



THIRD QUARTER NEWSLETTER 2008

October 22, 2008

Dear Clients, Friends and Fellow Professionals,

Although it is impossible to know what the coming months have in store, 2008 is certainly shaping up to be a year that most investors would like to forget. As you know, the fourth quarter did not begin with any good news. As of October 9th, the Dow was already down 20%, and the question in everyone's minds is whether there will be a turning point before the end of the year or whether the Bear market will continue into 2009 or beyond.

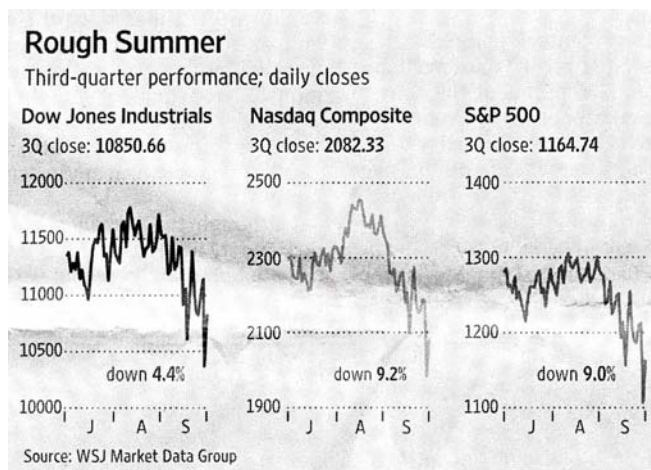
I wish I could predict the future and give you an answer! However, lacking that power, I have tried to provide you with a clear and detailed summary of the issues facing us today, the possible moves you can make with your money and what the consequences of such moves might be, and also my assessment of what it might take to turn things around.

STICKER SHOCK

While we are all aware of the decline in the stock market, let us review the specifics of the market's third quarter performance. The Dow Jones Industrial Average declined 3.7% for the quarter and the S&P 500 index decreased 9.0%. Year to date, they are down 16.6% and 19.3%, respectively. The Nasdaq Composite Index dropped 9.2% for the quarter and is down 21.1% through September 30th. In addition, the Dow Jones World Stock Index, excluding the U.S., dropped a stunning 22% during the third quarter!

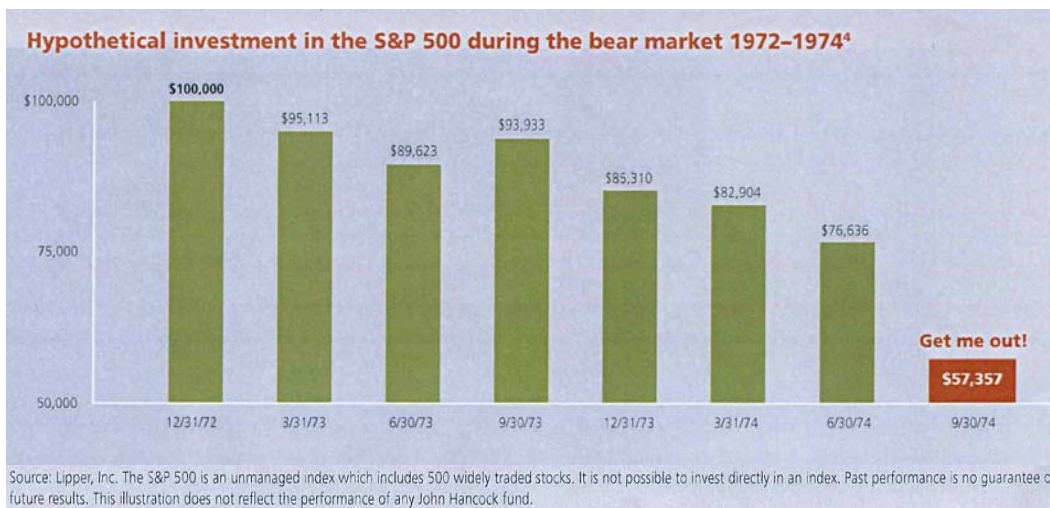
As depressing as these numbers are, nothing hits home as much as your personal account statement. Even investors who have closely followed market developments may still be surprised or even shocked by the decrease in the value of their accounts since their last statement. The turmoil of the last 18 months has created a heightened sense of fear and uncertainty, and that may cause some investors to anticipate that the losses reflected on their statements will continue until they have nothing left.

