

**Where we are now.**

As we navigate the toughest stock market decline that most investors have faced in their lifetime, and anticipate the changing of the guard in Washington, now is a good time to take stock of our current economic situation and begin to think about where the markets will be in the future, and whether the time to begin to think about investing in growth companies is now. It is our feeling that while the challenges we face in our economy are enormous, the anticipatory nature of the capital markets is a fact that cannot be ignored, and as investors and participants in these markets, we must look beyond the current pain towards the eventual recovery.

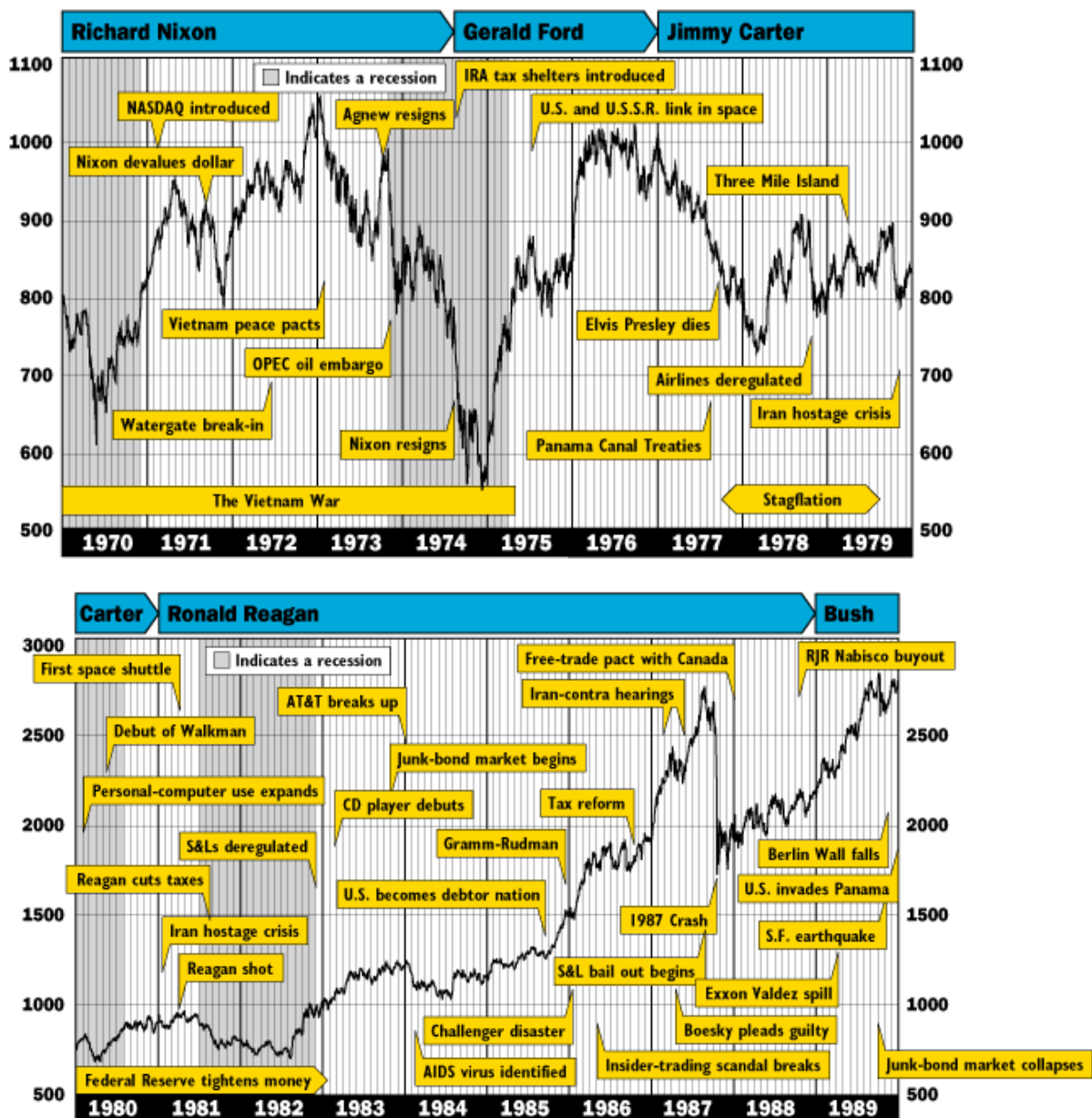
Clearly, we are in the throes of a recession that will lead to a substantial contraction of our economy. The plunge in the ISM index on November 3rd to levels not seen since 1982 starkly indicates that from a manufacturing point of view, we are correcting sharply. The bleak jobs report released last week indicates that virtually no sector of the economy will be spared. With the exception of the healthcare and local government sectors, large job losses have raised the unemployment rate to 6.5%, and we anticipate that it will continue to rise over the next 3-5 months towards 8%. The destruction of wealth that has occurred in our markets over the past six months will more acutely affect the consumer's behavior to a greater degree than any short term stimulus package can counter. The battle between inflationary pressures created by the incredible amount of capital that has been pumped into our economy by the Fed and the inherently deflationary nature of the current crisis at this point looks to be a standoff, with inflation in check for the moment, and the threat of a truly deflationary plunge remote. That said, we expect this recession to be both long and deep, perhaps reaching out over 24 months, dating from the time that we first entered the recession, which we feel was in January of 2008. Dr. Alan Sinai at Decision Economics feels that 2009 will be a lost year, and that none of the key economic indicators will turn up until the end of the year. He points to the 'hunkering down" of the US consumer and the expected decline in capex spending leading to a continued decline of real GDP for the remainder of 2008.

