

Fourth Quarter 2008 Investment Summary

Trinity Wealth Advisors

Values and Performance as of 12/31/08

Market Update

Some years evoke memories that are seared into the conscious. The year of 2008 -- as with 1929, 1941, 1969, 2001 -- will join that list. The Wall Street model died, and the five major investment banks are either gone (Lehman, Bear Stearns, Merrill Lynch) or have new structures (Goldman Sachs, Morgan Stanley).

Washington Mutual became the nation's biggest bank failure. AIG and the auto makers were given bailouts to prevent collapse. Fannie Mae and Freddie Mac were effectively nationalized.

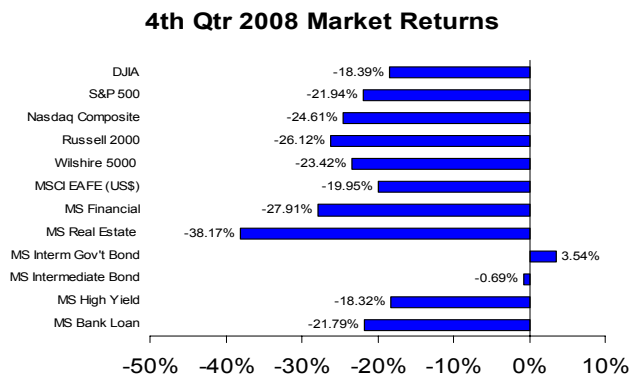
Oil ranged from \$145-plus to below \$40. Stock markets fell by double digits globally, and a U.S. bear market was confirmed. The Fed's key interest rate was cut nearly to zero. If all that weren't enough, Bernard Madoff stands accused of running a \$50 billion Ponzi scheme.

Stock markets fell swiftly in early October and have remained volatile as the government stepped in to restore order in most areas of lending. Markets hit a "bottom" on 11/20/08 and then increased approximately 20% to end the year on a positive streak, but the overall results for the quarter and for the year were dismal. Stock markets were down (-18% to -26%) in the U.S. for the quarter and (-35% to -40%) for the year. Foreign stocks were also hard hit, down (-20%) for the quarter and close to (-45%) for the year.

Here are just a few of the notable, if not notorious, low points of 2008:

- 38.5% decline in the S&P 500 index in 2008, the steepest annual drop since 1937.
- 52% decline in the S&P 500 index from Oct. 9, 2007 to Nov 20, 2008, the deepest bear market since 1932.
- \$17 trillion: amount lost in stock markets around the globe.
- 38: a record low in U.S. consumer confidence, December 2008.
- 18% decline in U.S. home prices year-over-year, October 2008.
- 2.6 million, the projected number of U.S. jobs lost in 2008.
- 32: the number of recessions Lehman Brothers survived before failing in September 2008.

Bond markets also suffered (with the exception of Treasuries) as investors demanded higher yields for anything that had a higher risk. The lower rated bonds, high yield and bank loan funds, were down (-18% to -22%) for the quarter and (-26% to -28%) for the year. These types of bonds are offering yields at historically high levels, 20% to 30% depending on credit quality. Corporate bonds also declined for the quarter (-0.7%) and for the year (-5%) because of the flight to quality that ensued. As a result government bonds were the only positive performing bond category, with intermediate bonds up 3.5% for the quarter and up 5% for the year. Yields declined dramatically for U.S. government bonds and during a short stretch in October, yields became negative to purchase the security of a guaranteed government bond. Today, yields are 1.3% to 1.7% for Treasury bonds, compared with 7%+ for corporate bonds.



