CONWAY • JARVIS

E-Update

October 9, 2008

In an attempt to keep you up to date on events of the past week, we offer our thoughts on the markets.

Throwing the Baby Out With the Bath Water

The character of the market decline has changed in the last few weeks. Good companies that will survive and thrive are being discarded with the Bad and the Ugly. Why? The latter stages of a market decline are marked by the record spike in the VIX that we are seeing along with widespread selling of indexes, mutual funds, and entire portfolios. These decisions make no distinction between companies that will suffer in the current conditions and great companies that are selling at 1988 prices and whose fundamentals mark them as generational investment opportunities. Do you buy them right now? If this was shaping up as a typical cyclical downturn, we would. However, with the global credit markets in turmoil and investors focused on macro-economic events in the present, we prefer to remain defensively positioned until the market becomes more forward-looking to a point beyond the current crisis. Yes, that means the bottom will then be seen through a rear-view mirror but the key to long-term investing success is avoiding the heroic and premature commitment of capital in times like these.

Very Recent History

Amidst all the pre-election theater of last week, Congress passed the long-awaited and once-fumbled Rescue Plan on Friday. It was greeted with relief by some, indifference by many, and scorn from investors and the stock market. Whereas the market had fired a shot over Congress' bow the Monday prior to Friday's vote, Europe received its wakeup call earlier this week from a two-day beat-down in the global equities markets. They got the message: The credit crisis may have started in the US but it was their problem now and living in denial was not an option. Ireland got the ball rolling by raising its insured bank deposit levels and other EU members grudgingly followed suit as they saw their depositors head for the Emerald Isle. Over the course of the last 72 hours, the EU has suddenly moved on from denial to acceptance and joined US and Asian central banks in yesterday morning's announcement of a coordinated cut in key interest rates of 50 basis points. This is a good start to crafting a response to the credit crisis on a global scale

It's Not a Question of Liquidity, It's a Lack of Confidence

So far this week, the Fed has acted to support the commercial paper market and lead the way to a global cut in interest rates. Both measures are designed to add liquidity to stimulate the flow of credit. However, credit remains frozen despite these and other prior additions of capital to lenders. This is a crisis in *confidence* that we believe will persist until uncertainty regarding the value of toxic collateral and the amount of leverage applied to it is removed. In addition to capital, the Treasury's execution of the Rescue Plan will bring much needed transparency to the price discovery process. This should allow them to separate the healthy banks from those who won't, and shouldn't, survive. Today's markets were roiled by speculation that the Treasury may be forced to exercise their final option: nationalizing the money center banks. We're hopeful that that can be avoided if credit flow resumes in the very near future and will be focused on the LIBOR rate and TED spread levels for indications of that.

The Domino Effect

Decoupling is a myth. The theory that some economies would thrive while the US struggled has been emphatically debunked by the not-so-surprising revelation that we are all linked by the Global Financial System. Our toxic mortgage-backed paper is plastered to the walls of every major bank around the world along with the Credit Default Swaps issued by every major insurer and broker. The US Housing market tipped our economy over, followed by Europe, Latin America, and Asia. The Credit Crisis started with the banks and brokers, it then migrated to the insurers, and has now trickled down to consumers on Main Street. The Good News? While we're currently all headed in the same direction, some economies will suffer less pain than the US and recover faster. With the tools available to investors today, those markets are open to us as never before and will present us with some great opportunities on the far side of this current decline.

Finally…..

Many thanks to those clients who have called us for assurance or to offer encouragement to us in these historic market conditions. It's great talking with you and we want to encourage those we haven't heard from to give us a call with questions, concerns, or simply to say hello. Trust us, we prefer talking to clients rather than watching the tape these days. We will be sending statements next week and think it's important to review with us in person or by phone for the purpose of planning for year-end and to talk about next year. Please call Dana to schedule appointments or teleconferences.

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