

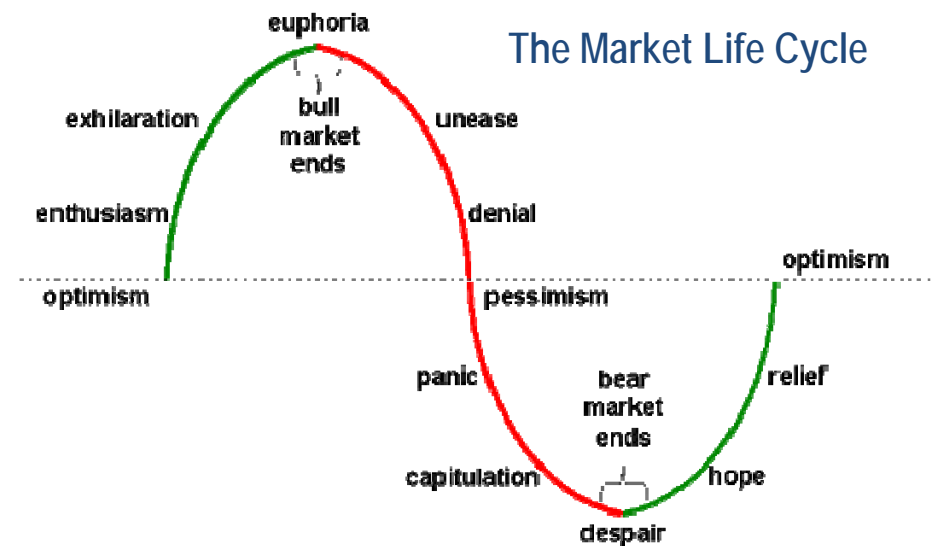


“Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria.”

- Sir John Templeton

It takes some pretty serious clout to compete with the political theater that takes place every four years in America. This time of year we are used to seeing *Donkeys* and *Elephants* battling it out across the country. But regardless of political affiliation, the *Bear* is the animal taking center stage in the minds of many Americans. Despite what pundits, economists and politicians may argue regarding recessions, when the stock market sees drops of this magnitude, investors are concerned about market declines and their portfolios, not whether or not we are “technically” in a recession.

If investors feel unnerved by what has been happening with their investments this year, there is good reason. This has been an historically volatile year; we **have had swings in excess of 1% or more on 45% of the market's trading days**. This is highly unusual, in fact by this measure, if this is sustained for the rest of the year, it **will be the third most volatile year since the 1920's** (Los Angeles Times, October 4, 2008).



Source: Ms. Liz Ann Sonders, Chief Investment Strategist of Charles Schwab

This past quarter was an extraordinarily frustrating period where virtually every asset class went down in tandem. The markets were impacted by **the expanding credit crisis** and **the global slowdown**. It has been an unprecedented time that saw one high profile financial titan after another fall victim to the credit crisis roiling the global markets. The table on the next page illustrates some of the incredible declines which we have witnessed. In fact, not only have stock markets and commodity prices been collapsing, we have

also seen strong downside trends among an array of fixed income investments. We have witnessed instability in many short-term debt instruments including money market funds. Throughout the year we have been evaluating, and in some cases, making changes to these historically “safe” investments.