Although anything is possible, the probability of this remains very low. It may help to remember that experienced investors have endured worse conditions in the past (including the not-so-distant tech-stock collapse in 2000-2001, which led to declines of more than 10% in four separate quarters, with one quarter's loss at nearly 17%).



It is easy for fear and uncertainty to lead to panic, but let me give you one reason to take a deep breath: **panic usually makes things worse**. The natural panic reaction to seeing your account values go down is to sell the investments that are doing so poorly. Unfortunately, selling the investment after it drops in value converts an unrealized loss into a realized loss, and that, in our opinion, is exactly what you do not want to do.

Remember—a loss on paper is still only a paper loss until you sell the investment! For example, if you purchased an investment for \$10,000 and 8 months later it was worth \$8,000, it would appear that you lost \$2,000. However, this is an unrealized loss and would only be recognized as a loss for tax purposes in the event that the asset was sold. However, investors who are in it for the long run often wait for a rebound in the stock market, hoping the investment will recover its paper losses over time and even post a positive rate of return.

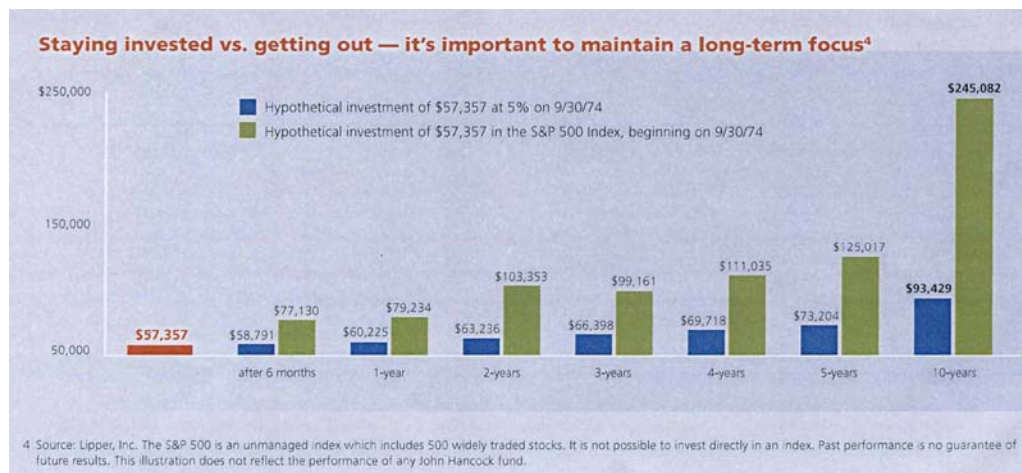


The old saying, “Buy low, sell high!” is difficult for many people to follow because it goes against their natural reaction. When the market posts great returns, people often want to buy, and when the market has a bad year (or more), people often want to get out. The chart above shows a

hypothetical investment during the Bear market of 1972-1974. At a certain point, people just want to cut their losses and get out. Unfortunately, people following these natural instincts ended up buying high and selling low! To make matters worse, some investors who sell at the lowest price often wait until the market has recovered and the prices are higher to buy back in!

A long-term investor who gets out of the stock market now will avoid more down days, but will also miss out on the up days when the market bounces back. The chart below illustrates that those who stayed invested in the 1970s Bear market did much better in the long run than those who pulled out into something safer.

