



Fourth Quarter
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INVESTING IN AMERICA: OPPORTUNITIES ABOUND

During the summer of 2007, investors first became aware of deterioration in the credit quality of securitized sub-prime mortgages. This seemingly isolated market has since snowballed to effect worldwide credit as financial institutions no longer trust the collateral provided by other institutions. As a result, lending has come to a virtual halt. Without the credit upon which most companies depend to grow, the crisis has recently extended in a dramatic fashion into equity markets. Unprecedented policy action, including nationalization of the mortgage market, direct and indirect investment into the nation's financial companies, and consumer focused stimulus packages, have thus far failed to buoy equity prices. All of this has dramatically increased the scale of an anticipated recession, and equity prices have suffered accordingly.

That's the bad news.

The good news for investors is that opportunities abound. This market has not been discriminating, selling both good and bad companies. With the proliferation of electronic trading and index based strategies, individual securities have traded in-step with the whole market and not on their fundamentals. The added value of active investing is prescient. As always, we believe that value can be found in companies with strong balance sheets and a history of dividend payments. This philosophy is positioned well for the current market, as companies with low-quality balance sheets have had difficulty funding their short-term commercial paper. In the next several months as low-quality companies attempt to refinance their outstanding debt, the risk premium necessary to do so can be expected to force some of them into bankruptcy.

At Cutler, we believe that this is an historical opportunity for owners of equities. We are attracted to valuations and dividend payments that can be found in asset-producing companies, and have been positioning portfolios accordingly. While the short-term environment has been deflationary, as banks, hedge funds, and homeowners deleverage, our belief is that the trillions of dollars being produced by central bankers should ultimately create inflation. Long-term, our portfolios are positioned to greatly benefit from this macro-economic trend.

“the trillions of dollars being produced by central bankers should ultimately create inflation”



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

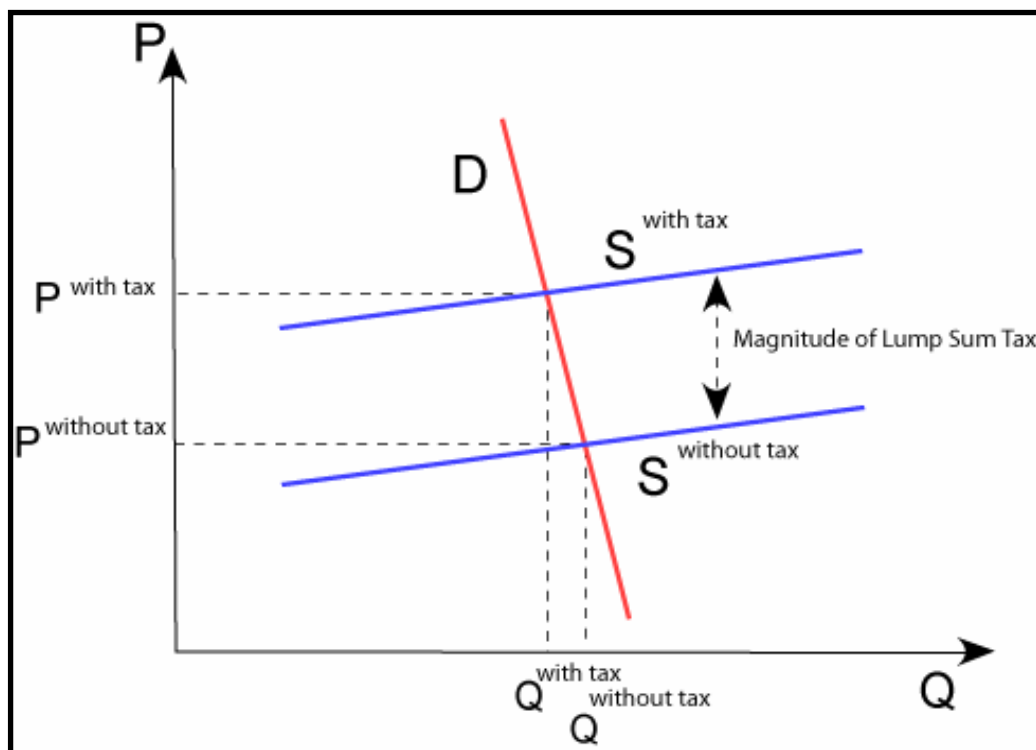


PRESIDENTIAL POLICY

PRESIDENTIAL POLICY ANALYSIS

Investors have long been aware of the impact government policies directly have on the stock market. Guessing which sectors will be favorable under different government regimes has some merit, but the unintended consequences of any policy change can be impossible to fully comprehend. At Cutler, we believe that policy analysis can be viewed within a lens that allows investors some comfort that their investments can remain politically agnostic.

