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Dear Valued Investor:

Financial markets have been on a long and winding road of turmoil and trouble, and it is not over, though we may, and I emphasize may, have seen the bottom in the stock market. The turmoil over the last few weeks has been incredible. Financial firms that were viewed as very market savvy with good risk controls have turned out to have highly levered portfolios invested in a very poor choice of securities. And we have seen some of these firms go under—Bear Stearns and Lehman Brothers—and effective government takeovers of Fannie Mae, Freddie Mac and the insurance company AIG. Merrill Lynch announced that it would be purchased by Bank of America, in part to gain a stable source of funding.

Fear and a complete lack of trust began to stop inter-bank lending on Wall Street last week. The Federal Reserve (the Fed) lost some control—after announcing on Tuesday that they would not cut the fed funds rate, but rather would hold it at 2%, the overnight inter bank lending rate soared as high as 6% on Wednesday. It took the Fed two days to regain the target for the fed funds rate. Meanwhile, 3-month Treasury bill yields fell to near zero as investors fled to safety. And some money market funds stopped redemptions as liquidity dried up and one major money fund "broke the buck", allowing the share price to fall below $1. All this turmoil caused the Dow to fall 504 points on Monday, rise 142 on Tuesday and then fall 449 points last Wednesday.

This trouble and more forced the Fed and the Treasury to shift to a much bigger program to address the mess. Last Thursday afternoon a "comprehensive solution" was announced, inspiring a 410 point rebound in the Dow. That initial effort was followed by the announcement of a broad new set of government interventions on Friday—a proposed $700 billion "Troubled Asset Recovery Program", an insurance program for existing, not new, assets in money market funds, a big expansion of Fed programs, financed by big new issues of Treasury debt. These plans and proposals led to a 369 point rally in the Dow last Friday. So, after a wild ride, the Dow ended up nearly unchanged from the prior Friday, down just 34 points. Also, the Fed had regained control over the fed funds rate and we closed the week with Treasury bill, note and bond yields returning to more normal levels.

Over the weekend, the Treasury and Fed worked with Congress to try to get some program details worked out. That process remains incomplete, because as the saying goes, the devil is in the details. There is, understandably, a lot of discussion around what to do with $700 billion. Will taxpayers be protected? What assets will be purchased? At what prices? From what sellers? Sold to what administrator? Who will be overseen by what regulatory/oversight body? And that is just the start of the list. Is the program big enough? Are there other features that should be added? Is the program fair and equitable or is this just a bailout of the rich and reckless? The answers and the preliminary program design will, I think, likely be determined this

week. Also, on Sunday two investment banks—Goldman Sachs and Morgan Stanley—requested a conversion from investment bank to commercial bank charters. The Fed granted that request late Sunday night. And this Monday, given continued uncertainty, the stock market was once again down, with the Dow down 373 points. The last few weeks have the plot line of a really bad movie.

Some questions I can take a stab at addressing:

**Q: Is $700 billion enough?**

**A:** Probably not; the amount may go higher, but it is important to note that the Treasury (all of us taxpayers) are not buying these "Troubled Assets" at par. The purchase prices will more likely reflect current market prices and offer potential for the Treasury to possibly make money on sales of these assets as the crisis subsides.

**Q: How big is $1 trillion dollars worth of "Troubled Assets"?**

**A:** Surprisingly, it is a fairly small percentage. Total outstanding debt in the U.S. is about $51 trillion, so these troubled assets total about 2% of the U.S. debt market. And a total write-off is unlikely. The problem is that the troubled assets are mainly held at some very big highly levered financial institutions that provide a lot of the grease for our financial market's functioning.

**Q: Outside of banking, how much balance sheet damage has been done?**

**A:** According to the Federal Reserve, non-financial U.S. corporate net worth has not fallen at all—rising about $800 billion to a new peak of $10.3 trillion in the second quarter. For U.S. households, net worth has fallen $2.6 trillion to $56 trillion from its peak in Q3 2007, about $600 billion in real estate valuation losses and $1.9 trillion in securities valuation losses. That drop, while obviously serious, is a 4.6% decline—still considerably less than the 9.5% drop over 2000-2001. And household net worth still stands $13 trillion higher than the previous peak in the first quarter of 2000.

