SARGENT BICKHAM LAGUDIS

November 6, 2008

Market Commentary and Review

"'Tis easy enough to be pleasant,
When life flows along like a song;
But the man worth while is the one who will smile
When everything goes dead wrong."
-Ella Wheeler Wilcox

SUMMARY:

The Bear Market entered a new phase, accelerating to be one of the worst Bears ever seen.

Of the eleven factors we identified as determining market direction this year, there has been improvement in several. Oil prices, commodities, and inflation are all falling. The election is behind us and the Fed and Treasury are now aggressively attacking the financial and economic crisis. Valuation is compelling.

It's time to cautiously begin increasing equity allocations.

In This Letter

Dear Clients and Friends,

We have been sending lots of updates via email that we hope are helpful during this challenging time. If you are not receiving them and would like to, please call Stephanie at 303.443.2433 and she will make sure you are on the distribution list. We thought it was time to go ahead and send a more complete newsletter summarizing where we are now, and trying to peer into 2009.

The following table summarizes returns through October and the last few years:

	October 2008	Year to Date 2008	Last 5 Yrs Annualized
Large Cap (S&P 500)	-16.8	-32.8	-1.6
Large Cap (Dow Jones Industrials)	-13.9	-28.2	-1.8
Mid Cap (S&P 400)	-21.6	-32.8	1.7
Small Cap (S&P 600)	-19.8	-26.1	3.3
Nasdaq 100	-15.8	-36.0	-0.9
Foreign Stocks (EAFE)	-20.2	-43.3	3.7
Bonds (Lehman Aggregate)	-2.4	-1.7	3.2
Emerging Markets	-27.4	-53.1	10.5
REITs (Vang. REIT index)	-31.8	-30.6	2.6
High Yield Bonds (Vang. High Yield)	-15.9	-24.4	-0.5
Commodities (AIG Index)	-21.5	-28.1	4.0
Alternative Assets Group (AAG) (11 Fund Avg)	-11.2	-18.0	4.9
65% Equity/ 35% Fixed-Benchmark	-11.8	-22.0	1.4
50% Equity/ 50% Fixed-Benchmark	-9.6	-18.5	1.9
35% Equity/ 65% Fixed-Benchmark	-7.4	-12.6	2.4

These numbers speak for themselves. It has been an historic decline in October, wiping out nearly all the gains we've seen over the last 5 years.

Here is a quick recap of what's happened in the last two short months:

- Sept. 7: Gov't seizes control of Fannie Mae & Freddie Mac.
- Sept. 14: Lehman files for bankruptcy. Merrill Lynch, fearing bankruptcy, was taken over by Bank of America
- Sept. 16: Gov't loans $85 billion to AIG to keep them from bankruptcy.
- Sept. 19: Gov't proposes TARP plan to Congress
- Sept. 21: Goldman Sachs and Morgan Stanley reorganize as banks
- Sept. 26: Washington Mutual fails.
- Sept. 29: Wachovia, on verge of failure, agrees to be sold first to Citigroup, then to Wells Fargo.
- Oct. 3: Gov't plan finally passed on 2nd proposal.
- Oct. 6: Europe goes into tailspin. Iceland, effectively bankrupt, borrows from Russia.
- Oct 8 to current: Coordinated moves by every central bank in the world including rate cuts, guaranteeing deposits, pumping in massive liquidity, guaranteeing inter-bank loans, commercial paper, etc.
- Oct. 14: U.S. and European central banks announce they will take equity stakes in banks.
- Oct. 16: Warren Buffett invests billions in Goldman Sachs and General Electric. Writes op-ed in NY Times titled "Buy American. I am".
- Oct. 20: Gov't begins directly buying / backing commercial paper. Libor and commercial paper rates begin falling.
- Oct. 27: Market drop reaches 46% making it the 3rd worst decline since the depression. The others were 2000-2002 (-49%) and 1973-1974 (-48%).
- Nov. 4: Barack Obama elected President. Market rallies 3.4%.
- Nov. 5 & 6: Market gives up significant portions of gain from Oct. 27th low.

