

Third Quarter
2008



Investment Commentary

The activity that has transpired in the financial markets in recent months has caused more alarm than anything we've experienced in our lengthy investment careers. The credit markets have been dysfunctional for months, but the risks to the broader economy significantly increased in September as credit markets came close to a standstill. Liquidity evaporated and the inability of businesses to access the short-term capital that they rely on to fund their normal business operations threatened to severely damage the economy.



Financial assets have seen volatility never before experienced. The first two weeks of October have seen price swings in the stock market that leave one breathless. There is evidence that huge deleveraging by hedge funds coupled with a deluge of short sellers triggered selling that caused many stocks as well as bonds to perform completely out of line with their underlying fundamentals. Extreme demand for the safety of U.S. Treasury securities resulted in rates on those securities plummeting to unprecedented lows.

The events which have occurred over the past few months are unprecedented in their scope and impact. The problems resulting from years of growth in the amount of debt relative to the size of the economy has now infected the global financial system. The major deleveraging environment is outside the experience of the vast majority of current investment professionals. Financial institutions, hedge funds, and households are being forced

to reduce debt at the same time, which is not only resulting in forced sales of investment assets, but is also reducing the amount of capital available to the credit markets. Governments worldwide, recognizing the severity of the problems, have agreed to provide whatever support is necessary to restore the functionality of the credit markets.

Regardless of what one may believe about the greed and poor judgment that brought us to this point, there is no question that the world needs a financial system that facilitates the workings of the economy. Businesses and banks rely on their ability to borrow so they can invest and grow and create new jobs and support their day-to-day operations. Main Street relies on this ability to borrow as well. Demand for a home, a car or other long term asset is dependent on borrowing ability. Without credit availability, consumer demand and global economic growth will be stymied. A sudden and significant reduction in the availability of credit has occurred and it is imperative for renewed economic growth and investor confidence that credit flows be restored.

A capital infusion into the banking system has been prescribed to allow the banks to take their losses and recapitalize. A governmental stake, in the form of preferred stock investments in the nation's largest banks, is designed to free up capital and get credit flowing once again to companies, consumers, and among the banks themselves. Additionally, the FDIC will guarantee the debt issued by banks and thrifts for a period of three years and provide unlimited insurance for non-interest bearing accounts. Insurance coverage for interest bearing accounts will be increased to \$250,000 per account.

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Though there remains a high degree of uncertainty over economic growth ahead, our expectations have become more positive. Recent declines in prices have taken us to levels where fear and pessimism have dominated trading and fundamentals have been ignored. This environment typically provides good long term investment opportunities.

In closing, we are in the midst of an extremely trying period, but while near-term risk remains high we are becoming more positive about potential future stability. The painful selloff in equities in recent weeks initially reflected investors' revised expectations about the level of economic weakness we will experience. But more recently the selloff showed signs of increasing fear and pessimism, and this is where longer-term opportunities are created for disciplined, valuation-driven investors. We are already seeing investment assets at levels where we believe we can earn good long-term returns going forward, under conservative assumptions.

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As always, we appreciate your confidence and trust, particularly in these trying times.

Best Regards,

Timothy S. Healey
Chief Investment Officer
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