**Q: What are the ramifications of all these actions on the financial sector?**

**A:** A full discussion is neither possible nor prudent at this point, but it is likely safe to say that a massive deleveraging of these crazy capital structures, already underway, will continue and likely become permanent, with much greater regulatory scrutiny. I suspect this is the reason why Goldman and Morgan Stanley threw in the towel and converted to commercial bank charters—going back to the old high leverage investment banking business model is unlikely. This de-leveraging process will hurt economic growth for some time to come but I think the end result will be a significant reduction in bank risk.

**Q: What is happening with our broker/dealer, LPL Financial?**

**A:** LPL Financial remains sound. LPL Financial has very low leverage, with capital well in excess of regulatory requirements, tight expense controls and ongoing review of the firm's counterparty risk. It does not have a book of securities or proprietary products. The money funds available for our use at LPL Financial remain open and functioning smoothly as does the Insured Cash Account. LPL Financial remains profitable with a solid business model devoted to providing you, and me, with a stable, sound financial platforms and financial investment solutions.

**Q: Will all this turmoil throw the economy into recession?**

**A:** This capital crunch, along with the rebound in oil prices and steadily weakening consumer spending may put us into recession, but if so, I expect it will not be a deep recession. Housing is a small part of GDP, the bank problems are concentrated, and many other banks and non-financial companies are actually doing pretty well. That said, I expect a continued pattern of ongoing, albeit small, monthly declines in employment, flat to down consumer spending, weak home prices and sluggish business investment for some time. Exports and, as always, government spending will be the growth engines. We are not hitting on all cylinders by any means.

**Q: Are there any positives out there?**

**A:** Absolutely. In my opinion there are plenty. I consider stock market valuations to be low, unlike 1999. Total U.S. company profits and non-financial corporate net worth are nearly double their previous peaks, but stock indices like the S&P 500 are now well below the previous peak in 2000. Outside of financial firms, aggregate corporate balance sheets have very low, or actually negative, leverage with financial assets exceeding liabilities by $1.2 trillion. While a $1 trillion federal program looks big, I would note that U.S. companies in aggregate have bought back nearly $1.6 trillion in stock (net of new issues) over the last four years. Interest rates are quite low, and I think inflation is under solid control. I could go on.

**Q: Are other financial company failures possible?**

**A:** Certainly. We are not at the end of this financial crisis and there may be "other shoes to drop", but given the deleveraging that has already occurred, and with the new proposals and new backstops already in place at the Fed and the Treasury, I believe the risk of further large failures is receding.

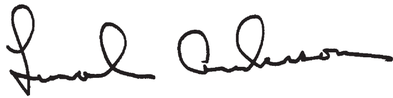
**Q: What should I do?**

**A:** Please, if you like, speak with your advisor, to address your concerns and discuss possible portfolio adjustments. I will tell you that, in my experience, in the face of pervasive fear and uncertainty in financial markets, big changes often turn out to be really, really bad mistakes. Capitulating and "going to cash" ahead of a big market recovery can put us in a very difficult place in deciding what to do next. Alternatively, trying to pick the bottom and load up on specific beaten down sectors or stocks in distress can, and has, proved to be disastrous. (Just ask the folks who bought Lehman Brothers stock when it fell to "cheap" levels.)

Generally speaking, in times like this, in my experience it is best to sit tight with a well diversified portfolio and put some trust in the U.S. economy and the companies and workers who make it so strong—that would be all of us. And let the Fed and the Treasury clean out the bad actors and institutions and restore order. I certainly expect that financial markets will remain volatile for some time, but we will work through this difficulty and return to growth.

As always and even more importantly today, please call your financial advisor with any questions or concerns.

Sincerely,



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