



The Global Liquidity Squeeze – What is your next move?

We are in the midst of what we believe is going to be a dreadful ride that requires not only seat belts but possibly helmets as well. As a forecast of future perceptions, the market is refusing to acknowledge that there is a light at the end of the tunnel. Instead, the market appears to be seeing a freight train heading right at us.

As of The Closing Bell on November 20, 2008, the S&P 500™ was down 51.9%, which exceeds the peak to trough decline of 48.1% in the '73/'74 bear market, according to Yahoo Finance. There have been a number of factors contributing to this recent selloff. Currently, two factors are overwhelming the markets:

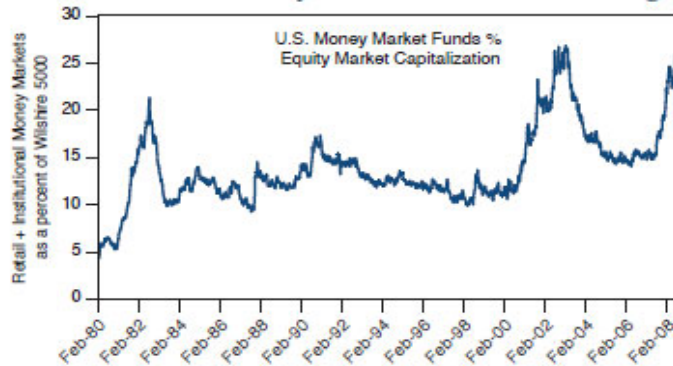
1. The global rush to cash
2. Uncertainty about the future of the US economy and Global Economies

Indiscriminate selling by all kinds of investors is occurring, including regular mutual funds and hedge funds, causing high intra-day volatility for stocks. **The rush for liquidity has flooded the system and has thrown fundamental valuations out the window.** In addition, there is a concern about a major recession on the horizon, which has already been priced into the market. This decline implies an economy that is worse than that which occurred in the mid 1970's. This might not come to pass, but while the demand for cash continues to surge, valuations have become irrelevant.

A good indicator of flight from the markets is the \$43 billion dollars redeemed from hedge funds in the month of September, according to The Financial Times. We are predicting that the hedge fund redemption numbers in October and November will be much larger. Remember, many hedge funds have very high leverage, so every dollar redeemed from hedge funds can lead to many more shares of stock being sold in the stock market. Mutual funds are also being hit extremely hard with redemptions. The net effect of all of the redemption activity is a downward spiral of every major index, a clear signal, in our opinion, that a capitulation point is close.

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Cash in Money Markets at All-time High



Source: Bloomberg

Where are the buyers? Caveat emptor has given way to caveat empty.

In the meantime, the media is having a feeding frenzy of bad news; some of it perceived, but much of it very real. Congress passed a controversial \$700 billion bailout of the financial services sector in early October, and now Americans are learning that (a) many government officials are reconsidering the way in which the funds should be used, and (b) there was no sufficient mechanism in place to track the disbursement of relief monies. Now the heads of the big three automakers are flying into Washington on their private jets to make an appeal that they too should be recipients of federal assistance, but the backlash is even stronger. Taxpayers are left asking "What's next?". No one can calculate just how much money will be needed, but it is becoming increasingly apparent that the \$700 billion bailout plan might not be enough if we are broadening the rescue plan to include the auto industry and all those that will follow.

The governments of several nations are following the lead of the United States and dipping into their respective treasuries to lend support to their own ailing economies. China recently announced a reported \$586 billion bailout package, which means that there will be \$586 billion fewer dollars available to purchase U.S. Treasury securities. According to the U.S. Treasury Department website, of the \$2.86 trillion in U.S. Treasury securities already owned by foreign governments, China and Japan each own approximately 20%.

The American consumer, whose spending accounts for roughly 70% of GDP, according to the Hoover Institution, is tapped out and pulling back in the face of a 6.5%¹ unemployment rate that is forecast to reach 8%² within the next two years. We believe these estimates might be a little too conservative. It is believed by Craig Johnson, President of Customer Growth Partners, that fully half of the \$100 billion that was distributed in the US economic stimulus package to qualified U.S.