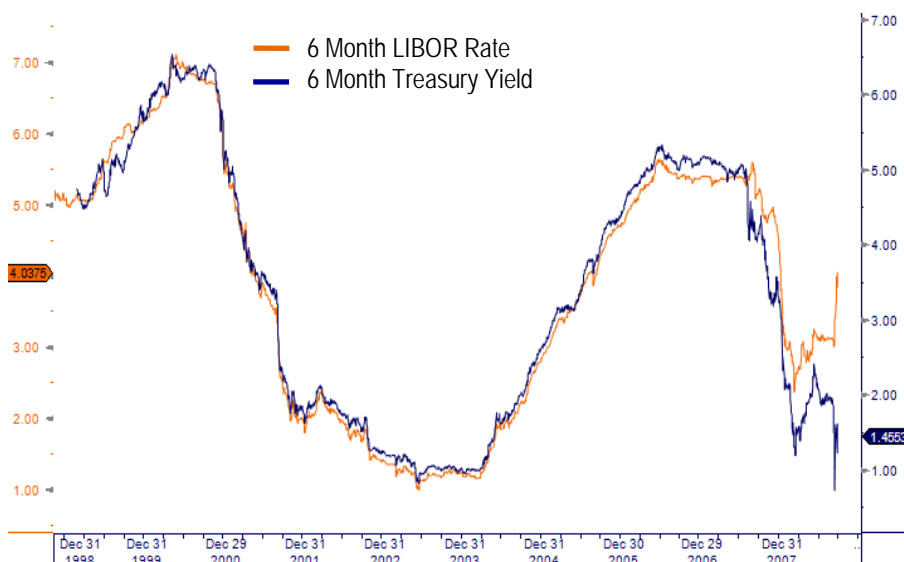
Widespread Declines Among All Assets		
Index	3rd QTR % Change Peak to Trough	1-YR % Change Peak to Trough
Standard & Poor's S&P 500	-15.2%	-27.9%
MSCI EAFE Index	-22.7%	-36.8%
MSCI Emerging Markets	-30.3%	-42.7%
Dow Jones Wilshire REIT	-16.3%	-27.5%
Gold	-24.0%	-27.5%
Crude Oil	-36.7%	-48.5%

Financial Titans Have Fallen		
Company	12 Month High	Price as of 9/30/2008
Lehman Brothers	\$ 66.00	\$ 0.22
Freddie Mac	\$ 61.41	\$ 1.71
Fannie Mae	\$ 64.65	\$ 1.53
American International Group	\$ 68.47	\$ 3.33
Washington Mutual	\$ 35.99	\$ 0.16
Wachovia Corporation	\$ 49.10	\$ 3.50

Source: Yahoo! Finance and WSJ Marketwatch as of 09/30/2008 - Past performance is no guarantee of future results. Please see important disclosures at the end of this document.

The Expanding Credit Crisis and the Taxpayer Bailout

Many people are currently asking themselves *how and why we got ourselves into this current situation*. Banks typically can lend out up to ten times (or more) the equity they have at any given time. This has allowed all of us to benefit from a credit system that allows



money to flow to us in the form of cheap and readily available loans. This crisis unfolded because banks made increasingly imprudent loans that were not properly priced or adequately monitored. New accounting rules which came into effect earlier this year forced banks to revalue all of their loans to *actual market value*. Past regulation was lax in monitoring the value banks were placing on these assets (after all, these banks had huge incentive to overstate the value of their assets) and we ended up with banks drastically overstating their asset base. As these banks have had to restate the value of all these assets, they have had to raise more capital to place as equity on their balance sheets or cut back on their loans. Firms that were not able to adjust financially were either bought at fire sale prices or failed.

A reflection of the lack of confidence is the divergence between the 6-month LIBOR rate and the 6-month Treasury yield. They have historically moved in tandem, but as the graph to the left shows, the

gap has recently widened to unprecedented levels, which increases borrowing costs for everyone, businesses and individuals alike.

With the failure of each bank, there was a constant stream of re-pricing, and this placed other banks at risk, eventually leading to a lack of faith by banks in each other. As *the domino effect unfolded*, this led to a crisis in confidence (and pricing) on all credit. As a consequence of this credit crisis, it is not just the banks at risk; it is the whole system we are all dependent on.

The approved \$700 billion bailout package should enable the government to purchase these bad loans that no one seems to want or knows how to value from banks at a discounted price. *The hope is this plan will quarantine the crisis and once again allow for the free flow of funds across not only financial institutions, but to main street America.*

The Global Slowdown

In early summer, concerns about the economic slowdown lasting longer and extending to economies around the world changed the outlook for equity investors. This led to two frustrating outcomes for investors:

- 1) All stock markets across the globe faced large declines
- 2) Previously strong commodity markets began to falter and suffered huge declines

What is the implication of these two factors? Diversification strategies of investors, including *international* investing and *commodities* did not diversify risk as is typical. In fact, *this quarter was an astounding anomaly where the decline was worse for a well-diversified investor than for someone less diversified.* Even traditionally safe bond funds with corporate and international exposure suffered unusually large declines.