Let's use Exxon Mobil as an example. It is widely accepted that Exxon Mobil would benefit from a Sen. McCain administration and suffer under a Sen. Obama administration. Sen. Obama has proposed a "windfall profits tax" that is intended to collect a greater percentage of Exxon Mobil's net income. If enacted, an investor may anticipate Exxon Mobil's stock price to suffer, but an economic analysis of the proposal suggests otherwise. Consider the graph below:



If price (P) does not substantially impact demand (D), then a tax will raise the price but the quantity (Q) sold will be relatively stable. The tax burden will be born primarily by consumers.

The graph demonstrates the "tax incidence" of the proposal. As can be seen, the higher tax rate results in a higher price. In a competitive environment, the costs of the tax increase will be fully passed on to consumers. (One can argue that oil companies do not operate in such an environment, but Exxon Mobil, the largest public company in the US, represents only 3% of global oil production.) Due to the lack of substitute products for oil, demand is considered inelastic. This means that price changes have a limited impact on consumer demand for Exxon's product. If a tax increase were imposed, then, Exxon would sell the same amount of oil, but will do so at a higher price.

Understanding this economic analysis will help an investor to fully understand the impact of a change in tax policy. This particular proposal may have a negative impact on stocks, but only through reduced spending power of consumers. The impact on the energy sector may not be as great as some would anticipate.



MARKET COMMENTARY

INTERNATIONAL UPDATE

The European banking system and its markets have not been immune to the credit issues storming through the US. However, the strength of the Euro has had a significant impact on Europe's ability to export; the economic slowdown will now exasperate that problem and could force Europe into an economic cycle worse than that facing the United States.

In the United Kingdom, weak banks have also either been nationalized or forced into mergers with stronger financial institutions after a series of mortgage-related credit losses, bank runs, and heavy reliance on now frozen short-term wholesale markets. Recent reports are that 10% of the U.K.'s sub-prime mortgages are currently in arrears and that house repossessions are escalating, putting further downward pressure on the British currency.

Japanese commercial banks have been busy buying up strategic interests in U.S. financial institutions, allowing them to utilize their cash-rich balance sheets. The relatively strong Japanese yen in conjunction with high raw materials costs and what is now a slowing of global growth has shrunk corporate profitability and increased domestic bankruptcies. Lower corporate profits will lead to a slower employment market and further dampen consumer sentiment. Japan did, however, introduce a ¥11,500 billion stimulus package to shore up the economy with tax breaks and fuel subsidies.

China has been experiencing slower growth (9% in September), prompting the government to loosen rates and to re-evaluate its currency policy in order to boost export-led growth. The government has also scrapped the stamp duty on stock purchases to attract interest in the stock market and indicated it may support the equity markets with capital.

Lastly, Russia, with \$40 billion in external debt due by the end of this year, is providing \$37 billion in loans to assist domestic borrowers as foreigners withdraw capital from the market.

Currently, we favor the valuations domestically over most global assets. Our global portfolios are over weighted in U S - b a s e d securities, which have been less volatile than most i n t e r n a t i o n a l markets over the past year. We feel that there are strong values in the portfolios, and have kept turnover to a minimum during the current market sell-off.



FINANCIAL CRISES - A BIT OF HISTORY

Anomalies from historic trends in the equity markets are rare. Investors are repeatedly tempted to believe, however, that things are better or worse than at other points in history; a sentiment that often provides overreaction to both bull and bear markets. Looking at history provides some guidance for investors, as a reversion to the mean will inevitably lead to normalized earnings and market valuations.

There have been 12 bear markets since World War II, and the average rebound to the previous bull market high has taken 1118 days. While this does not provide comfort to investors in the worst of times, buying equities at times of economic distress has historically been a very successful investment strategy. Warren Buffett recently wrote an Op-Ed in the New York Times to espouse his belief that the fundamental values of stocks are currently very attractive.

Investors are challenged, then, to determine whether the current crisis parallels previous economic events. Looking at a few past economic crashes may help provide some insight:

~ The Crash of 1929

The original "Black Thursday." On October 24th stocks sold off 13%. The following Tuesday, they fell another 11%. This sell-off is typically associated with the onset of the Great Depression, and equities lost 90% of their value before bottoming in 1932. Significantly different from the 1929 market crash has been the policy response by today's government institutions. In the 1930's, the government responded by raising interest rates, increasing tariffs, and running a budget surplus.

~ The Crash of 1987

Many Cutler clients will remember October 19th, 1987, when the Dow Jones Industrial Average lost 22% of its value in one day. This remains today by far the largest percentage loss of equities in a single day. The crash was exacerbated by "portfolio insurance" and the onset of electronic trading, as a flood of program trades compounded the snowball of sell orders. A rapid reduction in interest rates provided substantial liquidity to banking institutions, and the market recovered to its previous value in a few short months.

