



QUARTER TWO 2008

MARKET COMMENTARY

July 2008

SECOND QUARTER RECAP

The financial turmoil that began in the middle of last year and reached a crescendo during the early part of 2008, continued during the second quarter. Although the equity markets recovered nicely (+12%) between the S&P 500's March low point and the middle of May, this rebound proved to be short-lived. The combination of sharply rising oil prices, continued severe pressure on financial institutions, additional economic softness, and widespread earnings disappointments, conspired to undermine equities. In addition, an extremely weak housing market, mounting job losses, and plunging consumer confidence, also contributed to stock market declines. June was an especially difficult period with the S&P 500 index falling 8.4%. As a result, by the end of the three-month period, the S&P 500 had retraced all of the second quarter's gains and came close to retesting the March lows. (The index subsequently broke through the March low point in July and is currently approaching the January 2005 price level.) The S&P 500 finished the second quarter down 2.7% and -11.9% year-to-date. The performance of large capitalization financials was a significant reason for the S&P's weakness and, as a result, mid and small stocks fared better, especially in the growth sector. Small and mid cap stock indices achieved modest gains during the second quarter, but still experienced high single-digit losses for the first half of 2008.

PERFORMANCE MATRIX

Index	2008 2Q	2008 YTD
S&P 500	-2.7%	-11.9%
Russell 1000 Growth	1.2%	-9.1%
Russell 1000 Value	-5.3%	-13.6%
Russell Mid Cap	2.7%	-7.6%
Russell 2000 (small cap)	0.6%	-9.4%
Wilshire 5000	-1.5%	-11.0%
MSCI EAFE (international, \$, net)	-2.3%	-11.0%
Lehman Municipal Bond	0.6%	0.0%
Lehman Aggregate Bond	-1.0%	1.1%

Losses in international markets mirrored the U.S. A second quarter rebound in the value of the U.S. dollar relative to the euro caused the MSCI EAFE to decline more than 2% for the three-month period ending in June, while year-to-date the index fell 11% measured in U.S. dollars. Asian and emerging markets continued to benefit from dollar weakness in the second quarter. For example, equity markets in the Pacific region ex-Japan gained 1.7%, though they are still down more than 11% year-to-date. The speculative markets of China and India remained especially weak, down 26% and 41%, respectively, for the first half of the year. Two of the other “BRICs,” Brazil and Russia, enjoyed impressive double-digit gains during the quarter because of the resource-based nature of their economies. The Brazilian currency also strengthened considerably relative to the dollar and the Brazilian stock market was +12.5% year-to-date, while Russia was only down 1.8% for the first half of 2008.

EQUITY MARKETS

It was a tale of two cities during the second quarter. The energy sector performed extremely well (+17%) because of the sharp rise in the prices of oil and natural gas. Many portfolio managers who did not have enough exposure to this part of the market poured money into the area. Utilities, a traditionally defensive sector, also performed well, generating high single-digit returns, while technology and materials were modestly positive. In sharp contrast, the financial sector was down more than 18%. Any financial institution that is credit sensitive or exposed to the mortgage market was severely punished. Banks, in particular, were hard hit as the lax lending standards of the last few years have come home to roost. As we discussed in our first quarter market commentary, many financial institutions continue to take massive write-offs and raise loan loss provisions. As a result, they are being forced to replenish their capital at very dilutive prices. By definition, banks have highly leveraged capital structures and the losses they have incurred (and will incur in the future) have impaired their ability to extend credit and to pursue other revenue generating lines of business. Many of these institutions will earn far less in the future than they have in the past.

In addition to the financials, the industrial sector also performed poorly during the second quarter (-10%) because of investor concerns about a weak global economy. Industrials had held up relatively well in the early part of the year on the theory that global markets would decouple from the U.S. and those companies with a significant amount of business outside the U.S. would benefit from the weaker dollar. However, now that international markets, especially Europe, are starting to soften, that thesis is being called into question. The consumer discretionary sector also performed poorly during the most recent quarter. This area includes retailers, restaurants, media, and leisure, all areas that are being, and will be further, adversely affected by softer consumer spending attributable to declining home values, income pressures from higher gasoline prices, job losses, and waning confidence.