What's Next?

Reduced credit and fewer loans will lead to slower global growth. The less money we have circulating, the less we all spend. The credit crisis will slow consumer spending and reduce earnings growth for companies around the world.

The extreme volatility that is occurring, which is historic by any measure, should not be ignored. Any time we have reached these extreme levels of fear in the market (measured by something called the CBOE Volatility Index— or VIX), we have seen extreme “snap back” rallies. On September 29, the VIX hit its highest level ever of 48.4 and was immediately trumped on October 6 by a reading north of 57. The previous high of 45.74 was on October 8, 1998. This led to a multi-year bull market which saw the S&P 500™ increase 58% over an 18-month period. The last time we saw an extreme VIX reading above 40 was August 8, 2002, prior to a multi-year 87% increase in the markets. Therefore, *it is highly possible that the market could stage a meaningful rally based upon these rare volatility levels.*

It is helpful to remember that when there appears to be no shelter from the storm, which seems to be happening now, this often signals the beginning of the end of a bear market; the most recent example occurred in 2002. Although maintaining this perspective while in the midst of a bear market is very difficult, in retrospect these are often shown to be tremendous opportunities. Since the US led the

global markets into the slowdown, it is likely it will also lead the world out and could potentially be the world's leading developed stock market over the next 18 months.

A Look at Bear Markets

If you look at the duration of past S&P 500™ bear markets, twenty months is the average duration. This includes the 62 month "outlier" bear market which ended in April 1942. If you eliminate that bear market from the mix, the average drops to thirteen months. We are now past twelve months in this decline.

In the charts below, highlighting the length and breadth of bear markets and the periods following, one salient point can be made: following prolonged bear markets, the potential prolonged upside growth period can often stretch for several years and while there is no guarantee, several recoveries have previously provided triple digit returns.

S&P 500™ Bear Markets Since 1937			
Start	End	Months	Change
March 6, 1937	June 29, 1942	62	-60.0%
May 29, 1946	June 14, 1949	37	-29.6%
August 2, 1956	October 22, 1957	15	-21.5%
December 12, 1961	June 27, 1962	6	-28.0%
February 9, 1966	October 7, 1966	8	-22.2%
November 29, 1968	May 26, 1970	18	-36.1%
January 11, 1973	October 3, 1974	21	-48.2%
November 28, 1980	August 12, 1982	20	-27.1%
August 25, 1987	December 4, 1987	3	-33.5%
July 16, 1990	October 11, 1990	3	-19.9%
March 24, 2000	October 9, 2002	31	-49.1%
Average		20	-31.0%

Source: Standard and Poor's

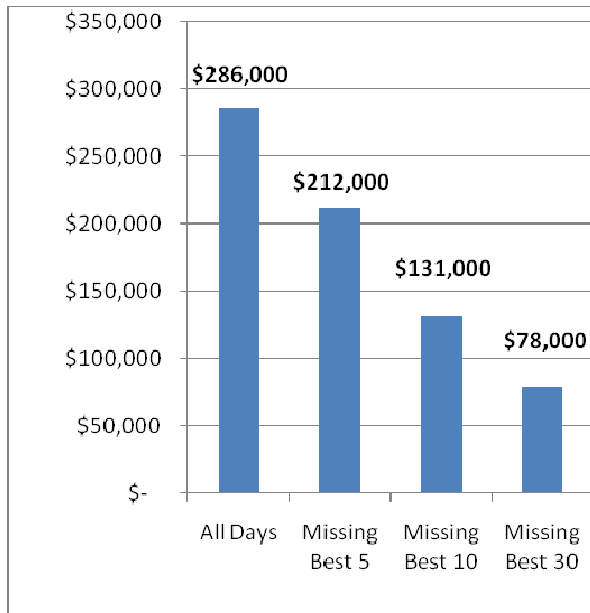
S&P 500™ Returns Following recent Bear Markets			
Bear Market Ending	12-mo. Return After	Months to Peak	Trough-to-Peak Returns
May 26, 1970	43.6%	32	73.5%
October 3, 1974	34.6%	74	125.6%
August 12, 1982	57.7%	61	222.8%
December 4, 1987	21.4%	32	64.8%
October 11, 1990	28.8%	113	417.0%
October 9, 2002	33.1%	90	101.5%
Average	36.5%	67	168.5%

Source: Yahoo! Finance Please see important disclosure at the end of this document. Past returns are not a guarantee of future results.

