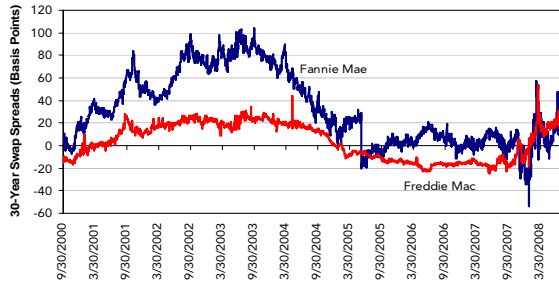


Economic Review

Several bank failures in July, including IndyMac Bank in California, resulted from continued defaults on home mortgage loans. An extraordinarily rapid and negative reaction to financial troubles at Fannie Mae and Freddie Mac prompted the federal government to take unprecedented steps to further shore up the troubled financial companies. After a temporary boost from tax rebate checks, GDP rose 1.9% in the second quarter. The 2009 budget deficit is expected to be near \$500 billion, prompting voters to question whether the Presidential candidates will have enough tax revenue to implement the programs they have pledged to fund, whether it be increased defense spending or nationalizing healthcare.

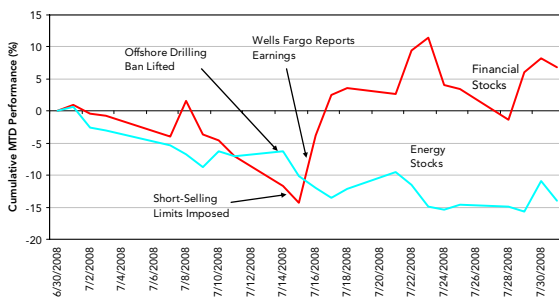
Risk Rises on Fannie and Freddie Bonds



Source: Bloomberg

Fannie Mae and Freddie Mac were perilously close to bankruptcy as home foreclosures rose and doubts about capitalization levels sent investors fleeing the companies' stocks. With reserve capital levels reported at levels two times lower than Bear Stearns before its collapse, or an over 60:1 leverage ratio, Congress gave the federal government the authority to directly purchase the companies' stocks in an effort to raise capital levels. Although the stock purchase did not materialize, the Federal Reserve pledged access to emergency funding and the Treasury more explicitly enunciated the federal guarantee against losses on the \$5 trillion of outstanding loans held by the two firms.

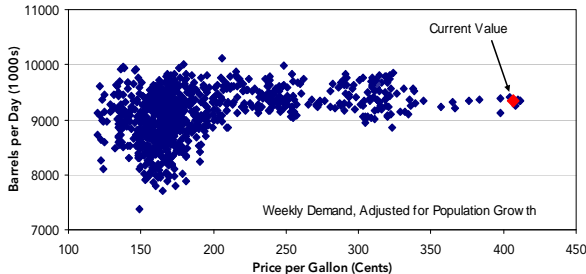
Finance Stocks Stage Record Turnaround



Source: Standard & Poor's

Mortgage lenders were given further relief after the President signed a mortgage relief bill. The bill provides an up-front tax credit for new home purchases, while authorizing the FHA to acquire \$300 billion in additional mortgage obligations. The FHA may purchase additional loans from banks, on the conditions that the homeowners are in financial distress, and the banks will voluntarily take a 10% or greater writedown on the debt. The future profits from home sales involved in the program would have to be split with the federal government. The bill intends to rid banks of a sizable amount of bad debt, therefore freeing capital for new loans and stabilizing a tumbling housing market.

Gasoline Demand Falls After Price Passes \$3.50/Gal



1991-2008; Prices adjusted for inflation;
Source: Energy Information Administration; US Census Bureau

Financial stocks staged a record gain following a trading ban on short-sales and positive earnings reports from several large institutions. The SEC order extended to the nineteen financial firms that are allowed to borrow directly from the Federal Reserve, and was aimed at culling increasing turmoil in stock prices that was driven by speculation and rumor more than fundamentals. The order banned naked short-selling, or executing a short-sale without ever actually having the shares available to sell. Prior to the ban, short sales could exceed the number of shares actually traded, wildly distorting stock fundamentals, and quickly send stock prices lower.

Positive earnings reports from Wells Fargo, Bank of America, and other banks turned a 14% month-to-date loss in financial stocks into an 11% gain over the course of six trading days.

Oil prices finally retreated, falling over \$25/barrel in July. The move was sparked by President Bush's repeal of the executive branch ban on offshore drilling. Oil markets had risen meteorically on the belief that demand would constantly grow with no prospect of supply increases in the foreseeable future, and fell on the prospect of increased production, even if production would take ten years to be online. Congressional leaders have prevented debate on a bill to repeal Congress' ban on offshore oil drilling, effectively leaving the issue unresolved.

As of July 31, 2008

| | July | 3 Months | YTD |
|---------------------|-------|----------|--------|
| S&P 500 | -0.8% | -8.0% | -12.7% |
| Russell 1000 Value | -0.4% | -10.0% | -13.9% |
| Russell 1000 Growth | -1.9% | -5.6% | -10.8% |
| Russell 2000 | 3.7% | 0.1% | -6.0% |
| MSCI EAFE | -3.2% | -10.3% | -13.8% |
| LB Agg | -0.1% | -0.9% | 1.0% |
| 3-Month T-Bills | 0.2% | 0.4% | 1.4% |

New York and California governors, along with Chicago mayor Daley, each presented budgets with immense deficits. Residents will likely face tax increases, as government programs remain inexorably difficult to cut or eliminate. The federal debt limit was raised to \$10.6 trillion.