Once again, let's review the eleven factors we laid out at the beginning of the year that would drive the markets:

1. Politics / Government. The election is finally over. Nearly half the country is now worried about the government swinging too far to the left and controlling our lives, including raising taxes and increasing spending. While these are legitimate concerns, it's too early to jump to conclusions. A majority of the people decided it was time to try something different. Whether the reasons were ideological or due to a lack of leadership, the current administration has failed in many respects. Regardless of your politics, we should all be hoping the new administration does better. We need to work together to solve some very significant problems including a shattered economy, a broken regulatory structure, two wars, a bankrupt medicare and social security, a health care system that costs too much and delivers too little, and a deficit that is out of control. While change is the most overused word of 2008, there is reason for optimism in a fresh start.
2. Federal Reserve policy. The Fed has been extremely active in attacking the credit crisis. Interest rates are now very low and will help stimulate the economy when credit begins flowing again.
3. Credit Crisis. We under-estimated how this would develop. We believed the banks, the government, and the market would deleverage in a more orderly manner. The government's bungling of the Lehman situation led to a domino effect that completely shut down the credit markets. This issue changed what would have been an ordinary recession and bear market into a worldwide crisis and significant recession that is still unfolding.
4. Oil prices climbed to nearly $150 bbl, and then fell like a rock to $60 bbl. The spike contributed to the decline in the economy and a spike in inflation. The drop will help consumers going forward but probably not enough to offset the loss of jobs, the loss in wealth from the stock market, and the hit to confidence.
5. Slow economic growth and rising unemployment – getting worse now. Expect 4th quarter GDP and 1Q09 to be negative. Expect unemployment to rise to 8%.
6. Slower earnings growth. Worse than expected and still declining. Annual earnings peaked in June 2007 and are down about 25%. We expect them to fall at least two more quarters.

7. Housing. There are some early signs of a bottoming in prices, but a recovery is still not here.
8. Foreign trade is now at risk. The dollar has increased significantly from its low and many foreign economies are in worse condition than the U.S.
9. The weak dollar has reversed, and is up 20% since March. This reduces inflation risks and encourages foreign investment in the U.S., but hurts exporting companies and investments in foreign stocks and bonds.
10. Like oil, commodity prices climbed and then popped. This will help many companies by lowering their input costs. Commodity investments, including gold, have fallen precipitously (like everything else).
11. Inflation topped out this year close to 4.75%. However, as we have said for months we do not expect inflation to be an issue for at least the next year. With falling commodity prices and rising unemployment, deflation will be a bigger concern. Longer term, this will bear watching as economic theory argues that the liquidity being pushed into the system will eventually create inflation.

Strategic Allocation Decisions

We've been under-weighted in stocks for a year, but in this environment we are envious of those market timers who are in 100% cash. However, that is simply not our process, and the worst thing an investor can do is jump from one philosophy or style to another. He is then forever chasing the latest fad with no compass. Here is our model based system summarized for your review:

Allocation Model	Equity Range	Current Target
100% Equities	60%-100%	60%
75% Equities/ 25% Bonds	45%-80%	45%
65% Equities/ 35% Bonds	40%-70%	40%
50% Equities/ 50% Bonds	30%-55%	30%
35% Equities/ 65% Bonds	20%-40%	20%

We now believe it is time to begin increasing equity allocations, not precipitously, but methodically and carefully. We like consumer staple and health care stocks and companies with good dividend yields. We are studying balance sheets closely and avoiding over-leveraged companies.

As we approach each year end, we make changes to portfolios for tax reasons. This year, due to the significant decline in the market we will harvest losses and re-invest in similar mutual funds or stocks. This makes sense even if the losses are greater than can be used currently because the losses can be carried forward indefinitely to offset future gains. We will also sell any mutual funds that might be distributing capital gains.

U.S. Stocks - Valuation

The debate about valuation continues in the financial press due to the different way analysts look at valuation. Some use reported earnings and others operating. Some look forward while others look backward. Some use long term averages. This is precisely the reason we developed our own model almost 20 years ago. I tried to incorporate as many different approaches as I could and then weight them according to what worked best in predicting market behavior. There is no perfect valuation process, but this one has been a good guideline especially when it gets to extreme readings, which is where we are today. Our model shows the market to be 30% undervalued. The only times the model has been at these levels were in 1974 and 1985, just before significant market advances.

