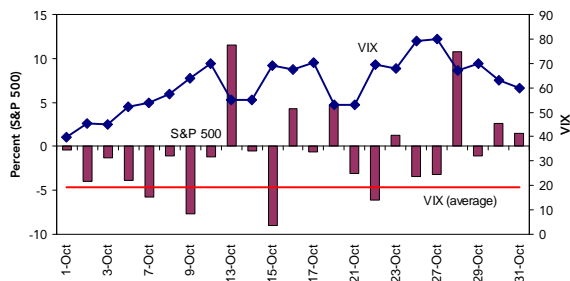


# Economic Review

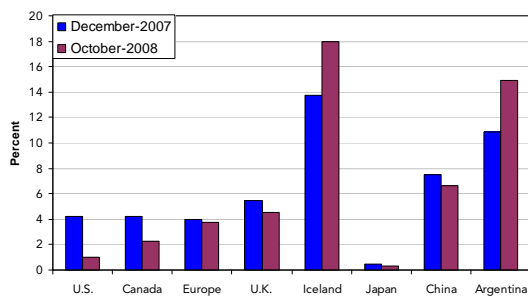
Stock markets worldwide crashed in early October. Amidst a worsening economic backdrop and tremendous liquidity concerns, investors sold stocks across all sectors. The selling begot further selling, as heavily leveraged funds were forced to liquidate positions to cover outstanding loans when traditional financing options became unavailable. The indiscriminate selling was a fallout of the Lehman Brothers bankruptcy, which drastically pared lenders' beliefs that borrowers would remain solvent long enough to repay loans, even for terms as short as one day. The atmosphere created the worst financial crisis since the 1930s, but has been met with unprecedented actions by governments worldwide, as they try to avoid mistakes that contributed to the Great Depression. The S&P 500 posted its worst month since October 1987, amidst record levels of volatility.

S&P 500 Daily Gains and Volatility



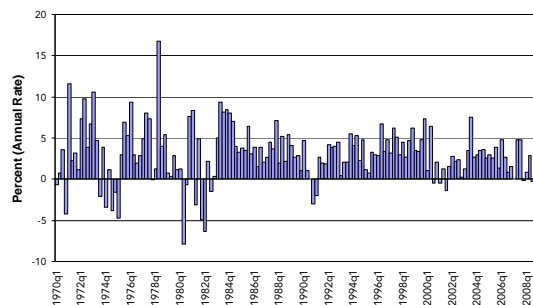
Sources: Standard & Poor's; Bloomberg

Central Bank Interest Rates



Source: Bloomberg

GDP Turns Negative in Third Quarter



Source: Bureau of Economic Analysis

**As of October 31, 2008**

|                            | October | 3 Months | YTD    |
|----------------------------|---------|----------|--------|
| <b>S&amp;P 500</b>         | -16.8%  | -23.1%   | -32.8% |
| <b>Russell 1000 Value</b>  | -17.3%  | -22.1%   | -32.9% |
| <b>Russell 1000 Growth</b> | -17.6%  | -26.4%   | -34.3% |
| <b>Russell 2000</b>        | -20.8%  | -24.5%   | -29.0% |
| <b>MSCI EAFE</b>           | -20.2%  | -34.5%   | -43.5% |
| <b>LB Agg</b>              | -2.4%   | -2.8%    | -1.7%  |
| <b>3-Month T-Bills</b>     | 0.1%    | 0.6%     | 1.9%   |

The Federal Reserve expanded its powers as it attempted to solve several concurrent financial problems. Likely the most effective action taken in October was the creation of a commercial paper lending facility, allowing the bank to become a direct buyer of commercial short-term debts. The action was taken after California and several states became unable to find financing and turned to the Federal Reserve for assistance, before private financing solutions appeared. The contraction in short-term lending jeopardized relatively healthy companies' and states' abilities to meet day-to-day funding requirements. The extent of the market's troubles was highlighted when GE Capital entered the program to restart its commercial paper activities.

Central banks coordinated their efforts on October 8, reducing interest rates in an attempt to ease upward pressure on interbank lending rates. The governments also lifted limits on funds made available to ease the liquidity shortfalls, and pledged nearly unlimited amounts of money to companies and banks in need. The coordination was an attempt to circumvent individual countries' efforts, which at times were at odds with each other, and to eliminate mistakes made in the 1930s, which were plagued by trade restrictions and money supply contractions. The Federal Reserve cut rates a second time, bringing the Fed Funds rate down to 1.0%.

The Troubled Assets Relief Program (TARP) was passed by Congress, and provided over \$700 billion to the Treasury to use for asset purchases and other functions within a wide latitude. The Treasury bought \$125 billion in equity stakes in nine major banks, and has plans to spend an equal amount on smaller banks. The terms provide the Treasury a 5% dividend for three years, rising thereafter, and allows repurchases of the preferred shares by the banks. The money was expected to be used by the banks to lend to the public, but so far it has been used to finance takeovers, which provide a higher profit to the banks than lending. Banking regulators increased pressure on lenders to renegotiate mortgage terms of distressed borrowers.

GDP for the third quarter was -0.3%, the largest contraction since the third quarter of 2001. Contributing to the slowdown were very weak auto sales, a strike at Boeing, slower export growth, weak consumer spending, and less construction. Federal government spending grew, which jumped as defense spending expanded at an 18% annual rate. Forecasts for fourth quarter growth point lower, given the rise in unemployment, slow consumer spending, and a likely slowdown in defense spending growth.

Gasoline prices finally fell sharply as crude oil slid to nearly \$61/barrel. The fall represents a savings of nearly \$300 billion annually for US consumers and businesses, compared to prices in the first half of the year, and is double the amount of the stimulus checks Congress paid out earlier in the year. In addition, grain prices fell sharply, likely ending a streak of increasing food prices. Inflation also peaked in July, and is likely to moderate going forward. Coupled with a sharp increase in the money supply, conditions conducive to an economic recovery are falling into place, although the next several months are expected to be difficult for the economy.