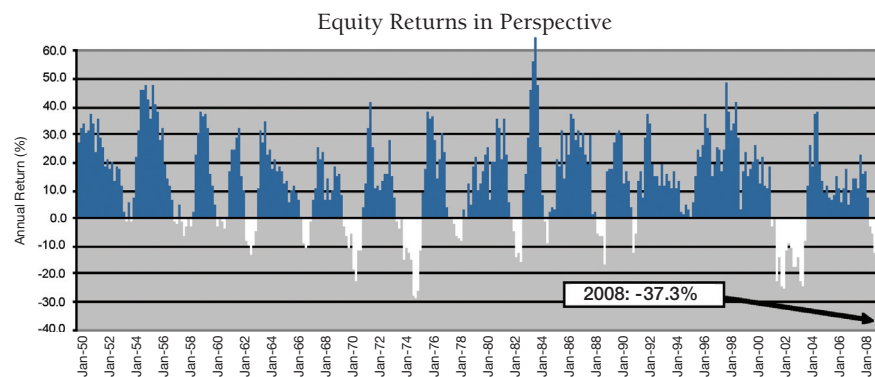


Just how bad was market performance in 2008?

The not-so perfect storm of sub-prime lending/housing weakness/credit crunch was sufficient to literally paralyze economic activity, and plunge world markets into the most severe decline since the Depression. We now know just how severe - \$30 trillion erased from world market values, with U.S. markets losing 38%, international markets almost 43%, and emerging markets 52%.

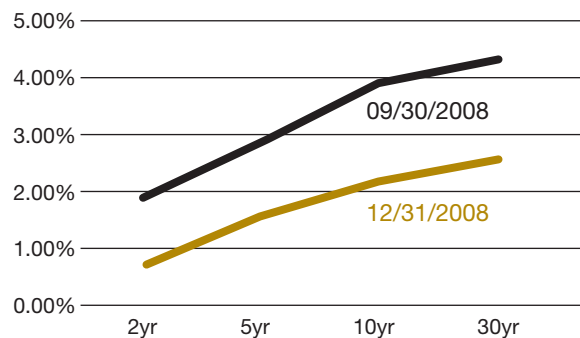


US Equity Returns: 1950 - 1978: Ibbotson and Associates, 1979 - Current: Russell 3000

- The recent 12 month experience is similar to Sept. 1974: -38.9%
- For equity investors, it's difficult to avoid and market time down markets – they happen
- Note positive equity markets following previous market downturns

And the picture on the fixed income front was also grim. The safety of fixed income investing came into question as credits that were once thought rock-solid suffered substantial price depreciation. Yield spreads, the difference between government and non-government debt, widened as investors, worried about the next casualty, demanded adequate compensation. The fact that spreads not only widened for financial services companies, but also in higher quality, straight-forward industrial debt only proved the depth of this financial crisis. All the volatility kept investors

Treasury Yield Curve



moving into Treasuries, and in spite of the government's heavy new issuance, yields on notes and bills reached new lows.

How does this recession compare to the Depression?

The analogies between the Great Depression and the current recession are understandable, but in fact, they are not very comparable. The Depression of the 1930s lasted for years and was made worse by policy missteps. Further, the levers of monetary and fiscal policy available today did not exist in the 30s. Finally, the reality of information technology and globalization which facilitate the ease and speed of money movement around the world further negates these comparisons.

When will the economy and the market turn around?

In spite of the historic magnitude of the events of this past year, there are signs of improvement and there are certainly reasons for some, albeit muted, optimism. Yes, it is true that the structural threat to credit markets and the accompanying lack of liquidity has brought on economic contraction around the world. GDP is shrinking around the world, job loss and wage stagnation is real, and consumption continues to slow.