~ US Savings and Loan Scandal

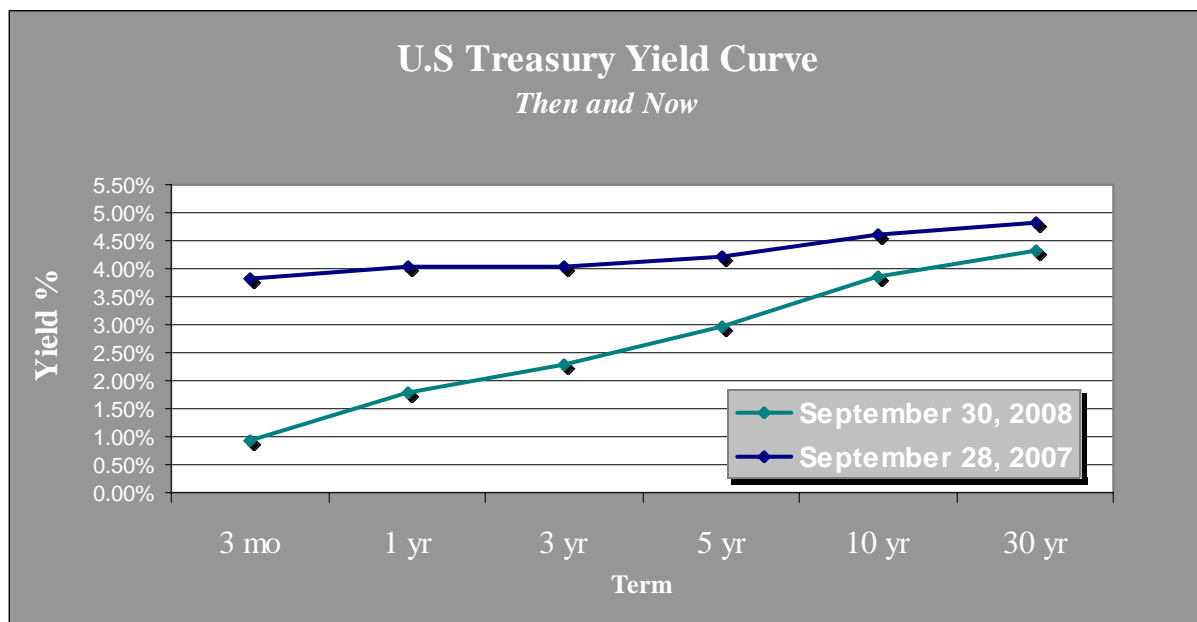
A market event which also began in the banking sector may draw many parallels to today's financial crises. The S&L Crisis was a liquidity event, in which many thrifts held deteriorating assets with insufficient capital support. By the end of the crisis, 2412 S&L's had gone bankrupt, with costs estimates as high as \$560 billion. Ultimately, the government established the Resolution Trust Company to dispose of failed institutions after January 1st, 1989. As is likely today, the result was a consolidated banking sector and a sharp reduction in home construction. These were all contributing factors to the 1990-1991 recession.



FIXED INCOME UPDATE

NAVIGATING TODAY'S CREDIT MARKETS

This has been a challenging year for the credit markets. Credit has been tight, pushing yields higher for most securities outside of treasuries. The Federal Reserve has been aggressively cutting rates, which has resulted in an increasingly steep yield curve. During the Third Quarter of 2008, the Lehman Aggregate Index produced a total return of 0.49%. The Quarter witnessed a continued deterioration of the credit markets, not just in the U.S., but worldwide. The results were a massive underperformance for the Corporate, Commercial Mortgage Backed Securities (CMBS), and Asset Back Securities (ABS) sectors. The Treasury sector benefited from a flight to quality, and produced a return of 2.3%. The Corporate market on the heels of bankruptcies and bailouts



produced a negative return of -7.8% or 10.10% below that of the Treasury market. This flight to quality in the US Treasury instruments has also had a significant impact on the US Dollar which has strengthened versus most major currencies as investors bought US Dollars to facilitate their treasury purchases.

Fixed Income Market Outlook & Strategy

As a result of unprecedented market volatility and the uncertainty of the economic growth potential for the US and world economies over the next six months, the duration of Cutler portfolios will be maintained at or near the duration of the benchmark. Any substantial deviation away from the duration of the index is not prudent at this time, as it would introduce unnecessary reinvestment risk in the portfolios.

The Corporate, collateralized mortgage backed securities, and asset backed securities sectors continue to pose difficult challenges as liquidity in these markets is almost non-existent. Market bids for securities, regardless of credit quality or sector, are either extremely weak or at vulture levels. This poses many challenges as attempts to restructure portfolios have become almost impossible. The best strategy continues to be to hold those securities which can be deemed solid and attempt, over time, to reduce exposure in any troubled issues. Any incoming cash due to interest payments or pay-downs will be re-deployed in either Agency securities or mortgages that are backed by a US agency.

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