



Economic & Investment Outlook

Fourth Quarter 2008

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Investment Outlook 2008 – Fourth Quarter

Economy

- Continuation of recessionary pressures for the remainder of 2008, i.e. a decline in economic activity represented by GDP, employment, industrial production, real income, and retail sales.
- Federal Reserve interest rate policy on hold through the remainder of the year. The Fed will talk tough on inflation to support the U.S. dollar but will keep interest rates steady to promote price stability and sustainable economic growth.
- CPI inflation measured on a twelve month basis (5.6%) may be close to a cyclical peak as it climbs slightly higher over the next several months. Inflation should moderate in the first half of 2009 due to lower commodity prices, a global economic slowdown, easing of wage inflation pressures, and favorable comparisons.
- The U.S. dollar has stabilized and could eventually strengthen against other currencies as the potential for a global economic slowdown, and in particular, a Eurozone recession increase.
- We anticipate home prices nationally to drop 10% from these levels. A housing recovery is not expected before year-end 2009.



Investment Outlook

2008 – Fourth Quarter

Fixed Income & Interest Rates

- Long term rates will drift higher as 1) investors focus on inflationary pressures, and 2) the supply of treasuries increase as the U.S. deficit widens. Bond returns over the next twelve months will be constrained by rising intermediate to long-term interest rates.
- The gradual rise in interest rates will be periodically interrupted by a flight to quality (lower treasury yields) resulting from disruptions in the financial markets.

Equities

- Financial markets will continue to experience higher levels of volatility until the credit markets stabilize, inflationary pressures subside, and economic activity improves (Q2/3 2009).
- 2008 S&P 500 estimated operating earnings of \$79(e) will be marginally lower than the 2007 S&P 500 actual operating earnings of \$82(a).
- Equity valuations are at reasonable levels but not cheap with the S & P 500 trading at 16 times 2008 estimated operating earnings. Expect 2008 reported earnings estimates to be revised lower over the next several quarters.
- International equities remain relatively attractive due to favorable valuations and anticipated growth rates greater than those in the U.S (with the exception of the Eurozone and Japan).