

January 22, 2008

To: All Clients of Foster Group

“As advisors, we’ve been expecting for some time that a significant correction was a distinct possibility. While the event comes as no surprise to us, it’s still unpleasant to go through. For many who became first-time investors in the past few years, this is their first experience with a prolonged market correction, and it’s pretty unnerving. Even for seasoned investors, this correction has proven challenging to their mental resolve.”

We wrote this paragraph to our clients in **March, 2001**. Then, as now, stock markets were in retreat and the feelings of anxiety were pervasive. In light of that anxiety, we felt it would be appropriate to communicate our view on events of the past few months.

Your Portfolio

First of all, what’s our advice for our clients today? Well, since it’s *impossible* to predict the future, we encourage you to stay the course. History and, perhaps more importantly, our own experience through the last significant market downturn from 2000 to 2003, tells us that those who fared best stuck with their long-term strategy, ignored market commentators and so-called “experts”, and let markets work. We still believe that’s the best, most reliable approach.

The media is doing nothing to calm the storm. “Talking heads” on the major news programs rehearse the woes of the housing & lending markets constantly. No doubt this generates viewer interest, but its effect serves more to disturb than to calm.

Is it normal to feel nervous and concerned when markets behave like this? ***Absolutely!*** “Educated” investors are human, too. Emotion always plays a part in investing; the key is preventing your emotions from ruling when making investment decisions.

We believe firmly that some of the greatest benefits of a structured portfolio are best realized in markets like this. ***The diversification that we’ve built into your portfolio will help protect you.*** We will not avoid all losses, but we’ve done what’s prudent to minimize them, *long before the correction began.*

We realize it’s difficult to watch the value of your account(s) decline and yet not react or feel the need to ***“do something”*** now. Our “reacting” was done *when we built your portfolio*. The structure and strategy that went into that construction process is what gives us the confidence

now to wait out this correction without guessing where we should be next. We believe the value of staying the course will become clearly evident as soon as the markets begin to recover, which history has demonstrated **will** happen. In the meantime, rest assured that we are well aware of what's happening with the markets in general, and your portfolio in particular. If you have questions or concerns, we invite your call.

Regarding Markets & the Economy

After several years of smooth sailing for stock and real estate markets, things became more challenging in the second half of 2007, continuing into early 2008.

Much of the present market correction stems from a period of artificially low interest rates and an overheated *residential* real estate market that cooled dramatically last year. As interest rates rose to more normal levels and mortgage payments increased, many borrowers could no longer afford to service the debt they had assumed, and began to default on their loan(s). This created havoc in the "*sub-prime*" loan market – loans made to borrowers whose credit ratings are below average. As lending institutions have begun absorbing the losses from these defaults, two primary effects are occurring.

First, home prices have declined substantially nationwide, especially in the most overpriced locales. While home prices remain well above 2000 levels, new housing construction has slowed dramatically, surplus homes are not selling quickly, and residential builders are being impacted significantly.

Second, financial institutions have lost billions of dollars. Because of this, their stock prices have fallen dramatically. This *specific* decline, though, has become a *general* fear that has trickled (perhaps flooded) into broad equities markets. Even companies *completely unrelated* to housing and lending are being bid down in the current market environment.

When this current investor pessimism will end is the million-dollar question. What is certain is that it *will* end. Financial crises are nothing new to investment markets. In recent history, the Latin American debt, Savings and Loan, and Russian debt crises are all evidence of this. Of course, we've had non-banking crises as well, including Black Monday in 1987, September 11, and the collapse of large companies like Enron and WorldCom.

As the mortgage-related market sorts itself out, liquidity will return and investors will breathe a sigh of relief. Investors' appetite for risk will return, and markets will function more normally. *In fact, there is good likelihood the worst may be behind us as many financial companies tried hard to clean up their balance sheets prior to year-end.*

Fear of recession is another current concern. From a broad economic standpoint, though, corporate productivity remains high; corporate profits are also high *with the exception of* housing and lending-related companies. Consumer spending remains reasonably good and business spending on equipment and infrastructure is strong. Tax rates are relatively low from a historical perspective. Monetary policy is accommodative; the Fed's injection of liquidity as needed seems successful, and the likelihood that they will intervene as necessary going forward is strong; they will go to almost any length to prevent a recession.

Housing and sub-prime problems seem to have had minimal effect on the *overall economy* so far. Their effect on *markets*, however, has been substantial. This is not surprising when you understand that short-term market movement is *not* governed by economic fundamentals; it is governed by *emotion*. Optimism (and greed) push market prices up; pessimism (and fear) push market prices down, as we're seeing right now.

In the short-term, valuations mean little. Stock prices can decline further when valuations are already low. They can also increase even when already overvalued. In the long-term, though, valuations have more to do with fundamentals than emotions. That's why crises have a way of resolving themselves, given some time. *Cooler heads always prevail in the end.*

Summary

We wish we could say with certainty when we'll reach the bottom of this correction; *there's no way to know for sure*. We do know we're closer than we were three months ago. We also know economic and market fundamentals will prevail in the long run, but for now, emotion rules.

We are available and welcome your call, e-mail or personal visit if you'd like to discuss your particular situation further.

Cordially,

Foster Group