For investors determined to buy low and sell high, it is often difficult to determine whether an investment is a “good buy” after it has declined, for example, by 80%, or whether that same investment will be “goodbye” if the company goes into bankruptcy. In the recent



past, many investors assumed that major companies on Wall Street would be able to survive a financial storm such as this. Unfortunately, this assumption was not always valid. Just look at Lehman Brothers, which was around for over 150 years. In our current financial turmoil, they were forced to declare bankruptcy and are not even in business anymore. Most investors as recently as a year ago never thought such a thing would take place.

THE ELECTION

The outcome of the election will likely have a major impact on the financial situation since the ideas and courses of action of the two candidates are significantly different. Wall Street may react differently depending on the final outcome. Wall Street does not like uncertainties, which we have now. However, on November 4th that uncertainty will be a certainty and therefore investors will be able to take steps they feel are prudent based upon the final outcome of the election.

FANNIE MAE & FREDDIE MAC

As the third quarter began, the two largest Government-sponsored entities – Fannie Mae and Freddy Mac—owned or guaranteed about half of the outstanding U.S. mortgage debt. Unfortunately, their operations were deteriorating as monthly unemployment numbers rose and the housing market continued to suffer.

In September, the Government took over these two mortgage giants. Their goals in doing so were to avoid the consequences of any potential negative reaction by foreign investors, and also to stabilize the housing market, which would be a confidence booster for the entire economy and the financial system.

RESCUE PLAN

Let me offer a very brief summary of our current crisis.

As more and more homeowners started defaulting on their mortgages, many mortgage-backed securities, especially those affected by the sub-prime rate mortgages, held by financial institutions became nearly impossible to sell or even to value. Many banks stopped lending to other banks out of fear that they would not get their money back. Even some large companies were having trouble raising cash on the overnight commercial-paper markets. If left unchecked, it could have been only a matter of days before businesses were unable to get the cash they needed to make purchases and meet their payroll. People could lose their jobs. Companies could close their doors. Financial companies around the world could possibly become unable to continue their operations due to a lack of liquidity and a lack of confidence in our financial system.

Federal Reserve chairman Ben Bernanke, Federal Treasury Secretary Henry Paulson and New York Fed President Timothy Geithner presented this scenario to Congress, warning that things could get very bleak very fast. The result, first introduced on September 17th, was the largest Government rescue (or bailout) plan in U.S. history.

Paulson and Bernanke suggested that \$700 billion dollars would be necessary to buy up Wall Street's toxic mortgage-backed assets, which the Government would eventually repackage and sell when the real estate market recovered. In this way, they hoped to avert the financial crisis, reassure nervous Americans and reinstate confidence in the financial arena.

Unfortunately, this proposal was not approved on Monday, September 29th, sparking the largest sell-off on Wall Street since the first day of trading after the September 11th terrorist attacks. President Bush made a public statement on Tuesday, September 30th and stressed the importance of this proposal and urged that it should be passed. Bush noted that the \$700 billion dollars in the proposed bailout was huge, but was dwarfed by the \$1 trillion dollars in lost wealth that resulted from Monday's stock-market plunge. Congress finally approved this plan to rescue the battered financial industry on Friday, October 3, and President Bush promptly signed it.

What this bailout intends to do is to take illiquid, mortgage-backed securities off financial companies' balance sheets and replace them with liquid assets that could then be used to loan money to consumers and businesses. This should help revitalize the economy by providing more credit and liquidity in the markets. The question is, will it be enough to rescue the economy?

Many investors thought the passing of the rescue plan was good news and expected the market to go up after the plan's final approval. Unfortunately, the stock market fell. Concerns about the economy overshadowed the approval of this rescue package. Investors only took a short period of time to start worrying about the difficult road that still lies ahead of the U.S. economy and were not as enthusiastic about this bailout as was predicted.

GOOD NEWS

There have been various courses of action and several bailouts and rescue plans the U.S. government has implemented over the last 12 months, including:

- \$150 billion Economic Stimulus Package in February
- Mortgage Bailout Bill July 2008
- Purchase of Fannie Mae and Freddie Mac by the Federal government
- The bailout of certain financial institutions
 - AIG
 - Bear Stearns
- The Federal Reserve Board has reduced Interest rates to 1.5% as of October 8th.
- The Federal Reserve Board has also taken a number of steps to significantly increase credit and liquidity in the financial systems.