The Credit Crisis and the Economy

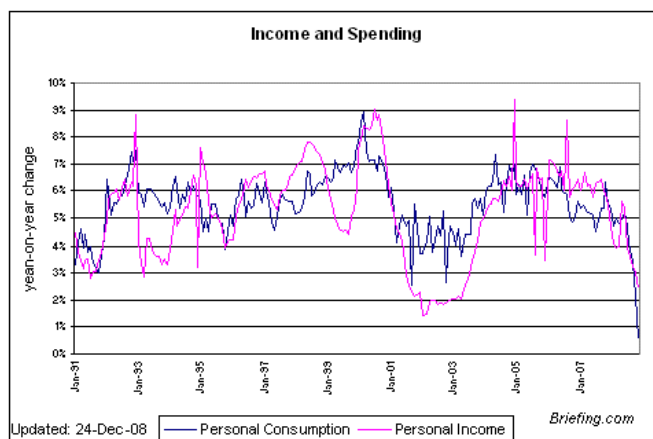
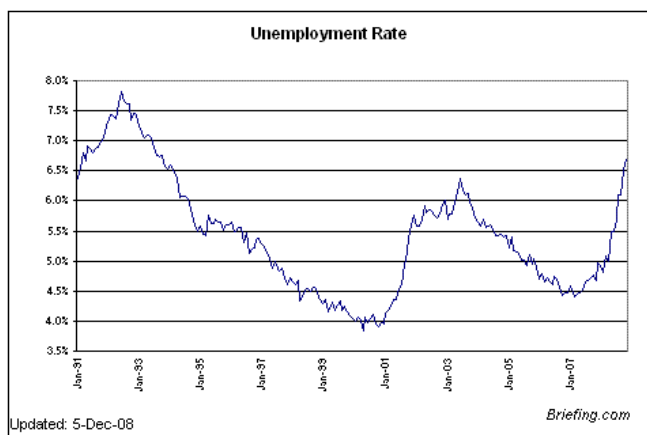
As we turn the page on 2008 in the wake of the credit crisis, the U.S. economy is mired in a recession which began in December 2007. While robust growth is not predicted for 2009, most of the intense parts of the financial crisis and market downturns are likely behind us. As a result, 2009 should be a year of economic stabilization which should eventually translate into a better year for investors as well. An economic recovery has been forecasted for later this year but is likely to be slow and we expect market volatility to continue.

In the meantime, the current economic news continues to be disappointing. Strapped consumers are tightening their belts and repairing their balance sheets in the face of rising unemployment and tight credit conditions. Over the long term, reducing debt and improving personal savings rates make households stronger, but this year they will constrain growth below recent levels.

Corporate earnings have fallen significantly this past year. Total net income is expected to fall 10% in the fourth quarter from a year ago and 25% overall in 2008. Corporate net income is currently expected to grow 5% in 2009, but early indications have been disappointing and forecasts are being revised downward.

The final unemployment report for 2008 closed the book on a miserable year for U.S. workers. The economy lost 2.6 million jobs in 2008, pushing the unemployment rate to a 16-year high of 7.2%. Nearly two million of those job losses were in the last four months, confirming that the recession accelerated as the financial crisis intensified. This is the first annual job loss since 2001 and the largest figure since 1945. However, as there are three times the number of workers now, the percent of jobs lost (1.75%) remain modest compared to past recessions. Additionally, jobless benefits rose recently to the highest level since 1982, demonstrating the troubles the unemployed are having in finding new jobs.

U.S. factories are marking their weakest period in nearly 30 years, and commercial real estate is beginning to show weakness as vacancy rates are expected to increase to 12.7% from 10% a year ago. Additionally, retail sales were down 8.3% in November, recording the deepest decline since the 1980 recession.



The challenge for corporate America will be to grow revenues in a deleveraging environment, a particularly difficult task for companies that historically have borrowed to expand, catered to the U.S. consumer, or both. Businesses will likely continue to postpone spending plans and reduce inventories until the outlook for the consumer improves, which may take some time as 60% of CEOs indicate that more lay-offs are expected.

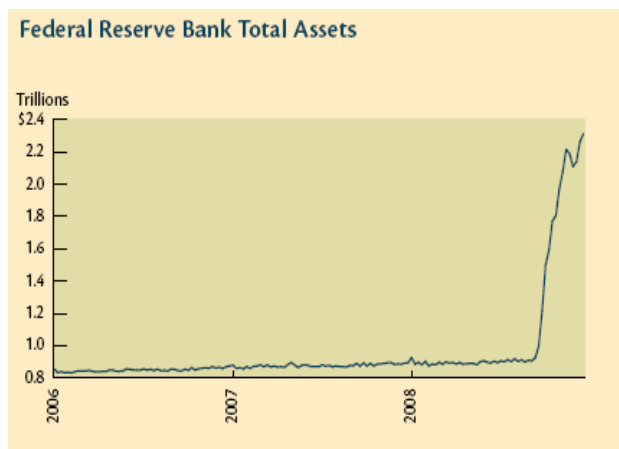
All eyes are on the federal government. The government's approach to the credit crisis has been to increase government borrowing in an aggressive and unconventional manner. The Treasury can borrow when the consumer can't, and the Federal Reserve can expand its balance sheet and lend when bank's are reluctant to. So the government's main tasks have been to 1) recapitalize the banks, 2) protect that capital and improve credit for good quality borrowers and 3) expand support for lower income Americans and create jobs.

