

January 1, 2009

<b><i>INVESTMENT STRATEGY OVERVIEW</i></b>
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The fourth quarter was dismal and while people like to bid a “fond farewell” to the year just ended, we feel “good riddance” is far more appropriate this time.

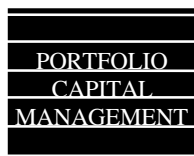
	<u>Value</u>	<u>December</u>	<u>3 Months</u>	<u>2008 YTD</u>
DJIA	8776.39	-0.6%	-19.1%	-33.8%
S&P 500	903.25	+0.8%	-22.6%	-38.5%
NASDAQ Comp.	1577.03	+2.7%	-24.3%	-40.5%
Value Line 1700	225.90	+3.6%	-35.3%	-48.7%
Russell 2000	499.45	+5.6%	-26.5%	-34.8%

As we look back on the year we witnessed a severe “financial crisis,” a rapidly deteriorating economy, the worst housing market in decades and a stock market decline not seen since 1931. We are happy to close the books on the past year, realizing while the outlook remains troublesome it should not be any worse than last year. In fact, encouraging signs began to develop in the last few weeks of 2008.

The fourth quarter saw enormous volatility as daily price swings of 4% to 5% were the norm not the exception. One measure of volatility is the VIX’s, which normally averages 30-40 in periods of extreme volatility reached 90. The violent moves in the fourth quarter were generated by hedge funds and mutual funds preparing for massive withdrawals. The selling typically hit the markets in the last 30 minutes which is why the markets typically experienced the most volatile swings right before they closed.

During the final weeks of December we saw the “rescue” of the auto industry, disappointing housing and manufacturing reports, as well as significant earnings revisions and additional write offs at selective financial institutions. The market was able to shrug off the news and manage to turn in a positive December. We believe the market “capitulation” occurred in November and the lows of this cycle are probably behind us. We say “probably” as only time will tell, but we wouldn’t be surprised to see a re-test of the lows at sometime this year. The market will likely continue to show modest improvement as President-elect Obama will finalize his economic stimulus package. Recent discussions about additional tax cuts should help convince Republicans to support the ambitious spending package.

The outlook for the economy has become much less favorable. Most economists expect the fourth quarter to show negative growth in the 5% to 6% range. Unemployment, which is a lagging indicator, is expected to rise from its current level of near 7%. Some extreme forecast project unemployment may reach double digit levels. We are hopeful the stimulus package that is expected to be passed after the new administration takes over will succeed and starts the economy on the road to recovery.



The actions taken by the Treasury and the Federal Reserve were necessary to return solvency to the financial industry. The movement of the TARP money directly into the banks lowered their leverage ratios and enabled the weakened capital structures to improve. The Federal Reserve has injected close to a trillion dollars into the financial system. While this action has raised inflation concerns, the banks are holding these funds to lower their leverage ratios. Over the next few years the Fed will have the opportunity to gradually unwind this capital infusion. The timing and success of this will dictate whether inflation rises moderately or more rapidly.

### Stock Market Outlook/Strategy

The stock market outlook is more constructive. As mentioned earlier the market recently has responded well to negative news which earlier would have pummeled the market. Likewise we are seeing some bargain hunting and the relative out performance of the “small-cap” indexes. The credit markets need to see improvement to provide sustainability to the stock market. The spreads between Treasury securities and highly rated corporate bonds need to narrow from the wide spreads that exist today. If these trends continue in the first quarter we will have much more confidence in a better stock market in 2009.

The slowdown has and will continue to impact corporate profit growth. S&P 500 earnings are estimated to decline over 17% for 2008 and another 11% in 2009. P/E ratios are in the middle of the historical range and selective stocks are offering attractive buying opportunities for the long term investor. We believe over the next several years investors should be pleased with purchases made at this time.