There were also a number of events that recently took place which may indicate the market is approaching the bottom:

- Warren Buffet invested \$5 billion into Goldman Sachs and \$3 billion into General Electric because he felt that these stocks were undervalued.
- Bank of America was assisted by the Government to purchase Merrill Lynch.

- Microsoft initiated a \$40 Billion, 5-year repurchase program for its stock. In addition, Microsoft increased its dividend by 18%. Many companies decide to purchase shares of their own stock because they believe that the price per share is low and the company feels that the price should increase in value. Management of a company has a much greater awareness of the operations and potential future earnings than the average investor that does not work at that institution. Therefore, a purchase by the company itself is a very good indicator that prices may have bottomed.

If you take into consideration all of the specific things they have done in the last 12 months to help the economy, it is obvious that the politicians are very concerned and will attempt to do about anything they have the ability to do in order to prevent an even greater problem than we have today. If these actions don't help, they will most likely do whatever they need to do to stabilize this economic environment.

VOLATILITY

Since the stock market began, there have always been periods of volatility and reasons not to invest. Recession, corporate scandals, war, or even a housing crisis or other significant event can make it difficult for investors to remain calm and confident and focused on the long term. Volatility can be especially stressful for clients during retirement.

We, as humans, are innately programmed to worry – sometimes about the wrong things. For example, people often have a great anxiety about commercial airplanes and terrorists. They rarely think about the problems with automobiles and diabetes. The latter pair is less dramatic but 250 times as lethal! Therefore, it may be time to reprogram your worry genes. We suggest taking volatility off the list. We feel investors should be indifferent to the daily ups and downs in the stock market—even ones as dramatic as we've seen lately. Volatility decreases significantly over a longer period of time.

We urge you to remain calm and have confidence that the necessary steps being taken by the Government and other entities will be able to help the economy and our financial lives. Do not let panic rule your emotions. Once that happens, it is very difficult, if not impossible, to restore confidence back into the system.

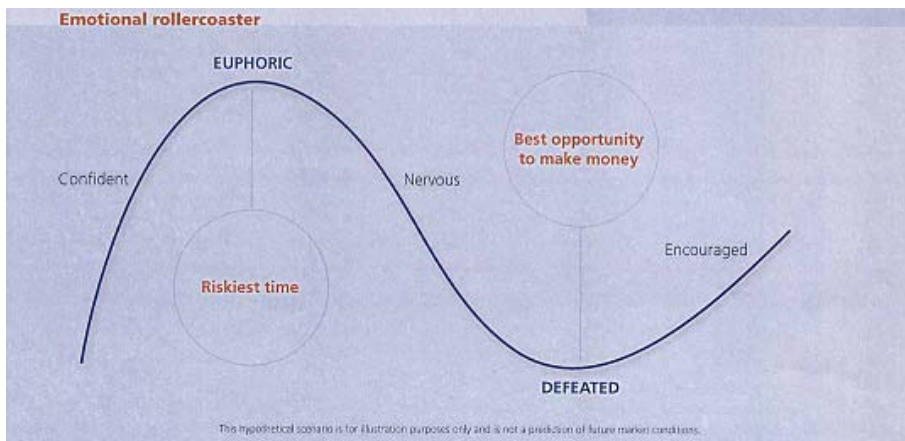
You don't want to sell an investment near the bottom of a market unless you have to. Review what you have and determine whether or not your existing investment plan is still appropriate for your particular situation. You should also look at each of your individual investments and see if any of these should be sold due to higher volatility and replaced with investments with lower risk.

Maintain diversification. The collapse of financial giants Fannie Mae and Freddie Mac is a significant reminder to many investors of what can happen when you are overexposed to one company or sector. Review any concentrated investments with a non-biased advisor, because it is very possible that you are holding the investment based on emotions rather than an economic approach.

