

THE ECONOMY AND THE MARKET

Since the beginning of January, domestic equity markets have been under pressure from uncertainty over the subprime-led credit crisis, its impact on liquidity, and fear of an overall freeze in the credit markets. This has created extremely negative sentiment in the equity markets. The past week saw the large write-down of Merrill Lynch, the potential downgrade of several bond insurers, and a surprisingly weak Philadelphia Fed Survey. These weighed on an already technically weak market and contributed to the market sell-off. Negative news overshadowed reports of declining jobless claims, the Bernanke testimony that seemed to signal continued Federal Reserve interest cuts, the Fed's inter-meeting rate cut, and Washington's move toward an economic stimulus package.

We think that equity markets are pricing in a worst case scenario - far worst than we are envisioning at this time. Liquidity does not seem to be an issue as LIBOR rates have come down below the effective funds rate. The bigger concern now is one of solvency. If banks continue to not lend because they are in the process of restoring their own capital, fed funds declines will have little near term effect and the current downturn could turn into a recession. Continued reductions in fed funds rates will eventually put the economy back on a positive trajectory. The question is whether the markets will continue to experience downside volatility; it is unclear as to whether all the negatives been priced into the markets at current levels.

Market valuations are low in comparison to those that existed prior to our last recession earlier in the decade. Lower market valuations can provide some downside protection in a slowing economy and can do so as long as earnings do not decline rapidly. Fourth quarter earnings are expected to decline, led by a very weak financial sector. Strong global growth has driven many sectors and companies with large overseas revenue exposure to double digit growth throughout 2007. It appears that the growth in overseas economies will continue in spite of slower growth in the United States.

The US consumer is being tested. Higher oil prices, declining home values, and a volatile stock market all weigh on consumer sentiment and spending. The overall income effect on consumer spending is more important than the wealth effect of declining home and portfolio values. Job creation and real wage growth are the main contributors to the income effect. Both are slowing; however, we have had lower jobless claims, and the sectors and companies benefiting from the continued global expansion appear to be retaining and growing jobs. This seems to potentially offset some of the losses seen in the financial and construction sectors.

While we may see some additional weakness in business conditions, a sharp decline in GDP and earnings does not seem evident. The Fed is fully engaged, aware of the downside risks, and has stepped in with aggressive easing. Washington looks to be ready to come up with some sort of a short-term stimulus package. We still think that there will be some continued uncertainties within the financial system and on-going concerns over

the availability of bank credit in the coming months. These uncertainties could lead to further market volatility, and, while we may not yet be at the cyclical lows in the equity markets, we feel we are very close.

While we respect this environment of increased volatility and increased uncertainty, we are resisting the urge to become bearish. If the economy does enter a recession, we feel it will be short and may already be reflected in current market prices.

In times of economic and market uncertainty, a well-designed, diversified investment portfolio that matches your risk tolerance and objectives will assist in preserving principal and keep you on the path to achieving your long term goals.

We appreciate your ongoing trust and confidence and, as always, invite any questions or concerns regarding any strategic wealth management issues.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. Investing is subject to risks including loss of principal invested. No strategy can assure a profit nor protect against loss.