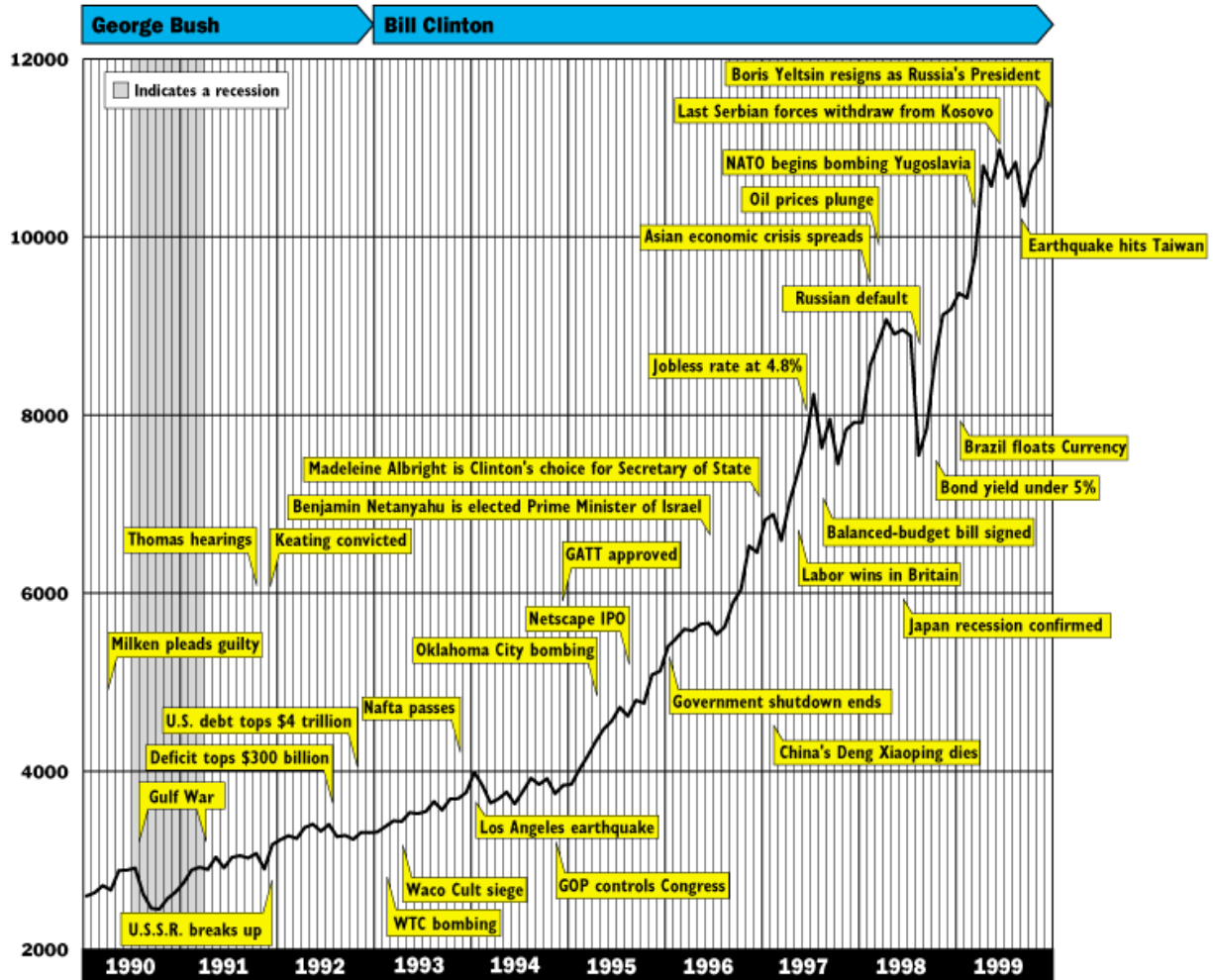
As far as the market itself is concerned, any number of alarming data points is available, including the chart below, which illustrates the amount of fear that is in the market today, even in comparison to the 1987 crash.



