



INVESTING IN AMERICA: THE GLASS HALF FULL

Third Quarter
2008

Anheuser-Busch, an American icon and seller of half of all beer in America, recently agreed to be acquired by a Belgian brewer, InBev. The Chrysler Building in Manhattan was just sold to a group in Abu Dhabi. Citigroup, Merrill Lynch, Morgan Stanley and others have this year accepted billions of dollars in capital from places as distant as the Middle East, Singapore, and China.

In times like these, American investors are on the defensive. With the dollar at all time lows, foreclosures at all time highs, several high profile bank failures, oil at \$140 per barrel, inflation rising, national debt rising, and the world's largest current account deficit, it is easy to look at the glass as half empty. However, it is also at times like these that investors should hearken the advice of one of America's most famous bankers, J.P. Morgan. Quoted in the New York Times, Mr. Morgan credited his success as described in the excerpt nearby.

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Since 1940, there have been 11 bear markets, marked by a 20% drop of the Dow Jones Industrial Average from its peak. During this current bear cycle, the DJIA peaked on October 9th of last year, meaning that the current downturn is over 8 months along. While historically bear markets have averaged 386 days, predicting the bottom is very difficult. The stock market has typically bottomed before the economy, as stocks begin to predict better times ahead.

“ My father told me,” Mr. Morgan is quoted as saying. “ to follow my own bent in business, but whatever that business, to work hard. One thing he said I shall always remember, not to discount the future of America. ‘ Remember, my son,’ he said, ‘ that any man who is a bear on the future of this country will go broke. There may be times when things are dark and cloudy in America, when uncertainty will cause some to distrust and others to think there is too much production, too much building of railroads, and too much development in other enterprises. In such times, and at all times, remember that the great growth of that vast country will take care of all.”

The New York Times

Circa 1908

Instead of viewing the recent foreign investments in our economy as a sign of weakness, they can be seen as an endorsement of the future of US assets. These sophisticated foreign investors are betting that they cannot achieve greater returns elsewhere. At Cutler, we agree. We believe that the current market cycle will, in retrospect, represent a substantial opportunity and investors will ultimately be rewarded for taking a long-term perspective.

[IT'S NOT SUCH A BIG WORLD WHEN YOU LOOK AT IT OUR WAY]



EQUITY MARKET UPDATE

COMMENTARY

Equity markets began the second quarter with some positive momentum. The Bear Stearns collapse in March was a crescendo that had many investors feeling the worst was over. April and May reflected this shifting sentiment, with positive 4.94% and 1.23% returns for the S&P 500. However, the market bears came roaring back in June with the worst monthly decline since 2002. The Dow Jones Industrial Average's 10.2% monthly loss was the third worst month in history. As had been the case over the current cycle, financials and housing led the market decline downward. Stalwart financial companies such as Bank of America and Wachovia were down over 30% in the quarter (neither is held by Cutler clients). With these declines, however, opportunities abound. For example, General Electric experienced substantial market declines with an earnings warning that sent the stock down of 13% in a single day. This type of volatility is unheralded for such "Nifty Fifty" holdovers. However, a company like General Electric, which is held in Cutler strategies, represents a compelling value today. Consider the following:

- GE has a dividend yield of 4.6%, while the US Treasury 10-year is under 4.0%.
- GE has grown its dividend over 300% in the past ten years, with consistent increases every year.
- GE is trading at 12 times last year's earnings, while growing earnings consistently in double-digits.

Given these metrics, it is difficult to imagine a scenario where the US-treasury would outperform GE stock given a 10-year horizon. Continued dividend increases would improve the yield on today's cost basis even more, giving GE potential for substantial returns on dividends alone! This is a basic tenet in the Cutler Equity Income strategy: that the shareholder can benefit from rising income, and participate in the long-term potential share value of the security.

At Cutler, we continue to feel that reducing portfolio risk, through purchasing companies with strong current income and relative valuations, remains a prudent approach in today's market. Market cycles can be tough for investors' to weather, but ultimately the long-term value of equity investing has been well documented.

In 2002, we first printed the chart to the right, demonstrating the upside potential of stocks coming out of a bear market.

