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Recession Fears Grip Wall Street As New Year Begins

Interim Update From Your Portfolio Management Team—January 23, 2008

So much for hopes of an optimistic beginning to the new year. Over the first two weeks of January, the S&P 500 index is down almost 11%, and is on pace to finish as the worst January in the history of the S&P 500 index, going back to 1950. Even the darlings of the recent bull market—emerging markets, and natural resource stocks—have not been immune from the carnage, as these stocks have fallen nearly 20% since the market peak in October.

Recognizing the growing fear that the U.S. was slipping into recession, the Federal Reserve Board took the unusual step on January 22 of cutting the Fed Funds rate by almost one full percentage point (0.75 % to be exact). This provided some hope to market participants on Tuesday, as the stock market started the day down almost 4% and finished the day down 'only' one percent.

The table below shows what a difficult start to the year it has been for stocks of all types:

Index	*January Return*
Dow Jones	- 9.8%
S&P 500	-10.8%
Russell 2000	-13.1%
EAFE	-14.0%
Lehman Bond	2.5%
90-Day T-bills	0.2%

Source: Wall Street Journal
Note: Dow Jones represents the Dow Jones Industrial Average; EAFE represents the MSCI index of foreign stocks; Lehman Bond represents the Lehman Aggregate Bond Index. Returns cover the period from 12/31/07 – 01/22/08.

For those of you who have been reading these commentaries for the past several months, you know that we have had rather serious concerns about the health of this market. As a result, we have maintained pretty high holdings in money market funds. As of the end of the year, across all strategies, we held nearly 60% in the Treasury money market fund, with another 7% in investment-grade bond funds (which have performed well as the Fed has been cutting interest rates).

Naturally, as the market weakness has continued into 2008, we have further reduced our equity allocation. As of January 23 our total equity exposure across all strategies stands at 12%. Most of this 12% consists of fairly conservative funds that have held up pretty well in this decline.

As you might imagine, since we hold all this money in money markets, we have held up quite well in this sharp market drop. Across all strategies, the FSA accounts are down less than 2% (in the month of January through 1/22) while the S&P 500 index is down almost 11%. Obviously, the more conservative strategies are down a bit less than this average, while the more aggressive strategies may be down a bit more than the average.

While there is a great deal of uncertainty swirling around the future of the U.S. economy and stock market returns, please rest assured that we are monitoring the markets each day to find the most appropriate investments for your portfolios. At the moment, that means high levels of money market and bond funds. As we look further out on the horizon, we believe that a better stock market environment lies on the other side of this bear market. And once we see the skies clear, we will move back to equities.

As managers who focus so much effort on managing risk, we are always glad to see the market correct some of the excesses from the prior bull market. This creates new opportunities going forward. And since we are willing to retreat to the safety of money market funds during times of high market stress, we try to avoid subjecting our clients to the roller coaster ride that the stock market often offers.

If you have any questions about your specific accounts, please do not hesitate to call or email us.

Thank you for your continued confidence.