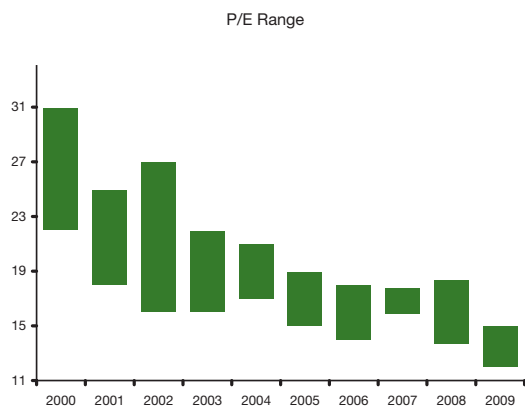
As for current levels of markets – we continue to view expected earnings, valuation levels and current prices as much more reasonable. Any positive view of markets for the next 12 months is predicated upon a U.S. economy that would likely begin to trough as early as the summer, and perhaps as late as the fall. Should those forecasts prove accurate, we would expect markets to begin to discount that eventuality very soon. Six months ago, 2009 estimates for S&P 500 earnings were in the \$90 range. Today, analysts have reduced those expectations to around \$63 for this year, and that number seems closer to reality and to be achievable.

S&P 500		12/31/2008						
Price		903.25						
Dividend Yield (12 Months)		3.14%						
Dividend Yield (Indicated)		2.98%						
Earnings Per Share								
	2003	2004	2005	2006	2007	2008	2009	
Mar	12.48	15.87	18.00	20.75	22.39	16.62	14.15	
Jun	12.92	16.98	19.42	21.95	24.06	17.02	15.55	
Sep	14.41	16.88	18.84	23.03	20.87	15.96	16.50	
Dec	14.88	17.95	20.19	21.99	15.22	10.96	17.65	
Yr.	54.69	67.68	76.45	87.72	82.54	60.56	63.85	
Yr. to Yr.		24%	13%	15%	-6%	-27%	5%	

Estimates: Bottom Up

This current level prices the index at about 14 times those estimates - certainly not excessive, but not particularly under-priced either.

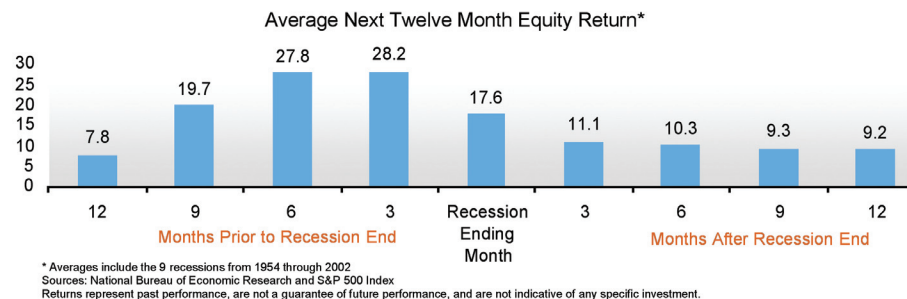
S&P 500	12/31/2008
P/E Ratio (2008)	14.91



If earnings estimates for this year are now close, we are optimistic that 2009 will likely be one of at least single-digit returns.

So, what should we do?

Ernie Ankrim, Chief Investment Strategist at Russell Investments, reminds us that people with a long term investment horizon – at least three years – should strongly consider retaining exposure to the market. He warns against the risks of getting overly conservative and points out that this is especially true when the yields on the safest assets, treasury bonds, are close to zero. Further, the dramatic explosion in injected liquidity may well bring us inflation concerns after we're through this recession. Protection against inflation almost always requires taking more risk (like in stocks or riskier bonds) than the most conservative investments. The chart below illustrates the average market return in past recessions before and after the recession ended.



If we do not stay in the market, we will miss the run-up prior to the recession's end – whenever that will be. These are tough times and in the next short term likely to be even more painful, but we truly believe the best course of action is to remain invested in the market.

Allan Keyes, Chief Investment Officer

Elizabeth D. Swartz, Senior Vice President, Fixed Income Manager