

**Spectrum Investor® 3rd Quarter  
2008 Investment Review**

Enclosed are your investment returns for the 3rd Quarter 2008. This past quarter was one that will forever change the landscape on Wall Street. The deepening financial crisis shook the foundation of the financial system, forcing 158-year-old Lehman Brothers into bankruptcy, Merrill Lynch into an 11<sup>th</sup> hour marriage with Bank of America, while Fannie Mae and Freddie Mac were placed under government receivership in a federal takeover. The S&P 500 Index finished down 9% for the quarter and down 20.7% YTD through September 30, 2008 (*USA Today* 10/1/08).

On Friday, October 3, 2008 the Troubled Asset Relief Program (TARP) bill, a \$700 billion financial markets rescue package, was signed by President Bush. TARP is using the US Treasury balance sheet to take on impaired mortgage assets from banks and other financial institutions that can't find buyers for such instruments. The treasury could fund the TARP by issuing securities that pay less than 2% for short maturities, but at the same time, could earn double-digit returns on the assets as they are resold (*Barrons* 10/6/08).

**What caused the problem?** To encourage broader home ownership, Congress amended the Community Reinvestment Act in 1995 that required commercial and mortgage banks to lend to high-risk borrowers. Banks that failed to comply were hit with fines and feared rejection when they requested mergers and branch expansions. Suddenly, the subprime mortgage business was born and Countrywide Financial became its poster child. Furthermore, to encourage home ownership, the federal government offered an explicit guarantee to cover the performance of mortgage securities giants, Fannie Mae and Freddie Mac. The result was corporate abuse and an easy money policy that lasted for more than a decade in real estate and, like all artificial inflationary policies, the overheated property market led to widespread turbulence including foreign markets that invested in our subprime mortgage business. Recently, the Financial Accounting Standards Board (FASB) imposed mark-to-market accounting regulations on financial institutions, forcing mortgages and other loans to be written down, in some cases to zero, simply because they could not be sold even if they were still being paid by customers. As a result, we've seen financial tornadoes causing institutions to be downgraded and in some cases, completely collapse (*Forecasts & Strategies* 10/08).

The last time the US banking system hit the skids was in the late 1980s and early 1990s when the savings and loan industry buckled under the weight of mountains of debts gone bad. Like today's subprime mortgage crisis, the savings and loan affair was years in the making, involving many of the same ingredients. Over the 10 years through 1995, 1,043 thrifts failed. Between 1990 and 1995, the period during which most of the savings and loans bills came due, the American economy grew by an average of just 1.85% annually or almost two percentage points below its potential. Unemployment averaged 6.4% over those six years. In comparison, during the Great Depression unemployment reached 25% (*Historical Perspectives* 8/25/08).

**Good News:** As a hint of stabilization in the markets during the May-July 2008 period, home prices fell 2.2%. That is far less than February-April 2008 when home prices fell more than 6%. Since the peak of the housing market in mid 2006, the S&P/Case Shiller 20 City Home Price Index has fallen 19.5% (Standard & Poor's 10/1/08). Lawrence Yun, chief economist at the National Association of Realtors, said that the slowing pace of real estate price declines may indicate some stabilization in the market. The good news is the surprising strength of the dollar, which has allowed the Fed the option to lower interest rates and also the surprising strength of small cap value stocks, which historically lead market recoveries. The other good news is Fed Chairman Ben Bernanke's efforts, rather than to simply watch the economy tank, which was the case in the 30s, he is flooding the system with money to support the global economy (*USA Today* 10/7/08).

**What to do:** Attached is a comparison of five previous market downturns comparing a balanced allocation strategy 60% stocks/40% bonds (60/40) to a strategy investing 100% in stocks. The bottom line is, a well diversified balanced strategy should weather the storm for you. If 60/40 is still too aggressive for you, a 50/50 asset allocation strategy should help. I have mentioned in our previous newsletters about our trips to Warren Buffett's Berkshire Hathaway shareholder meetings. So what's he doing lately? In the last month, he bought Constellation Energy Group, 10% of Goldman Sachs and \$3 billion of GE. A possible bottoming sign may be Wall Street's "fear gauge", which has hit a record high this week and is now 40% higher than it was at the bottom of the 2002 bear market (*USA Today* 10/9/08). As John Templeton, a well known investor who died this year at age 95 stated, "Buy during maximum periods of pessimism and sell during maximum periods of optimism." (*WSJ* 9/19/08, *USA Today* 10/3/08).

In conclusion, stay the course, but if you are having trouble sleeping at night, pull back 10-15% out of stocks to a more conservative asset allocation (see model portfolios). Check out our website at [www.ciadviser.com](http://www.ciadviser.com) for providers' website instructions or call us at 1-800-242-4735. Investing is a marathon, not a sprint. We appreciate your business.

**Spectrum Investor® Update 9/30/08**

Category Average	3 <sup>rd</sup> Qtr	1 Year	3 Year
Intermediate-Term Bond	-3.65%	-2.45%	1.48%
Moderate Allocation	-8.94%	-16.40%	0.46%
Large Cap Value	-7.94%	-23.87%	-0.84%
Large Cap Blend	-10.21%	-22.45%	-0.45%
Large Cap Growth	-13.81%	-23.22%	-0.90%
Mid Cap Value	-8.90%	-21.33%	-0.66%
Mid Cap Blend	-11.51%	-21.78%	-0.33%
Mid Cap Growth	-16.28%	-24.84%	-0.41%
Small Cap Value	-1.24%	-15.71%	-0.13%
Small Cap Blend	-5.55%	-18.87%	-0.13%
Small Cap Growth	-9.79%	-23.01%	-1.10%
Foreign Large Blend	-20.73%	-30.24%	1.36%
Real Estate	2.25%	-14.46%	3.41%
Natural Resources	-32.56%	-16.70%	4.76%

Source: Morningstar, 3 yr Return is annualized by Morningstar. Past Performance is not an indication of future results.

9/30/08

Dow: 10,850

NASDAQ: 2,082

S&P 500: 1164

Barrel of Oil: \$100

Source: *USA Today* 10/1/08

10Yr T-Note: 3.83

Inflation Rate: 5.4% (8/2008)

Unemployment Rate: 6.1%

Source: [www.bls.gov](http://www.bls.gov) (9/08)