Getting In and Out Of Markets

During times of uncertainty, such as what we are facing today, it is of course very tempting to go to the sidelines and wait until the dust settles before re-investing. However, this is a very dangerous proposition for investors. The cost of missing recoveries can be very detrimental to your investment success, and every day can have a huge impact. The chart below shows what happens over a ten year period if an investor were to miss the biggest 5, 10, and 30 market up days. The results are dramatically lower than for an investor who simply held on, despite their discomfort.

Hypothetical Value of \$100,000 invested in the S&P 500™ in Jan. 1980*



Source: Moss-Adams (February 2008)

Looking at this chart from a gain/loss perspective, the concept of “holding for the long term” and avoiding attempting to time the market should be quite clear. *When markets rebound, they have generally done so very abruptly. We cannot predict precisely what will occur, but given the emotion-driven quality of today’s market, the recovery could be especially rapid.*

Consumer Confidence

Reflecting the worries many investors feel, consumer confidence this year reached its lowest point since 1990. If we evaluate what happens to markets during times of extremely low consumer confidence, the picture for investors could actually be very positive. With investing, you typically get paid high returns during periods when you feel most anxious. *There have only been three instances in the past 40 years that consumer confidence has reached a low reading below sixty, and in every instance there were*

large positive effects for equity investors over the next year. There are of course no guarantees, but historically, times of the greatest fear have produced times of the greatest rewards.

Consumer Confidence Under 60%	Market Next Year S&P 500
1974	+ 37%
1980	+ 32%
1990	+ 30%
2008	?

Source: SCCM/July 2008

What Should You Be Doing?

In times of investment volatility, we are hard-coded to seek shelter. However, this is seldom a prudent strategy because it assumes that investors can properly time the market. The economy is not going to give us any clues toward market timing because *markets lead the economy*, not the other way around.

Sitting tight when your investments are falling can be difficult; everyone dislikes investing in times like these but it is crucial to avoid emotional decision-making at all costs. Selling into weakness and turmoil is rarely a sound strategy and requires two perfect decisions; when to get out and when to get back in. Remember that locking in losses by selling assets for unneeded liquidity needs creates the challenge of when you should be re-entering the markets and potentially missing out on possible upswings.

The market has already fallen because the stock market is a gauge of the future. The current relevant question is what happens a year or two from now? In our opinion, given the extremes we have been experiencing recently and the incredible pessimism in the system, the more likely scenario is a far better market outlook over the next few years. In addition current valuations are discounting for such pessimism in earnings in the future that it should be relatively easy for companies to provide positive surprises after the current turmoil is resolved. *However, we should buckle our seat belts and be prepared for a bumpy ride. The de-levering (or reduction in debt) will slow*

global growth for a little while, but it is important to remember that afterward it should also create a safer environment for investors, because lower debt usually means less risk.

A Final Word

Focus on what you can control. *This is an important time to meet with us to determine that you are on track relative to your life goals.* All decisions about your investments should be made from a personal perspective in relation to your overall master plan. These decisions should be made considering both your short and long-term investment objectives. We are here to help you navigate your options and understand what this market environment really means to you.

Here are some potential action steps we suggest depending on your personal situation:

- First, understanding your long-term goals may allow you to not make rash decisions regarding your portfolio in the current market environment. It may be appropriate to sit tight and make little or no adjustments to your portfolio.
- Second, depending upon personal situation it may be appropriate to make strategic adjustments to your portfolio. We have a number of investment options at our disposal. Sitting with your adviser and reviewing these options to create a more defensive or comfortable strategy against these market conditions may be appropriate.

These are challenging times and we are here to work with you to help guide you through these difficult market conditions and we would like thank you for your continued trust and confidence.

Sincerely,

Kelly Trevethan, CIMA®
Chief Executive Officer & Managing Director

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