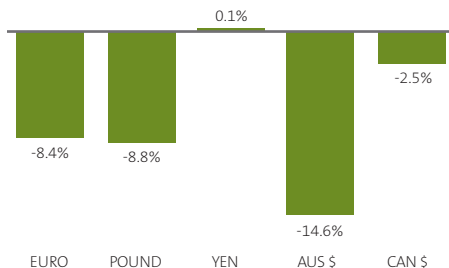
has negative year-to-date with a -8.0% return after being up 27.2% for the first six months. The Index is also negative for the twelve months with a -3.7% return. All sectors of the commodity market were down for the quarter. Oil and Unleaded Gas were down 28.2% and 28.3%. The agriculture sectors were down even more with Corn down 35.2% and Wheat down 33.2% for the quarter. Metals were also down with Gold fairsing the best by being down only 4.9% while Aluminum was down 21.9% and Copper 24.6%.

The dramatic run up in the first part of the year has kept some of the commodity sectors positive for the nine months though. Oil is up 13.0% with Unleaded Gas up 1.3%. Corn was still up 3.6%, but Wheat, with a record harvest this year, is down 30.6%. Metals are mixed with Gold up 6.7%, Aluminum up 3.5% and Copper down 4.7%.

The disparity between corn and wheat is really apparent over the twelve months as corn is up 32.4% while wheat is down 17.1%. It makes you wonder how much of this is the ethanol effect.

CURRENCY MARKET

3 months ended 09/30/08



The U.S. Dollar weakness in the first half of the year reversed course like so many other things this quarter by rising against most major currencies. The Euro was down 8.4% against the U.S. Dollar for the quarter and 1.7% for nine months, but up 1.2% for the twelve month period.

The British Pound is down against the US Dollar in all three periods with an 8.8% decrease for three months, 9.0% for nine months and 11.2% for twelve months. The Japanese Yen was flat against US Dollar with a 0.1% increase for the third quarter. The Yen is still positive against the Dollar for nine and twelve months with a 5.8% and 8.5% increase. The Australian Dollar and Canadian Dollar, both of which are strongly sensitive to commodity prices, declined against the US Dollar. The Australian Dollar is down 14.%, 6.6% and 7.6%, while the Canadian Dollar is down 2.5%, 5.4% and 4.4% for the three, nine and twelve months.

UPDATE

The markets have all remained strained so far in the fourth quarter. The markets continued south in the first two weeks of October with both the Dow and S&P 500 setting lows on October 10th. Since the lows of the month, the market is up about 15%.

The consensus view is that a recession is inevitable and it might be quite severe. The Gross Domestic Product (GDP) fell 0.3% annually for the third quarter. The worst consumer spending in 28 years drove the GDP number lower. Consumer spending represents 70% of the GDP. Spending dropped 3.1% after increasing 1.2% in the second quarter. Purchases of durable goods fell 14% while spending on services increased by 0.6%. Spending on non-durable goods fell 6.4%. Meanwhile, Federal government spending increased 13.8% with defense spending up 18.1%.

Initial claims for jobless benefits remained around the 500,000 level, which is above the average for the 2001 recession. Claims for workers that have been drawing for more than one week are running around 3,700,000, which is a five year high. Many expect that the

unemployment rate will crest between 8 and 10%.

Concerns over the stability of the credit market continue and the credit-worthiness of borrowers. The average investment grade corporate bond is currently yielding 500 basis points above Treasuries, while below investment grade or high yield bonds are 1,500 above. That translates into yield of 8% to 18%.

The prices of commodities have been under even more pressure, especially oil and gasoline. Oil is currently in the mid-sixties, a 50% decrease from the peaks in July. Gasoline is selling at prices which haven't been seen in a couple of years.

With the easing of commodity prices, The Federal Reserve felt that they could ease rates in order to stimulate the economy. The Fed cut the Federal Funds Rate and the Discount Rate on October 8th by 0.5% and again on October 29th by another 0.5%. The Discount Rate, which is the rate the central bank charges depository institutions that borrow reserves, stands at 1.25% while the Federal Funds Rate, which is the rate that banks charge to each other for intra-lending, at 1.0%.

While 2008 is not in the book yet, it is clear that 2008 will be a year that will be remembered and one that we all wish we could forget.

Jack Kraus