The \$350 billion first installment from the Treasury's Troubled Asset Relief Program (TARP) has been utilized to help avert a banking collapse, but it's far from providing enough capital necessary to accomplish the goal of containing the economic downturn. This is still a work in progress and there will be additional capital injections made to the banking sector. Fed Chairman Ben Bernanke claims to be willing to do whatever is necessary to unblock the financial logjam. And he is putting our money where his mouth is. Over the last year the Fed balance sheet has more than doubled to over \$2.3 trillion with more expansion to come.

U.S. Treasury
Troubled Asset Relief Program
 TARP Accounting—Money Spent and Authorized to Date (\$B)

Total Designated First Tranche	\$350.0
Bank Recapitalization—Spent	168.0
Bank Recapitalization—Authorized	82.0
AIG Bailout	40.0
Citigroup Bailout & Backstop	25.0
Consumer Loans—Authorized	20.0
Big Three Auto Bailout	13.4
Total Spent/Authorized	\$348.4
TARP Second Tranche	\$350.0

Source of chart data: U.S. Treasury, as of December 19, 2008.



Source of chart data: Federal Reserve Board, as of December 17, 2008.

The Fed's direct participation in the interbank and commercial paper markets have helped interest rates in these markets to fall, and lending has returned to pre-Lehman Brothers levels. Nonetheless, all of the trillions will go for naught unless home prices stabilize, consumer confidence improves, and businesses hire and invest. While rising unemployment may continue to depress housing prices, renewed lending can slow the decline. This is why the Fed's plan for 2009 will include expansion to support mortgage lending and foreclosures, consumer lending, and likely investment-grade corporate debt and municipal debt. The Fed balance sheet should continue to expand as the Fed becomes the de facto loan market for municipalities, businesses and consumers.

Early indications are that the Fed's moves have had some positive impact. For example, mortgage applications for refinancing surged once the Fed pledged to buy mortgage-backed debt. Interest rates for mortgages, long stuck at over 6% recently fell below 5.2%. Currently there is a Treasury proposal on the table to support the issuance of 4.5% home-purchase mortgages.

The Obama administration's fiscal stimulus plan is being designed to be aggressive as well. The economic recovery package could approach \$1 trillion with the stated goal of creating 2.5 million jobs. Though specifics are still unknown, the plan is likely to include tax reductions, an expansion of unemployment benefits, payroll tax rebates for middle income Americans, and investments in public infrastructure and green technology. This policy course concentrates on putting out today's fire (recession) while deferring concerns about too much spending (inflation). Over the coming months, the massive monetary and fiscal stimulus in the system will have a significant impact. Ultimately the rate of decline in economic activity will decelerate, and the economy will modestly recover. Further down the road we will be in a better position to evaluate the impact of this spending, which could include higher taxes, reductions in federal services, a weaker dollar, and the threat of inflation. Current 2009 budget deficit projections are expected to be \$1.2 trillion, or 8.3% of GDP, which are postwar records by both measures. And these projections don't include any outlays from the expected stimulus package.

In the Pipeline

A rundown of stimulus plans and other measures coming in 2009

- **Fiscal:** The Obama administration is planning tax cuts and spending increases of \$750 billion or more over two years.
- **Bank rescue:** The Treasury Department is likely to tap another \$350 billion of Troubled Asset Relief Program funds to bail out banks and other financial institutions.
- **Mortgage debt purchases:** The Federal Reserve is planning to purchase up to \$600 billion of debt issued or guaranteed by Fannie Mae, Freddie Mac and other government-linked mortgage firms.
- **Consumer loans:** The Fed will lend up to \$200 billion to investors buying debt tied to credit-card loans, car loans and student loans.
- **Foreclosures:** Lawmakers and White House officials will explore new programs to reduce the number of mortgage foreclosures.

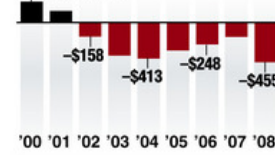
Seeing red

The U.S. Congressional Budget Office forecasts that the annual budget deficit will top \$1 trillion this year, driving up the already swollen debt.