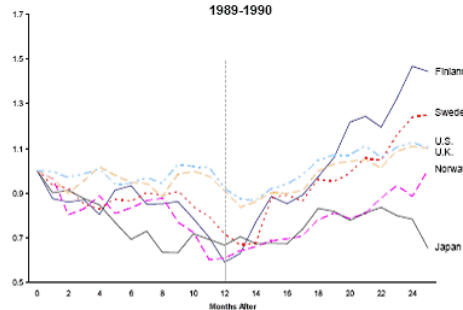
Certainly, data points like that show us that the financial upheaval and unprecedented governmental intervention in the market could lead to unpredictable results, and make the thought of timing a stock market recovery a daunting task. Even so, we feel comfortable anticipating the eventual recovery of the broad markets based upon historical precedent, and while we would currently characterize ourselves as tactically neutral, we turn an eye towards the middle of next year, when we anticipate the formation of a bottom and an upward turn in the markets.

The market, as mentioned earlier, is a predictive mechanism. It seems to us that if Professor Sinai is correct and the economy itself will begin to emerge from this long, deep recession in late 2009, the market will anticipate that by about 6 months, and stock prices will move ahead from that point. In the charts below, the Dow Jones Industrial Averages begin to move upward from 4-6 months ahead of the end of the major recessionary periods of 1973-5, 1981-2, and 1990-91. The last charts included below further illustrate the performance of equity markets during financial crises and during recessionary periods.



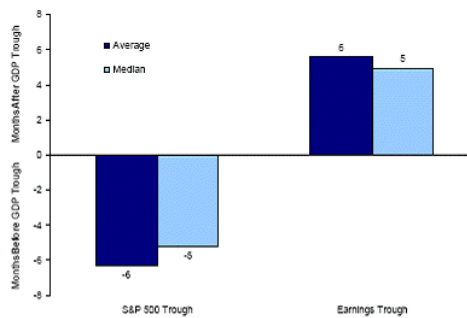


1. Equity Performance Two Years Following the Onset of a Financial Crisis<sup>1</sup> 1989-1990



- According to a recent IMF study, it takes about 2-2.5 years for the economy to fully recover from a banking crisis.
- However, equity markets typically trough about a year into the crisis. By this measure, the US market would make its low around Q4 this year.

2. S&P 500 and Earnings Trough Relative to GDP Trough (Based on 21 Recessions Since 1900)



- Looking at all 21 US recessions since 1900, the equity market typically troughs about 5-6 months before GDP troughs.
- On the other hand, earnings tend to trough 5-6 months after GDP troughs (i.e. almost 12 months after the equity market troughs).

<sup>1</sup> Financial crisis onset dates: Finland (9/1991), Norway (10/1991), Sweden (9/1991), Japan (11/1991), the UK (9/1989), and the US (9/1989).  
Source: Investment Strategy Group, Datastream, Empirical, IMF, S&P 500

The government's unprecedented efforts to mitigate the effects of the credit crisis and housing downturn have taken the form of an enormous amount of fiscal stimulus along with monetary easing in the form of lower interest rates. This is the right approach, in our estimation, and one that will go a long way towards laying the foundation for recovery in the broad economy. Dr. Jeremy Siegel notes that in emerging from a recession, stocks typically move ahead 10-15%, consolidate their gains for a period of three to six months, and then find their footing. That seems to us a likely scenario, and one that would play out over the first half of next year.

The government's various responses to the unfolding crisis have been scrutinized closely over the past months, and there is certainly room to criticize the amount of transparency and the uneven level of disclosure that has surrounded the process. However, we feel that the short term goals of the Emergency Economic Stabilization Act and the TARP program have been met, inasmuch as the immediate job to be done, dealing with the imminent failure of a number of large financial institutions, was completed successfully. The cumulative effect of the EESA has been to allow us to move beyond the risk of institutional collapse and into a place where we can deal with the recession itself. The new administration is committed to a long term approach to stimulus focusing on infrastructure and help for homeowners at risk for foreclosure. Several creative ideas on the remaking of the mortgage industry are being discussed by the Obama economic transition team, and we feel strongly that the administration will look to the lessons of the first FDR administration which clearly showed that bold new approaches to systemic failures like the one we have recently experienced can be extremely effective and beneficial in the short and long term.

As far as the capital markets are concerned, activity there will coincide with the creation of a strong consolidation period in the markets, and the IPO calendar should begin to fill up around the middle of the year. One of the hidden benefits of a market dislocation like the one that we've experienced is that the backlog of quality initial public offerings grows during the period when the markets are closed, and because the recession spares neither publicly traded or privately held companies, the weaker candidates will not survive the turmoil, leaving a very strong group of IPO candidates ready to test the markets when the capital markets window eventually opens. Call it a natural selection of emerging growth companies.

Sincerely,



Matt Regan  
Director of Brokerage Services