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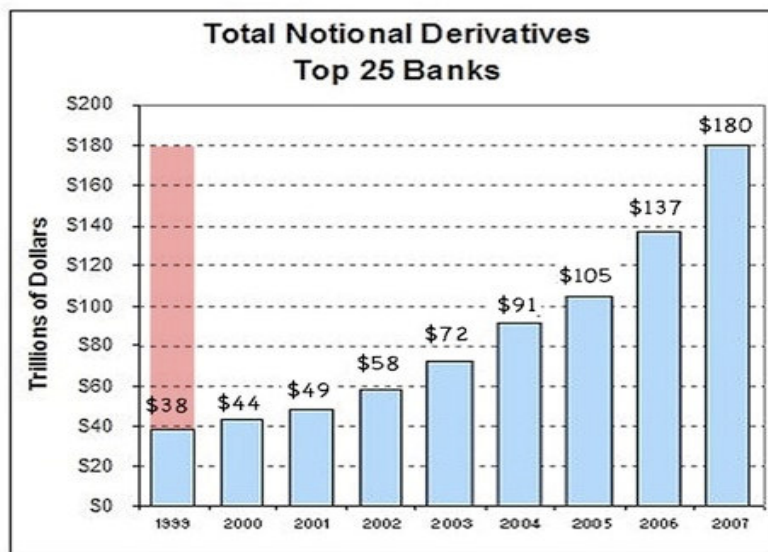
4th Quarter 2008 Capital Markets Outlook

Towards the end of each quarter we meet several times to discuss any changes in our outlook for the current year. We both will have reviewed several Capital Market Outlook publications from a number of respected investment houses including Raymond James. This along with our research of the global markets from both an economic and geo-political perspective helps us establish our expectations for the coming quarter / year.

Our objective is to establish an outline for how we believe the markets may behave and identify what we see as the major risks to investments across all market segments. We do not pretend to be able to predict what will happen in the future, rather we want to establish confidence that the portfolios we recommend are positioned to benefit from positive market environments and are helping to reduce risk exposure through diverse asset allocation and manager selection during negative market periods.

The following is our 4th Quarter 2008 Capital Markets Outlook:

Crisis in Banking, Housing, Equities...Global Economies:



Source: Comptroller of the Currency, 3rd Quarter 2007 Format: CIS

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Notional value: The total value of a leveraged position's assets. This term is commonly used in the options, futures and currency markets because a very small amount of invested money can control a large position, and have a large consequence for the trader / bank.

<http://www.investopedia.com/terms/n/notionalvalue.asp>

Times are extraordinary, and they require us to look at what we have done and rethink if we need to make changes. After completing this exercise we have determined now is not the time for wholesale changes but we must stay vigilant. We will examine how we came to our decision and the thought process. Let's first look at a short concise history of past events that have contributed to our global economic condition, without pointing fingers, and tell you how we think this will all play out in our current situation. This helps us in deciding whether our portfolio building process is working, will continue to work and what if any changes are necessary. The history:

In the late 1980's many of our U.S. saving & loan companies were investing an increasing percentage of their deposit assets into more high risk bonds and real estate loans. While the returns were much better the risk was also higher. Around this same time the market for the high yielding securities was exploding, driven by Drexel Burnham Lambert Inc. (DBL) who essentially created the market. At the time, Drexel came under scrutiny by the SEC for many violations of insider trading this resulted in the Racketeer Influenced and Corrupt Organizations Act (commonly referred to as **RICO Act**) being invoked and the eventual collapse of that firm. Why mention this? Well if you recall the Savings & Loan were large investors into the investments DBL had help create. Around this same time our government also looked at the S&L companies and determined that their portfolios' had invested too heavily into these riskier assets. The government decided force the S&L to liquidate all the speculative "junk" bonds from their portfolios and reflect the current value on a "mark to market" basis.