¹ Yahoo Finance (11/07/2008)

² Wallstreet Journal (11/21/2008)

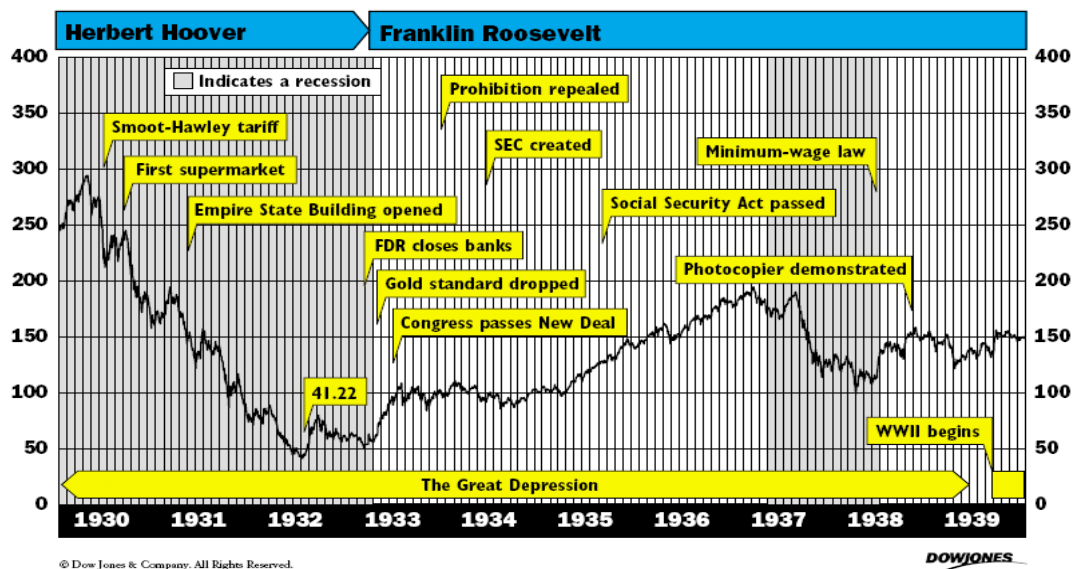
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citizens went to pay down their existing debts, was put under the pillow, or went directly into savings accounts.

We are also seeing a phenomenon called "lame-duck-itis". The current presidential administration has gone underground and we can only surmise that the house is frozen, with perhaps few wanting to be remembered for bailing out financial firms with reckless abandon. There seems to be a void of leadership. People are now wondering: what will the impact of our economic woes be on the global economy in 2009? What will the impact on corporate profitability be?

We struggle to find good news in this market, there may be some in Oil prices which have fallen significantly from their July 11, 2008 high. If you live in the right part of the country, currently, you may pay less than \$1.90 for a gallon of regular gasoline. This represents about \$30 billion that consumers will not have to spend on energy-related expenses over the next six months. The Fed reports that household debt service has fallen from a high of 14.85% in the fourth quarter of 2006 to 13.6% today, and the trend continues downward.

According to the Dow Jones Company, as displayed in the below chart, The Great Depression lasted from 1929-1938. Starting in 1932, during the height of the Depression, the Dow Jones Industrial Average went up more than 200% in four years (1932-36). Next year may be rough for the economy, but that does not mean that the equity markets will not recover. The market reacts to changes in expectations. We are pricing in such an awful scenario for the economy that it is quite possible that once the liquidity mess is cleaned out we could be set for an incredible few years of price recovery. **The chart below shows how the market reacted in advance of the economy, both in the decline and the recovery.** In fact, it started going up about a third of the way through the duration of the actual Great Depression.



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So what can you possibly do? Is there anything to help get you through this crisis? If you already have a master plan in place, now is the time to revisit your assumptions and see if there are any tradeoffs you should make to better position yourself in this environment. **If you do not have a master plan in place, now is the time to act.** The world has changed and the old rules for investing are no longer valid. **Making investment decisions without a clear vision of your complete financial life, particularly in times like these, is no way to attempt to navigate the current crisis.** Contact your adviser immediately to understand what this market means to your financial life.

Thank you for your continued trust and confidence.

Kelly Trevethan & The United Capital Investment Committee

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- *The Standard & Poor's S&P 500™ Index is a market value-weighted average of the performance of 500 stocks of the largest US companies as measured primarily by market capitalization.*
- *The Dow Jones Industrials Average is a share price weighted average of 30 large companies selected by the editors of the Wall Street Journal.*

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