The dichotomy in performance during the first half of the year is creating some large changes in the benchmark indices that could have performance implications in the future, especially for value managers. With the precipitous drop in the value of the large banks and brokers, as of June 30th financials only accounted for 14.3% of the S&P 500, a decrease of 2.5 percentage points from March 31st, and 25% of the Russell 1000 Value index, At the end of 2005, financials were 20% of the S&P 500 and 37% of the Russell 1000 Value index, and those weights were even higher in prior

periods. Conversely, the energy sector has become significantly more important from an investment standpoint. After bottoming out at around 5% or 6% of the index weight in the S&P 500 in the 2002/2003 period, energy has jumped from 10% to just over 16% during the last two-and-a-half years, while the weighting has risen to more than 18% in the large cap value index, an increase of just under five percentage points. Multiply these changes by trillions of dollars and incorporate the funds flows of index funds, and benchmark-conscious investment managers will have to think differently about what drives the market and how they structure their portfolios going forward. A similar trend occurred during the second half of the 1990s when technology peaked at 35% of the S&P 500 at the end of the first quarter 2000. It now accounts for 16% of the index.

S&P 500 SECTOR PERFORMANCE

S&P 500 Sector	Sector Wt. (6/30/08)	2008 2Q	2008 YTD
Energy	16.2%	17.3%	8.9%
Materials	4.8%	4.4%	1.3%
Industrials	11.1%	-10.1%	-13.6%
Consumer Discretionary	8.1%	-7.8%	-13.2%
Consumer Staples	10.8%	-5.3%	-7.4%
Health Care	11.9%	-1.2%	-12.6%
Financials	14.3%	-18.3%	-29.7%
Information Technology	16.4%	2.5%	-13.1%
Telecommunications Services	3.3%	-4.1%	-17.3%
Utilities	4.0%	8.0%	-2.8%
S&P 500	100.0%	-2.7%	-11.9%

FIXED INCOME

After experiencing considerable turmoil earlier in the year, a topic we discussed in our prior commentary, fixed income markets returned to *some* degree of normalcy during the second quarter. However, many dislocations still persist. The auction rate securities market, for example, continues to be gridlocked, while some of the asset-backed markets have been permanently transformed. In addition, in contrast to prior periods, fixed income markets did not provide much of a positive offset to the negative returns experienced in the equity markets. The inexorable rise in oil prices during the second quarter to more than \$140/barrel, as well as escalating food prices, has increased policy-makers' and investors' concern about inflation. Although higher energy and food prices have yet to seep into so-called "core" measures of inflation, the Fed has become increasingly worried that in the short-term companies will pass on these higher costs to end users. As a result, the Fed has indicated that it will

keep the fed funds rate at 2% for the foreseeable future. Bond investors are also very concerned about inflation and this sentiment, as well as the Fed's signals that further rate cuts are unlikely and rate *increases* (or so the market thinks) could occur later this year, adversely impacting fixed income returns. During the second quarter, the Lehman Aggregate Index declined 1%. In a complete *reversal* of what occurred during the first quarter, U.S. Treasuries sold off across the yield curve and declined by 1% to 4%, while high-yield corporate bonds, the riskiest part of the market, appreciated. Municipal bonds rallied modestly as investors recognized the value they offered, though the muni market came under pressure in June with the downgrades of bond insurers MBIA and AMBAC. (The Lehman Municipal Bond index appreciated 0.6% during the quarter.) Although this asset class did relatively well, there continue to be dislocations in the municipal bond market. As of June 30, 2008, the yield of the Lehman Municipal Bond 10-year compared to the 10-year Treasury bond was 106%, an indication that munis still offer very good value.

