CAUBLE & HARRE WEALTH MANAGEMENT

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I wanted to write about recent market events and how they affect our thinking about the investment climate.

Many of you have certainly read that you should create a long term investment allocation and stick with that allocation through thick and thin. Markets will fluctuate, and if you sell out at the bottom due to fear, you will miss out on the upside, when it arrives.

It is true that a poorly constructed investment plan might force you to sell at precisely the wrong time, and a properly constructed plan is one that gives you the option to stay put in a difficult market. Investors 'staying the course' is good general advice that is correct most of the time. I am not one of those people that treat this advice as gospel. I always worry about that one time when things are different, and the right thing to do is to sell and preserve capital.

Right or wrong, for me, we reached that point on Wednesday of last week when there was panic in the normally staid money market world. Investors would only buy Treasury bills, driving the yield into negative territory. The selling in the equity markets was severe, and based on fear. Banks did not want to lend to each other, and investors were not interested in buying anything. There did not seem to be a catalyst to change the status quo. The markets were grinding to a halt. It is impossible to go back and predict what precisely would have happened on Thursday if events would have occurred differently, but I was in the mindset to begin acting if there was another shoe to drop.

As is happened, Ben Bernanke (Fed Chairman) and Henry Paulson (Treasury Secretary) also were ready to act. In an almost unprecedented move, they went to Capitol Hill and asked Congress to step in with legislation that would restore some confidence in the market. We all know what the markets did on Thursday and Friday.

I wanted to comment on these actions and discuss what we believe the result of these actions could be and how we currently view the investment landscape.

I would not categorize this as a bailout. The government will buy these assets for less than they are ultimately worth. It will, in my opinion, be a profitable enterprise for the government and the taxpayer.

Also do not think that Federal legislation will be a panacea for all financial firms. The purpose of the legislation as proposed is not to save all financial institutions. The purpose, in my opinion, is to save enough of them to convince investors and savers that stability can be found somewhere in

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the system, and therefore to avoid systemic failure across the entire system. There will, I believe, be many more firms that will not survive. They will either fail, or will discover that their business model is no longer profitable in the new, yet to be determined, regulatory environment. Goldman Sachs and Morgan Stanley have reached this conclusion and will convert to banks. This will limit their future profitability.

Also, Congress now needs to act. There is a question as to whether they will act on the legislation as proposed, or will try to 'fix' it to serve their own purposes or try to enact their own 'justice'. This could impact the effectiveness of any legislation. There is plenty of blame to go around. Congress failed to provide effective oversight of Fannie Mae and Freddie Mac, even though they were warned of its problems. Investment banks increased their leverage too much and created complex securities, placing too much trust in the future liquidity of these markets. Consumers took on too much risk in the hopes of making large returns in real estate.

Mortgages and derivatives are the two investment products that have caused the problems. The complexity of these two products is an issue in and of itself. Given enough time, investors and regulators could figure out how all of these securities will perform over time. The problem is that the firms that hold these products are highly levered, and are dependent on people lending to them on a daily and weekly basis. Unfortunately, investors stopped wanting to lend, because they no longer knew enough about the company they were lending to. Having so much debt to service, these firms had no time to wait. They tried to sell securities to raise money, but no one wanted what they had to sell (again not having time to figure out what they were buying).

Without the ability to raise new capital, more financial firms would have had to file for bankruptcy. This would have thrown the short-term lending market into disarray. Industrial firms depending on short term money markets would have had to shut down operations and lay off workers. This is the meltdown that Bernanke and Paulson were trying to avoid when they went to Congress.

Either by way of additional disclosures, or selling assets to the Government, some firms will be able to clarify their financial standing to market participants and thereby garner investors trust, albeit conditional. These firms will keep the basic financial plumbing of our economy operating, although at sub-optimal levels. Both the deleveraging process that consumers and some corporations need to go through and the process of restoring the health of our financial services infrastructure will impact domestic spending and investment and economic growth for the next several years.

From an investment standpoint, the question is whether current market prices incorporate these lower expectations. Also, global growth may be impacted for a time, but the changes that have occurred in the economies and market infrastructures in many countries will be positive for

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continued economic expansion outside of the U.S. U.S. companies that sell into these international markets will benefit.

Also note that the Sovereign Wealth Funds around the world have accumulated huge sums of money over the past few years. The majority of this wealth has not been invested long term. The investment of these funds will impact investment returns going forward. Hopefully western assets, both fixed income and domestic, will be attractive to these investors.

These are some of the reasons to maintain some exposure to the equity markets. Certainly, a diversified approach makes sense. Many who have not been diversified (not at our firm) have likely already paid a steep price. It would be fair to say that I am cautiously optimistic, but very sensitive to loud noises. A lot has yet to be determined, and many events are difficult if not impossible to predict. That said, I continue to think about what might break and how these events could impact your account.

I will close with a quote from John Fay, a columnist with the Financial Times who wrote September 17, 2008

"It is easy to assert that the solution to any market failure is better regulation. If regulators were all-knowing and all-powerful; if they were wiser than the chief executives but willing to do the job for a fraction of the remuneration awarded to such executives; if they understood what was happening in the dealing rooms of Citigroup, Merrill or Lehman better than Chuck Prince, Stan O'Neal, or Dick Fuld; then banking regulation could protect us against financial instability. But such a world does not exist. Market economies outperform planned economies not because business people are smarter than civil servants – sometimes they are, sometimes not. But no one has enough information or foresight to understand the changing environment, so the market's messy processes of experiment and correction yield better results than a regulator's analysis."

My take on this is that regulation is not perfect, the markets are not perfect, but we are all better off with our imperfect current system than we would be under a planned economy.

If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

Peter B. Harre, CFA