DOW JONES (DJIA) Bear Markets

How Stocks Weather The Storm

-- Peak --	-- Trough --	%	Price Return from Trough:	
Date	Date	Decline	1 Year	2 Year %
6/17/1901	11/9/1903	-46%	54%	98%
1/19/1906	11/15/1907	-49%	67%	89%
9/30/1912	12/24/1914	-44%	82%	78%
11/21/1916	12/19/1917	-40%	24%	59%
11/3/1919	8/24/1921	-47%	56%	44%
9/3/1929	7/8/1932	-89%	155%	130%
3/10/1937	3/31/1938	-49%	33%	48%
9/12/1939	4/28/1942	-40%	42%	45%
12/13/1961	6/26/1962	-27%	35%	51%
2/9/1966	10/7/1966	-25%	24%	26%
11/1/1968	5/26/1970	-36%	43%	50%
1/11/1973	12/6/1974	-45%	43%	64%
9/21/1976	2/8/1978	-27%	9%	18%
4/27/1981	8/12/1982	-24%	52%	55%
8/25/1987	10/19/1987	-36%	24%	52%
1/14/2000	9/30/2002	-35%	25%	39%
Average All periods		-41%	48%	59%
Average W/O Depression		-38%	41%	54%



401K PLANNING: IN THE NEWS

In our last newsletter, we highlighted Cutler's comprehensive defined contribution 401k offering, the Cutler emPlan. The roll out of this product has received a very positive response from our clients looking to take advantage of the recent changes in the industry and the broadly diversified investment strategies included in the emPlan. As discussed, this platform

- Reduces plan administration headaches
- Simplifies participant choices, which increases participation
- Lowers overall plan costs, increasing the employers' bottom line and employees' savings



Cutler is one of the first managers in the country to offer a 401k platform utilizing Exchange Traded Funds (ETF). The popularity of ETF investing was recently highlighted in an article from Yahoo! Finance entitled "Target Your Retirement with Life-Cycle ETFs." The author noted the importance of 401k portfolios becoming more conservative as the employee nears retirement. It highlights some of the appeal for this investment approach, such as ease of use, well-defined strategies, and cost advantages. It truly is the new paradigm in 401k plans.

INTERNATIONAL UPDATE

International markets have not been immune to the same factors impacting the US markets. Inflation, credit problems, and slowing growth have impacted both European and Asian shares across the board. China and India, former darlings of emerging market investors, have fallen dramatically off their highs due to concerns of slower growth.

The Government of China is responding to the threat of creeping inflation, as China's central bank raised banking reserve requirements several times during the quarter to absorb excessive liquidity from the system. Some observers believe that this will curb consumption at the pump and soften demand for oil prices. China has grown demand for oil faster than any other country in recent years, increasing consumption from just under 5 million barrels per day in 2000 to about 8 million today. A softening of this demand growth would be a welcome development and may temper the rapid increase in oil prices.

In Europe, inflation has been the primary concern, and the European Central Bank (ECB) raised rates 25 basis points to 4.25%. Inflation in Europe is at a 16-year high, and the ECB should be commended for this controversial tightening in the face of a

weakening economy. The ECB has the luxury of having only one mandate: controlling inflation. This differs from the US Federal Reserve Bank, which is mandated with controlling inflation and maximizing growth. Ultimately, successfully reigning in inflation pressures on the continent will be bullish for European shares, which today are modestly more expensively than those in the US.

Indices	Year Start	Current	% Change
Shanghai Composite	5261.56	2736.10	-48.00
Sensex (India)	20286.99	13461.60	-33.64
CAC40 (France)	5614.80	4434.85	-21.01
DAX (Germany)	8067.32	6418.32	-20.44
Dow Jones	13261.23	11350.01	-14.41
Nasdaq Composite	2663.78	2292.98	-13.92
FTSE 100 (U.K.)	6456.90	5625.90	-12.87
Nikkei 225 (Japan)	14691.41	13481.38	-8.24
IBOVESPA (Brazil)	63886.00	65018.00	1.77
RTSI (Russia)	2290.51	2303.34	0.56

While the US markets have declined, the stability of the US economy is apparent on a global basis.



