

Economic Review

December was marked by two high profile cases of fraud and corruption. Investment manager Bernard Madoff was charged with defrauding investors out of \$50 billion. Several charities, foundations, and individuals lost their entire investments. Inquiries into the SEC's lax enforcement of securities laws during reviews of Madoff's firm were announced. Illinois governor Rod Blagojevich was arrested on allegations that he solicited payments to fill Barack Obama's empty Senate seat, and withheld state payments to a children's hospital while awaiting a campaign contribution from its directors. The leadership vacuum stemming from the corruption charges prompted Moody's to assign a lower rating to the state's short-term debt. A subsequent bond issue by the state carried an interest rate four times higher than similar issues, due to rising accounts payable and a stressed cash position. Numerous states faced massive budget deficits, and began announcing layoffs, along with fee and tax increases. President Bush authorized \$17.4 billion in loans to GM and Chrysler, terms of which required major labor agreement restructurings.

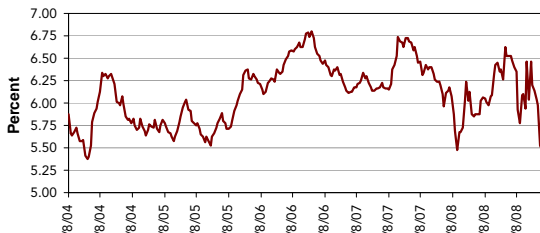
Retail Gasoline Prices Plummet



Source: Energy Information Administration

The Federal Reserve lowered interest rates to historic lows, setting its Fed Funds Rate from 0% to 0.25%, essentially matching the rate at which markets were already trading. The bank announced an increase in its purchases of asset and mortgage-backed securities as its next focus to halt the decline of asset values. In conjunction with rate cuts and expected government debt issuance, the dollar declined swiftly against most major currencies.

Mortgage Rates at Multi-Decade Lows

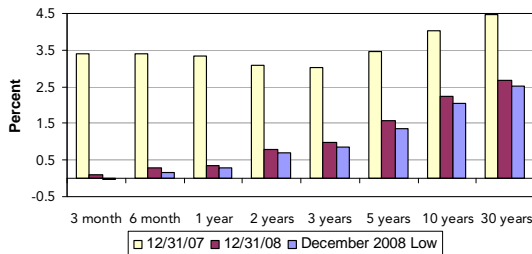


Source: St. Louis Federal Reserve

Mortgage rates declined to 5.2% following rumors that the Treasury would direct Fannie Mae to issue mortgages as low as 4.5%. Mortgage applications rose by a record amount immediately following the news. Government data showed that over 50% of borrowers who received mortgage modifications were back in default six months later. The Mortgage Bankers Association reported that 7% of mortgages were in default, and 3% were in foreclosure during the third quarter.

Corporate bond yields fell while LIBOR dropped below 2%, easing pressure on credit markets. Treasury bond yields fell to record lows as investors continued to park money amidst the recent market turbulence. 30-year bond yields dropped as low as 2.51%, 10-year yields fell to 2.04%, and 3-month yields actually traded as low as -0.035%. The historically low rates were bolstered when the Fed alluded to potential purchases of Treasuries to combat deflationary pressures. High-yield rates rose to 23% as investors avoided the category prior to the resolution of the U.S. automakers current plight.

Treasury Yields Remain Low



Sources: Bloomberg; Barclays

The employment outlook continued to weaken as 533,000 jobs were lost in November, bringing the expected total for 2008 to well over two million. The unemployment rate rose to 6.7%, but was lower than forecast as over 400,000 people were considered to not be actively looking for employment and were removed from the final tally. Consumer sentiment remained low, while outstanding consumer debt fell for the first time in over fifty years.

Crude oil prices fell to a low of \$32.40/barrel as worldwide demand contracted. OPEC members pressed for a two million barrel/day reduction in production (about 2.5% of worldwide production) as their economies strained under falling revenue. Retail gasoline fell to \$1.67/gallon, a level last seen in February 2004. The fall in oil prices brought large cutbacks in new exploration and production projects, since many recent projects would only be profitable if prices are above \$60/barrel.

Market Returns

As of December 31, 2008

	December	3 Months	YTD
S&P 500	1.1%	-21.9%	-37.0%
Russell 1000 Value	1.4%	-22.2%	-36.9%
Russell 1000 Growth	1.8%	-22.8%	-38.4%
Russell 2000	5.8%	-26.1%	-33.8%
MSCI EAFE	6.0%	-20.0%	-43.4%
Barclays Agg	3.7%	4.6%	5.2%
3-Month T-Bills	0.0%	0.2%	2.1%

Consumer prices contracted for a second consecutive month in November, reflecting falling energy, producer inputs, and housing prices. The measure contracted at a 14.9% annual rate through October and November. Producer prices fell at an even greater pace, as raw materials prices plunged. Core consumer prices contracted at a 0.3% annual rate over the past two months.

New credit card regulations, effective in 2010, will prohibit companies from raising fixed rates on existing balances, while also stating that payments above minimum levels must first be applied to balances carrying the highest interest rates.