The market returns in fourth quarter were negative as the S&P 500 and the DJIA declined 22.6% and 19.1% respectively. Other more broadly based indexes posted larger declines in the quarter. The markets showed tremendous volatility throughout most of the quarter. The markets focused on the financial crisis and the prospect of slowing global growth. The sectors that outperformed were telecommunications, utilities, health care, and consumer staples, sectors all considered defensive in a weakening economy. In contrast, financial, materials, and energy sectors were among the weakest.

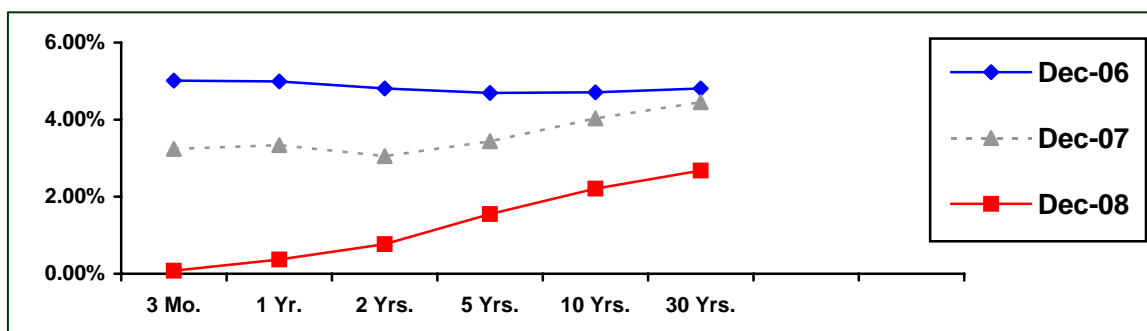
During the third quarter we made several changes to the portfolios. We sold BHP (BHP), Manulife (MFC), and Medtronic (MDT). In addition we took additional tax losses in selective accounts to offset capital gains taken earlier in the year. We purchased EMC (EMC), and Lab Corp of America (LH). Early in 2009 we plan on making additional purchases in new stocks and those stocks that were sold for tax losses. This activity will reduce our cash positions to more normal levels.

As the markets crashed in the fall, there was no “safe place” to hide in the market except in cash. Although we had slightly elevated cash levels at the time, it was not high enough to keep the portfolios from falling in line with the overall markets. Our investment style has served our clients well over the long term. We believe after a few years we will look back on this time and realize the markets presented an excellent buying opportunity.



### Fixed Income Outlook

The Federal Reserve lowered the Federal Funds Rate in December by 0.75% to 0.25%. The focus of the Federal Reserve has been to provide liquidity and work towards moving the credit markets back to “normalcy.” Yields have fallen dramatically as short term maturities have moved to near zero, as investors have sought the safety of Treasury securities at the expense of yield.



	<u>12/31/06</u>	<u>12/31/07</u>	<u>12/31/08</u>	<u>2008 Change</u>
3 Mos.	5.01 %	3.24 %	0.08 %	-3.16 %
1 Yr.	4.99 %	3.34 %	0.37 %	-2.97 %
2 Yrs.	4.81 %	3.05 %	0.77 %	-2.28 %
5 Yrs.	4.69 %	3.44 %	1.55 %	-1.89 %
10 Yrs.	4.71 %	4.03 %	2.21 %	-1.82 %
30 Yrs.	4.81 %	4.45 %	2.68 %	-1.77 %

The yield curve shown above has become significantly more positively sloped as a result of the flight to quality. Yield spreads on all other debt, Government Agency, corporate bonds, and municipal bonds have remained wide compared to Treasury's. The current Treasury yield curve provides more risk than reward. While rates may stay low for a while longer, once investors believe and economic recovery is at hand, Treasury yields will move sharply higher. We believe this recent increase in yield spreads are providing attractive investments opportunities. As the credit markets stabilize, the opportunity to purchase attractively priced corporate bonds and municipal bonds will provide investors with good returns in these sectors. As the market returns to normal spread relationships, Treasury securities are likely to fall in price relative to other high quality fixed income investments.