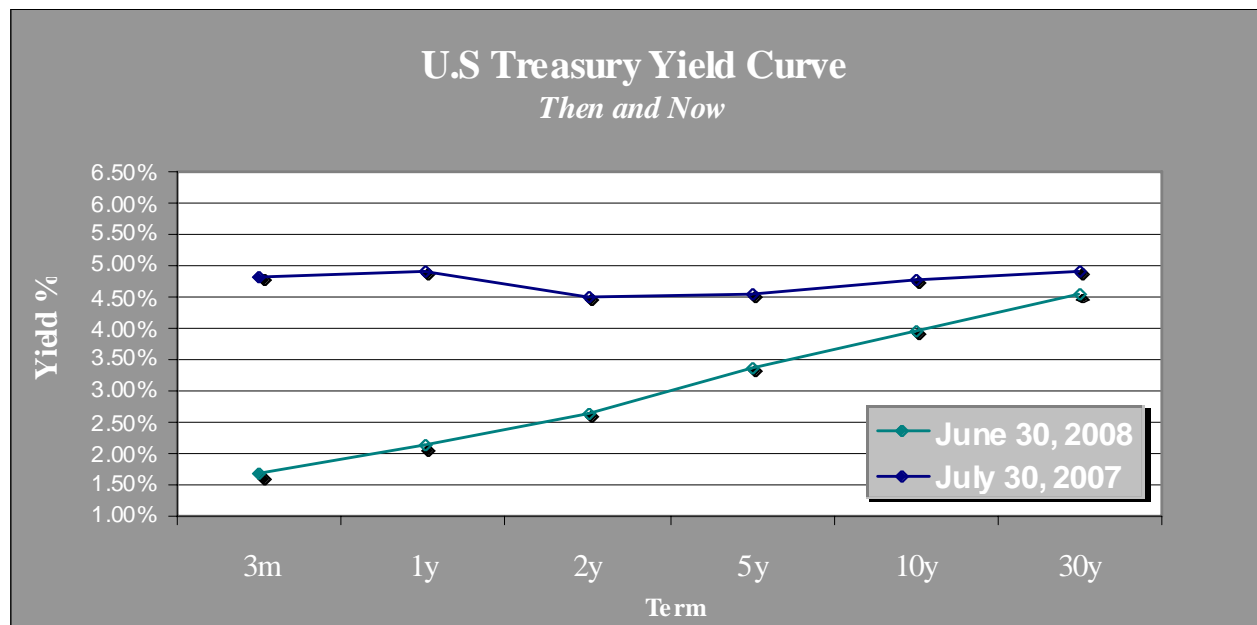
FIXED INCOME UPDATE

WHERE WILL RATES GO FROM HERE?

With the Federal Reserve on hold and inflation on the rise, further cuts in the Federal Funds rate are unlikely. As a result, there is a greater risk of rising rates across the yield curve than there is in declining rates. This warrants a portfolio duration that is either neutral to the index or slightly lower than the index (Duration is the average maturity date of the securities in the portfolio). In either case, a substantial deviation away from the duration of the index is not prudent at this time.

This past quarter, the yield curve saw the spread widen in some sectors and compress in other sectors. For example, the spread between the 2-year Treasury note and the 10-year Treasury note narrowed by 48 basis points while the spread between the 2-year Treasury note and the 3-month Treasury bill widened by 63 basis points. Given the volatility and uncertainty in the marketplace, it is more appropriate to structure a portfolio that is relatively "term structure neutral," meaning the overall portfolio mirrors the relevant index. As a result, Cutler's fixed income portfolios will continue to focus on roll down opportunities in the 2-5 year and 7-10 year sectors of the yield curve. The callable Agency sector continues to provide excellent opportunities to pickup yield and provide a greater return profile versus Treasury and Mortgage securities. Given the underperformance of this sector versus the Treasury sector during the last 12 months, it is reasonable to anticipate that the return expectations of this sector will be superior.

A continued focus on the sectors of the market that will have little negative impact from a slowing economy or persistent housing troubles will be pursued. Additionally, emphasis will continue to be placed on higher credit quality securities as these securities will most likely narrow in yield spread before the lower credit securities. Overall, the fixed income markets are priced for an economic slowdown, specifically attracting investors seeking safety from other asset classes. While Cutler's portfolios remained conservatively positioned, on a valuation basis, fixed income is higher than the long-term trends.



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