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Dear Valued Investor:

Today, we have endured a full scale global financial panic. The main stock market indices, the Dow, the S&P 500, and the NASDAQ finished down about 4 percent each. It was much worse earlier in the day. Last night and this morning we saw similar drops in Asia and Europe. This selling was indiscriminate; all of the major S&P sectors were down by like amounts. Oil and other commodity prices were also down sharply. While declines in oil prices provided a rare piece of good news for U.S. consumers, emerging nation stock markets were down sharply, especially for commodity producing nations like Russia and Brazil.

I expect we will see further emergency actions on the part of the Federal Reserve (the Fed) and the Treasury. I will be shocked if the Fed does not quickly cut the fed funds target rate again. Not that that matters all that much. We have already seen another huge expansion of the TAF program that allows financial institutions, now pretty widely defined, to park troubled assets at the Fed, and this change will likely generate another huge expansion of the Fed's balance sheet. Bernanke is determined to meet surging demand for precautionary cash by banks as well non-financial companies with whatever sums are required. The Fed can expand the money supply without limit and, at least for now, is doing exactly that. I view this monetary policy to be doing the right things to quell this panic. And their actions are not hurting the dollar exchange rate. It has been moving sharply higher all through this crisis.

As for fiscal policy, last Friday (it seems like ages ago) Congress passed and the President signed the Emergency Economic Stabilization Act (EESA) aimed at steadying the financial system by, among other things, authorizing the U.S. Treasury to buy up to $700 billion in troubled financial institution assets with the Troubled Asset Relief Program (TARP). I expect that program will be up and running very quickly. There will be mostly positive but some negative outcomes to this measure.

I believe the EESA is necessary and will work. If the $700 billion proves insufficient, then more money will likely be authorized to help resolve the crisis. We are now fully engaged. Also, on the plus side, it includes about $150 billion in tax breaks and calls for changes in accounting rules. On the downside, this program could create more taxpayer risk due to expanded deposit insurance limits. While I do believe higher deposit insurance limits will help stabilize the current environment, I also see that taxpayers might be even more on the hook if, down the road, another large deposit insured bank fails.

One of the many, unhappy outcomes of the credit crisis has been, through various mergers and shotgun weddings, a major expansion of the super large, deposit insured, commercial bank system, resulting in an ever deeper integration of commercial banking with investment banking, insurance and other financial operations.

This interdependence is not optimal. The extreme stress of recent months has exposed serious weaknesses in the structure of large, highly integrated financial companies. We have seen their failures to control risk, willingness to cut and run on their proprietary securities and markets, and from security issuers, a willingness to steer depositors into investments they never should have owned. Taxpayers have been put very much at risk by the "too big to fail" integrated financial institutions. I think it's critical that we take a hard look at these structures that are clearly fraught with serious risks and conflicts.

There is a silver lining to this dark cloud. Bank lending is not "grinding to a halt" nor is there likely to be a wave of bank failures. The vast majority of small and medium size banks are handling the situation pretty well, continuing to provide loans and maintaining adequate financial controls. This is not the Great Depression II. I think small community banks and many regional deposit insured commercial banks do a lot of good and are very necessary. They know their customers, help them save, lend wisely, don't lever up their balance sheets, help investors and the like—all good things. And the Fed, along with the FDIC, stands ready, unlike during the Great Depression, to stop deposit runs in their tracks and assist these banks.

And the financial system has been enduring increasingly heavy stress over the last month. Over the last two weeks, we have been experiencing a twist on the bank runs that accompany classic financial panics. Fearing failure, depositors have in the past started pulling money out of a bank in mass. Now we are seeing runs on the lending side, something new in my experience. Banks and other large financial institutions set up extensive revolving credit lines with companies. The credit lines provide guaranteed access to specified loan amounts at floating rates. Companies pay the bank a fee for the credit line, and normally it's viewed as pretty good business. The banks never imagined that companies would all ask to draw down their credit lines at the same time, but over the last two weeks, that is what happened. Every CFO worth his salt called up the bank and drew down their credit line—a run on the lending side. The upward pressure on LIBOR and other lending rates was enormous, forcing the Fed to completely buckle and take hundreds of billions onto its balance sheet to stabilize short-term interest rates.

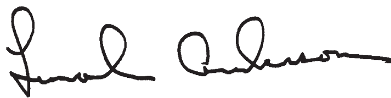
Last, I would like to briefly touch on the economic impacts of the credit crisis. They are likely serious enough to take the already weak U.S. economy into recession this quarter. Last Friday's employment report for September showed a recession-size drop of 159,000 in payroll employment. And the Purchasing Managers' Report, which until now I noted was not in recession territory, fell off the cliff in September. So now a recession appears to be underway. I do not think it will be deep if the financial crisis abates. And I think the actions taken by the Federal government and the Federal Reserve will restore order to the credit markets. Remember, there still is a lot of order out there. These problems, while complex, are still narrowly defined. I hope and expect they will stay that way.

Markets are shell shocked over all these events. The equity markets fell on Friday despite the passage of the EESA, reflecting continued concerns about the banking system. The market earlier today reflected indiscriminant selling such as we have not seen since the crash of 1987 before bouncing back somewhat late in the day. At this point, in the middle of a full-blown financial panic, there is no attention being paid to fundamentals. What I consider to be perfectly sound companies and AAA rated municipal general obligation bonds are being hammered down. Yields on these bonds reflect fears of default. And this situation is forcing some states to request emergency short-term assistance from the Treasury. If they need assistance, I am confident that they will get it. I very much doubt that there will be any state defaults on general obligation municipal debt.

It is important to remember that the vast majority of U.S. companies remain sound. We are in the midst of a financial crisis that is bringing on a recession, but not economic devastation. Stock prices are being driven down by what I consider to be indiscriminant selling that is not justified by the fundamentals to very low valuations, making it a very bad time to abandon the long-term plan for your portfolio. I urge patience and calm. We will come out of this crisis intact and return to rising economic growth and financial market stability.

As always please call your financial advisor with questions or concerns.

Sincerely,



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