You should also keep enough money liquid for providing cash flow over the next one or two years, plus money for planned expenditures such as a new car or home repairs. As long as you are diversified and maintain the adequate amount of liquidity, then in most cases it is best to stay the course. However, if you are still worried, it may be best to work with us to sell a portion of your equities to reduce your risk and your worries.

EMOTIONAL FACTORS

Market cycles depend as much on people's emotions as they do on market fundamentals. When a stock or other investment you purchase goes up, you feel euphoric. When it goes down, you feel defeated. But making an investment decision based on emotional reasons instead of analytical ones can lead to costly mistakes. As they say about a roller coaster, you only get hurt if you jump off in the middle of the ride!



Because of the prominent (and not always beneficial) role that emotion plays during difficult financial times, I think it is important to take a closer look at some of the emotional and psychological traps to avoid.

Remembering only the recent past. There is a psychological quirk called “recency will”, which is basically our tendency to pay too much attention to the recent

past when making decisions. For example, in 1999, the average investor looked only at the previous years' results and thought the market would rise 30% in 2000, according to Brian Bruce, editor of the Journal of Behavioral Science. A look at longer-term history would have made the bursting of the tech bubble and the Standard & Poor's 500 Stock Index's 3-year plunge less surprising. Dr. Bruce says that “recency” can also make investors more pessimistic. Events such as the Korean War, the Cuban missile crisis, and Bear markets such as the 1987 market crash, destroyed investor optimism. But in the year following the bottom of each of those setbacks, the S&P 500 rose 36% on the average, according to Dr. Bruce.

Making our fears a reality. In the financial business, fear is particularly poisonous because it can be self-fulfilling. There have been a number of articles in the financial journals illustrating how many investors are now getting to the point that they are concerned whether or not this market will recover or go into the abyss. Many of these articles have told a story where an investor closed out his brokerage account and put the proceeds in a CD at a local bank. If everybody were to sell their stocks, then it is a realistic assumption that the stock markets, both domestic and global, would most likely take a nose dive. If everyone was selling and no one was buying, simple economics tells us that prices would fall. In addition, if too many people invest their money in bank accounts or Treasury Bills, that would bring interest rates down to even a lower level than their current 2%!

Becoming impulsive. In addition to psychology working against us, we are also biologically programmed to make poor decisions under stress. Psychiatrist Richard Peterson points out that stress hormones push our brains to make short-term, impulsive decisions, when financial problems most often call for long-term creative solutions. For example, many investors argue that it is best to get out of the stock market now before it goes down even lower. Yes, it is possible for the markets to go down even further, but the value of real estate has most likely also dropped and people aren't clamoring to sell their property. Real estate investors understand that they own their investment for the long term and most often hold a belief that real estate prices will recover over time. We must avoid giving in to impulse and instead try to manage our long-term equities in a similar patient manner. Remember, the stock market may go down, but it very rarely stays down!

Understanding the power of positive thinking. Financial markets are a big confidence game and unfortunately much of the confidence has disappeared at this time. In fact, some of the institutions that lost the public's confidence are no longer in existence, such as IndyMac Bank and Lehman Brothers. Once doubt takes hold in Wall Street offices, it tends to spread to the market and many other institutions and investors feel there will be a domino effect to other similar financial companies. But it doesn't have to happen this way. The power of positive thinking will be one of the major ingredients in restoring our domestic and global economies closer to where they should be. We cannot let fear of catastrophe dictate actions that actually bring the catastrophe closer. Few institutions have enough ready cash to fight off a full-fledged, fear-driven run.

