

March 7, 2008

Dear Valued Investor:

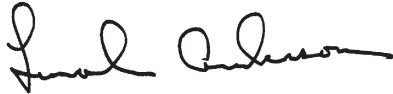
I have to say honestly – as I always do – that this sub-prime problem is obviously bigger than I anticipated. The amount of leverage in “hedge” funds and many of the big banks has caused some serious dislocations. Also, we have had bad actors – some secondary mortgage companies that have not allowed folks to refinance their first mortgages, primary dealers that have backed away from supporting auction rate securities markets, predatory lenders, etc. The scope of this problem also caught the Treasury and the Federal Reserve (Fed) by surprise, but they are catching up fast. The Fed has cut rates sharply and will likely cut them again. They have also injected more than \$60 billion into the banking system and announced today that they are expanding that program by another \$100 billion this month. And Washington has moved quickly with the short-term fiscal stimulus package. Many of you should be seeing tax rebate checks by May.

All this turmoil in credit markets, continued increases in oil prices and the psychological impact of the scary headlines has slowed the economy. Real GDP rose 3.8% and 4.9% in the second and third quarters of last year, but was up only 0.6% in the fourth. And today we got an employment report that showed a 63,000 decline in payroll employment in February, following a 22,000 decline in January. At this point it looks as though GDP growth will be in the +0.5% to -0.5% range in the first quarter, with another round of credit turmoil, housing declines and sky-high oil prices placing a big burden on the economy. My two biggest concerns have worsened – oil prices are still rising, and the dollar exchange rate continues to fall. In both these areas I think government policy has been poor. So, while I still think we will avoid recession, the odds are rising.

However, it is important to maintain perspective. Yesterday the Fed released data for the nation’s balance sheet for the fourth quarter. While this vast compendium of data shows trouble in banks, it also shows great areas of strength. U.S. household net worth dropped \$533 billion in the quarter, but still shows a rise of \$1.9 trillion over the last four quarters to a whopping \$57.7 trillion. U.S. non-financial corporations increased net worth by \$1.8 trillion over 2007 to \$16.1 trillion at yearend. At that point their net worth was 33% above their aggregate equity market value, and their debt to net worth ratio fell to a 22 year low. Finally, when you hear people throwing around big hypothetical numbers like “\$500 billion in bank write-downs”, remember that \$500 billion amounts to 3% of the \$15.8 trillion in financial sector debt.

As I have said before, in times like this, investment decision making gets tough and time horizons shrink. While I cannot say whether this market turmoil will be long-lived or not, I do believe that the actions being taken by the Fed will turn things around. And I think bailing out of some equity sectors that have been, in my opinion indiscriminately hit (technology, healthcare and exporting industrials), or going to cash would likely be a mistake. As always, please call your financial advisor with any questions or concerns.

Sincerely,



Lincoln Anderson  
Managing Director, Chief Investment Officer

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