Where we're at

Actual budget surplus/deficit, by fiscal year ending Sept. 30

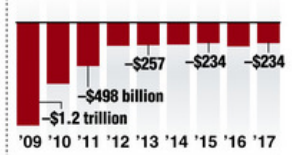
\$236 billion



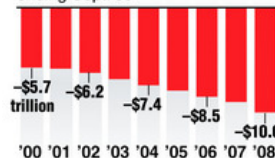
Where we're headed

Projected budget deficit, by fiscal year ending Sept. 30

-\$1.2 trillion



Actual public debt, by fiscal year ending Sept. 30



Anticipated 2009 spending not included in deficit projections:

- Stimulus package Up to \$800 billion
- Afghanistan, Iraq wars About \$136 billion

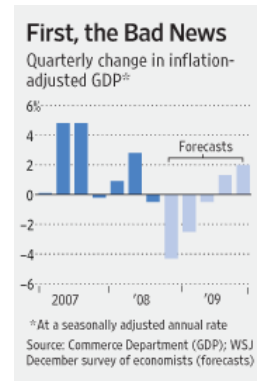
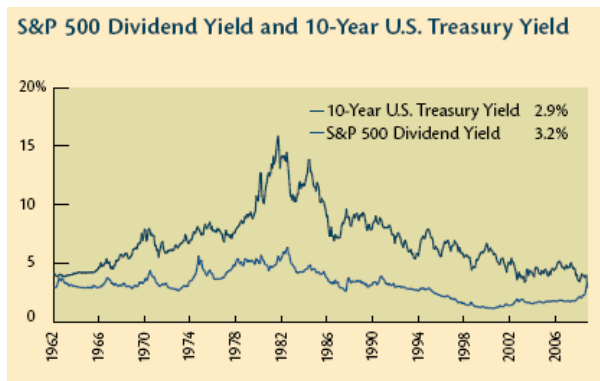
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Source: U.S. Congressional Budget Office, U.S. Treasury, AP
Graphic: Pat Carr

Complicating matters is the world-wide nature of the economic crisis. Europe is facing a significant recession. Japan, despite its horde of savings, is also declining quickly. Even the Chinese economic powerhouse is slowing, which is forcing China to focus more on internal spending than purchasing U.S. Treasuries. Meanwhile, now that oil prices have collapsed, cash-rich sovereign wealth funds are focused on supporting their own economies rather than seeking investments in other countries.

Some Encouraging News and Perspective

With short term treasury yields dropping to effectively 0%, we began to see institutional buyers return to the markets, and we have seen the markets recover more than 20% since 11/20/08. Typically, bull markets emerge out of bad news, so headlines can be deceptive. Markets tend to anticipate recoveries and begin to move up well ahead of positive economic or earnings news. So, earnings estimates may still be in decline and the economy still in recession, when the markets begin to go up. Of course, it is very difficult to predict the exact timing of any recovery, and we believe the markets will continue to exhibit high volatility.

What is there to be optimistic about? First, trillions of dollars are being spent around the globe to stimulate economic growth and consumption. Additionally, interest rates are low and likely going lower nearly everywhere. This has the twin effect of stimulating growth, and lowering the discount rate applied to capital projects and corporate earnings.



Also, reaching a five-year market low is a rare event. In fact, it has only occurred five times since 1926; in June of 1932, April of 1942, June of 1970, September of 1974 and September of 2002. Historically, once a five-year low occurred and a bottom was reached, the subsequent five-year annualized returns averaged close

to 20%. This next economic cycle certainly may be different than past recoveries, but still should offer significant upside possibilities.

Another positive sign is that corporate insiders are buying their stocks at a pace rarely seen in the past 40 years, with insiders more bullish now than at any time since 1975.

Summary:

The economy's current state of motion is contraction, a recession that threatens to be the worst since the 1970's. In 2009, the federal government will be applying a very large and powerful force against it, a combination of tax cuts, spending and central-bank programs that will throw hundreds of billions, if not trillions, of dollars at the problem. The collision of these two forces will have a decisive impact on the investment climate for years to come.

Economists believe 2009 will be a year of stabilization and possible recovery towards the end of the year. Fortunately for investors, robust economic growth will not be necessary to generate investment returns in 2009. The markets have already priced in the possibility of a deep and long recession. Given the fear gripping the markets, modest improvements could have a significant impact on investor confidence and improving stock prices. There is historical precedence for a rally in the market following the sharp declines experienced in 2008. And the massive build-up in money market funds and cash equivalents of \$8.85 trillion might provide the fuel for market strength in 2009.

We certainly have a lot to monitor this quarter. The new administration will start to enact legislation in February that will confirm the details of the stimulus package, and the economic data will begin to show us the depths of the recession.

Jim Evens
Investment Director