In effect we told one side of the market to sell everything now for whatever the market would bear while we had just removed the largest market maker in junk bonds! The result was no liquidity; irrational price drops on ALL bonds in this sector not just the questionable firms. (I recall buying Vons grocery store 15% bonds at 75 cents on the dollar)

More and more S&L's were losing value in their reserves and this forced down their stock price, credit agencies cut their ratings effectively cutting them off from funding, which contributed to their collapse. This led to the U.S. Government creating the Resolution Trust Corporation, a Trust designed to oversee the operation and liquidation of all of the "toxic" assets held by S&L's that were insolvent. (Sound familiar?) Over the next 5-6 years these assets were sold off and cost the U.S. Taxpayer about \$124 billion dollars (Source: JP Morgan). However many investors stepped in and bought these assets and made profits in the coming years. (A client of ours actually acquired a 45 unit apartment complex in Denver...sold his business here and moved there to run the property. He paid \$300,000.00! Needless to say he did very well.)

So we see that in hindsight some of our own well intentioned actions contributed to making the S&L crisis much worse. The crisis today born out of the collapse of the mortgage market is different, however in our opinion also has many parallels:

Our country, its leaders and citizens alike, have made affordable housing and homeownership an American goal. In fact this desire and the collapse of the U.S. home market during the Great Depression led to the establishment in 1932 of the Federal Home Loan Bank system: to provide funds to savings and loan institutions and to make mortgages more affordable. The 12 Federal Home Loan Banks are government-sponsored enterprises (GSE's), federally chartered but privately capitalized and managed. In 1968 we established The Government National Mortgage Association (GNMA, also known as Ginnie Mae). This is a U.S. government owned corporation within the Department of Housing and Urban Development (HUD). Ginnie Mae securities are the only mortgage backed securities, (MBS) that are guaranteed by the United States government. Again, the goal was to encourage and support home ownership for all. This worked so well we established more GSE's, Fannie Mae and Freddie Mac; while not guaranteed by the direct backing of the U.S. Government, they were considered AAA private agencies that the government would stand behind. All this worked rather well, with some exceptions, until a few uncoordinated changes took place.

In an effort to keep lending fair for all the 1968 Fair Housing Act has over the years been expanded to protect against discrimination. However, soon the distinction between the forms of discrimination and economic disparities became blurred. As a result lending practices were eased to include less

qualified buyers with greater risk. However, these loans were either guaranteed by the U.S. government or a GSE which the market took as an implied government guarantee. In Helping more people achieve homeownership; the discipline of sound underwriting was lessened because of an “implied government guarantee”. During this time the investment community had become increasingly skilled in the creation of derivative investments. **Derivatives** are financial instruments whose values depend on the value of other underlying financial instruments. In essence they take something and divide it into parts, say principle and interest payments of a home loan or tranches of faster paying off loans and slower pay loans. Then thousands of these loans are bundled together and resold to investors. One result was more loans, greater leverage and more investors since the underlying asset (home loan) was “backed” by a U.S. government GSE. Add to that the creation of Credit Default Swap (Collateralized debt obligations (CDOs) are an unregulated security. CDOs are constructed from a portfolio of fixed-income assets. These assets are divided by the ratings firms that assess their value into different tranches: senior tranches (AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are applied in reverse order of seniority and so junior tranches offer higher coupons (interest rates) to compensate for the added default risk. Since 1987, CDOs have become an important funding vehicle for fixed-income assets. Source Wikipedia) and the cross insurance of leveraged positions exploded.

The deregulation of the banking industry repealing portions of the 1933 Glass-Steagall Act has been going on for decades. The provisions that prohibit a bank holding company from owning other financial companies were repealed on November 12, 1999, by the Gramm-Leach-Bliley Act, which passed in Congress with a 343-86 vote in the House of Representatives, before being sent to conference committee; the final bipartisan bill (Senate: 90-8-1, House: 362-57-15) signed by President Bill Clinton (source: http://en.wikipedia.org/wiki/Glass_Steagal_Act) allowed more aggressive investment practices to seep into our banking system. This was a continuation of changes to Glass-Steagall Act that began in 1980-1982 with the deregulation of the S&L industry. This was a period where both major political parties had determined that the public would be better served by the changes...again enough blame to go around for all.