Following the crowd. Many experts say that the stock market has become a case study in the psychology of crowds. In normal times, it runs on a healthy mix of fear and greed. However, fear now seems to rule, with investors selling at the first sense of a problem. The crowd tends to overreact, and then ask questions later. Why? Everyone is yelling "The sky is falling". Every headline raises questions about another great depression. The technical term for this is "negative feedback loop." The rest of us just call it a panic. One person in a panic can be written off as overreacting, but it's hard to ignore a crowd in a panic, and even harder not to be swept along yourself. How else do you explain yet another recent plunge in the stock market that set the Standard & Poor's 500 Stock Index to its lowest level in 5 years? If anything, the stock markets should have been positively affected when the Federal Reserve stated it would now loan money directly to companies. Although stocks did open higher, they quickly tumbled as rumors started about the viability of large financial firms like Morgan Stanley and the Royal Bank of Scotland.

Reading the signs. Looking back at history, this negative attitude can be read as an indicator that the bottom may be near. If the stock market is indeed close to the bottom, history suggests that any rally within the next few weeks will most likely be big. However, enough investors have to first be persuaded that the economy and housing market will begin recovering soon. Perhaps the most important indicator to watch will be the credit markets: Investors will regain confidence when they believe financial firms are adequately capitalized and money is flowing more freely through the financial system.

All of us are worried and uncertain about what the future of the markets will be, but remember that no matter what happens, we remain focused on serving you. We encourage you to come to us with your questions and concerns, and we thank you for the trust and confidence you have placed in us.

Yours Truly,

Skip & Maria

Norman J, "Skip" Santori, CFP[®], ChFC[®], AIF[®]
Certified Financial Planner
Chartered Financial Consultant
Accredited Investment Fiduciary

Maria Peters, CFP[®], AIF[®]
Certified Financial Planner
Accredited Investment Fiduciary

P.S. "We have nothing to fear but fear itself!" – Franklin D. Roosevelt

P.S. P.S. Remember – The stock market is one of the few things that people don't buy when it goes on sale.

As always, our commitment is to work closely with you, staying fully engaged at every step, so that you are empowered to make smart decisions with your money To help insure that you do so, please contact us if you have any life situation changes, such as financial, family, career, risk tolerance or expect a change in your or your family's future.

Note: Investors should be aware that there are risks inherent in all investments, such as fluctuations in investment principal. With any investment vehicle, past performance is not a guarantee of future results. Material discussed herewith is meant for general illustration and/or informational purposes only, please note that individual situations can vary. Therefore, the information should be relied upon when coordinated with individual professional advice.

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There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. Rebalancing a non-retirement account may create taxable events that may increase your tax liability.

Sources: Wall Street Journal (7/28/08, 8/1/08, 8/11/08, 8/25/08, 8/27/08, 9/2/08, 9/3/08, 9/10/08, 9/11/08, 9/12/08, 9/17/08, 9/18/08, 9/19/08, 9/23/08, 9/25/08, 9/29/08, 10/2/08, 10/6/08, 10/7/08), Investor's Business Daily (7/23/08, 7/24/08), Barron's (8/11/08, 9/1/08, 9/22/08, 10/6/08), Fortune Magazine (7/21/08, 9/15/08, 9/29/08), NY Times (10/8/08), Business Week Magazine (8/4/08, 8/18/08, 9/29/08, 10/6/08, 10/13/08), The Economist (9/20/08, 9/27/08, 10/4/08), Money Magazine (September 2008), Newsweek (8/11/08, 10/13/08), Time Magazine (10/13/08), Nick Murray Newsletter (January 2008, August 2008, October 2008), Wealth Manager Magazine (September 2007, October 2008), Forbes (9/1/08, 9/15/08, 10/2/08), Investment News (9/15/08, 9/22/08), Registered Rep Magazine (September 2008), US News & World Report (8/18-25/08), Financial Planning Magazine (September 2008), Kiplinger's Personal Finance (8/2008), Pension & Investments (8/4/08), Personal Finance Newsletter (8/13/08, 8/27/08), Profitable Investing (September 2008), PFP Planner (September/October 2008), Research Magazine (June 2008), Dow Forecasts (9/22/08), Financial Advisor Magazine (September 2008), Boomer Market Advisor (September 2008). Contents provided by MDP, Inc.