OUTLOOK

U.S. equities currently face numerous challenges that have contributed to considerable year-to-date weakness and are likely to keep the market under pressure in the near-term. Although the U.S. economy is technically not in a recession and consumer spending is being kept afloat by government payments, it is certainly possible the U.S. economy could contract later this year or in 2009. An alternative scenario is very sluggish growth. The sharp rise in energy prices, the continued deterioration in the housing market, and significant job losses during the first half of the year, have adversely impacted consumer spending. The plunge in consumer confidence and a much more restrictive credit environment, will only cause the consumer to pull back even further. As more companies have announced earnings shortfalls, corporations have also become more cautious and capital spending has been reined in. Excluding the financial sector and the auto companies, corporate America is currently not in bad financial shape. However, as demand continues to wane, top-line revenue growth will subside, placing more pressure on corporate profits. We have seen increased evidence of this during June and July with many high-profile earnings disappointments.

Elevated commodity prices are a significant issue for the economy and have placed increased pressure on consumers. Up until recently, the Federal Reserve had focused more on the deteriorating economy, but commodity-driven inflation has become more problematic and has forced the Fed to put further interest rate cuts on hold.

It is hard to find many positives at this point. Prior interest rate cuts, which work with a lag, will benefit the economy at some point, though some analysts believe this benefit is being offset by the tighter credit environment. The weak dollar is another positive for export-oriented industries, but many overseas markets are starting to experience softness as well. While U.S. equity valuations are reasonable and many of our portfolio managers indicate that selected stocks are beginning to offer terrific values, it is difficult to know what the valuation of a company really is when the earnings projections and book values are uncertain.

The outlook for the equity markets continues to be very hazy, especially with the presidential election in the fall and potential changes in tax policy. Although the stock market has already undergone a significant correction, it seems likely that equity returns will be negative in calendar 2008 (a not very profound conclusion). At some point, though we do not know when, investors will capitulate, and the market will finish discounting the negatives and look forward to the next recovery. As we discussed in our prior market commentary, the key questions will be the depth and duration of any recession, the impact the economy will have on corporate earnings, and the market's perception of the timing and magnitude of the potential rebound. Some economists have argued that we are likely to experience an extended period of economic weakness, and this scenario is certainly possible given the magnitude of the housing bubble and the gut-wrenching financial havoc it has caused. Importantly, we will need to see some stability return to the financial sector before the stock market can bottom, but we are not there yet. There is further pain to come and it will take more time to work through the issues the industry faces. Certainly, a pullback in the price of oil would be a potential catalyst for a market rally. However, given the tight supply/demand situation, compounded by the instability in many parts of the oil-producing world, the only way demand could weaken is if we experience a global recession. Other potential positives for the equity markets are the pervasive negative psychology and the large amount of cash waiting on the sidelines. In addition, any positive news on inflation would be viewed favorably by both the equity and fixed income markets.

For fixed income markets, economic weakness *should be* beneficial to returns, but this is partially offset by escalating inflation concerns. During the 2008 calendar year, low single-digit returns seem plausible for fixed income investments.

While the fall in the equity markets has been sharp, it is important to recognize that the value of your portfolio of equities and fixed income has declined substantially less because of the diversification of your investments. We realize that this is not much consolation, but periodic downturns are a "normal" part of investing and we are reminded of the old adage that "it is always darkest before the dawn." We encourage you to stay the course, focus on the long-term, continue to rebalance, and stick to your original investment plan. Eventually, though we do not know when, equity markets will rebound.

OTHER MATTERS

In accordance with SEC regulations, we request that you contact us in the event that there have been any material changes in your financial circumstances or investment objectives, or if you wish to impose any reasonable restrictions on the management of your accounts or modify existing restrictions on the management of your accounts.

Sincerely,

MINTZ LEVIN FINANCIAL ADVISORS, LLC

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