With this the industry got aggressive, and so did Fannie Mae and Freddie Mac. The GSE's expanded their lending activity with everyone willing to buy the investment pools because the U.S. government was the back stop...so low grade investments became AAA! Since that time we have seen an explosion of Federal Home Loan Bank obligations. The combined \$1.5

trillion debt and \$4.7 trillion in bond guarantees of Fannie Mae and Freddie Mac are 46 percent more than the \$5.04 trillion of Treasury debt held by the public. (Source: Bloomberg.com) Wow!

Our point is that our current situation has grown over decades, what started as well intentioned programs have morphed into more than the original intent. This along with our countries ability to exploit any opportunity to make money and a lax oversight by our own regulatory agencies resulted in the 2008 \$700 billion dollar economic rescue bill. We are not calling it a bail out because we think it only promotes blame and finger pointing. The reasons we are at this moment are complex, however the issue must be addressed and that is what Congress and the Administration have done. Our position is that the U.S. is well ahead of the rest of the world in addressing this housing crisis (the other nations have been doing very similar programs over the years) and the passage of this bill is the beginning of the stabilization and recovery of all our markets. As to how to invest going forward we believe a well diversified spread risk portfolio is the best way to protect your long term investments and gives you the greatest opportunity to recover from the recent market declines.

The Economy:

The 1st Quarter U.S. Gross Domestic Product (GDP) was revised down to .9% growth; the 2nd Quarter was revised down to .5% growth, still an annualized growth rate of 2.8%. However the latest government estimates have lowered overall 2008 growth to between 1 and 1.9%. This means it is highly likely that the 3rd quarter will have a negative growth number. This only confirms what we have been saying for the last 10 months. It also is a strong indicator that we are past the mid point for the average recession length. We would look for the recovery to begin in 2009; however the markets could begin to recover sooner in anticipation of this.

Source :(<http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>)

Equity Valuations:

Current estimates of the S&P 2008 EPS are \$77.44 (Source: standardandpoors.com). With the S&P 500 closing at 1099.23 on 10-03-2008, the current market is trading at only a 14.2 forward Price to Earnings (PE) estimates. This is below the long term historical average for the S&P 500 (S&P 50 year historical,

1955 – 2005, median P/E of 17. Source: Mark Panzner, Rabo Securities). In light of this we do not believe the market is over valued at this time. In fact we take the opposite view that it is currently undervalued provided a recovery begins in the economy. The absolute level the markets may trade is speculation and we do not engage in that kind of timing. We merely recognize that values are becoming more compelling from a long term historical perspective.

Bond Markets:

Since September of 2007 the Federal Reserve has been lowering the Federal Funds Rate from 5.25% to our current level of 2.0%. In their last meeting we began to hear language that the FED would pause in the current ease policy. However, in light of the recent passage of the \$700 billion financial rescue plan and the current 6.1% unemployment rate we feel the FED has one more rate cut left before any change in current policy. We also anticipate Europe will be lowering their rates too.

Currency Markets:

The dollar is rallying! Everything is relative. You might think that our recent economic upheavals would make the \$ go down in value, but no! It seems that Europe is headed down our same path; however they have to coordinate their decisions through the European Union. As we have seen in our own Congress, it is hard to get guys from the same country to agree imagine if you were from different countries. In fact the government of Ireland has already taken “independent” action to guarantee their Irish banks even though they are part of the European Union. This will get interesting and because of this we see interest rates in Europe will likely be cut in the near future.

Oil:

High \$145.15 07-03-2008.....Brent (US. Dollars per Barrel) 09-30-2008 \$95.33. We see this trend continuing. Overall global demand is on the decline and near term production capacity are at all time highs. When you factor in that a nationalize oil industry and its revenue represents the majority of the major producers GDP (Saudi Arabia, Venezuela...etc.) they can not afford to stop pumping oil.

“In the end, how your investments behave is much less important than how you behave.”

**Benjamin Graham
The Intelligent Investor**

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