Investment Grade Bonds

The only bonds showing positive returns this year are Treasury bonds. All others including mortgage backed, municipal, corporate, and inflation protected bonds (TIPs) have negative total returns. This has been caused by fallout from the credit crisis including massive sales by hedge funds. At this point, we favor municipal bonds, which have yields greater than Treasuries. On a taxable equivalent basis there are yields of 7% or more. Certificates of deposit are also attractive now as banks are competing for deposits. Yields of 5% are available for 5 year maturities. We are cautious about the corporate market, but recently picked up some General Electric bonds with 7% or higher yields. GE has many problems, but is still one of the only AAA rated credits. Finally, we think TIPs are a good hedge against the possibility of inflation down the road. These are yielding 3% to 3.5%, and the inflation rate is added on top. So, for example, if inflation averages 3% you would receive 6% to 6.5%.

Generally, our confidence in investment grade corporate bonds has been shattered this year. Over the last 25 years there has been nothing like what we have witnessed in the last two months. Lehman Brothers was an A rated company and went bankrupt over night. Morgan Stanley bonds dropped by 50% in one week and recovered almost fully after the government's equity injection was announced. Other corporate bonds have dropped 40% to 50% in value. Going forward, we have doubts about whether we'll invest in individual corporate bonds. The increased yield does not appear to justify the risk. In the meantime, we're analyzing the bonds we have. Generally, we think the depressed prices are more a function of the dislocations in the market rather than a true indication of the likelihood of default; but these are uncertain times. As exhibited by Morgan Stanley and Goldman Sachs, if a financial company can re-organize as a bank they become more stable.

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CIT and GMAC are two companies working on this. We believe they are likely to accomplish some kind of re-organization that will improve their situations, so we do not believe it is wise to sell at these levels.

Dividend / Defensive Group:
This market decline has left nothing unscathed. As previously reported, our investments in what we believed were defensive preferred or high dividend paying companies has not protected us against significant declines, and in some cases bankruptcy. This has cut across all industries. Nonetheless, there are even more companies that now have high yields. We are focused on finding stocks with attractive yields for portfolios that will provide a high level of income as we await stability in the economy and the stock market.

Alternative Assets Group:
Again, this market decline has challenged all asset classes and strategies. This strategy, which held up beautifully in the 2000 – 2002 bear market, underperformed our expectations this year even though it has outperformed the market by about 50%. The market neutral and merger arbitrage strategies performed the best, and the commodity and high yield strategies performed the worst.

Model Equity: Every time we write a newsletter we get questions about why a client's portfolio differs from comments made here. The Model Equity Portfolio is a real account that we use to test our skills against the market and report our strategies and performance. However, because all our accounts are customized there will be stocks mentioned that will differ from individual portfolios.

The model equity account has outperformed the market by 4.8% this year, but is still down 28% through October. We have recently added positions in defensive stocks such as Walt Disney, McDonalds, and a number of healthcare companies such as Baxter, Covance, Teva, Thermo Fischer, and Johnson and Johnson. Healthcare is our largest allocation at 20%, industrials are second with 19%, and consumer staples are third with 13%. Our most significant underweight is financials with only 1.5% of the portfolio.

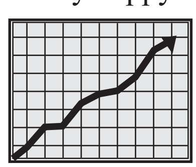
Foreign Equities and Fixed Income:
In July we commented we were concerned about Europe's slowing economy and Asia's rising inflation. In the first case, Europe is in fact falling into recession even faster than the U.S., and it could be worse there than here. In Asia, inflation is receding as a threat, but economic slowing cannot be avoided. They will still grow faster than the rest of the world, which remains an important investment theme. But, there has been no safe haven in foreign markets. In fact, the U.S. market has fallen considerably less than many countries around the world.

Longer term, we are still worried about the value of the dollar and it is inevitable that the U.S. will become a smaller piece of the global economic pie. But in the near term, we think U.S. stocks offer compelling value with less risk than foreign stocks or bonds so we are marginally reducing allocations.

Company News:
We've had one change in personnel recently. Stephanie Yuan has replaced Cresa Pugh as our receptionist. Cresa is now in Thailand working in a medical clinic. Stephanie is the new bright and shiny voice behind the phone and desk up front. She's a recent graduate of the University of Colorado.

As we previously announced, 2008 is our 20th anniversary. We thank those of you who provided names of people for us to contact and remind the rest of you we have received all our clients through referrals, and would be proud to help your friends, family, or associates. Like all businesses it is important for us to continue to grow so we can keep adding the resources to provide you the best possible service and performance. If you know of anyone who might be interested in our services, or simply receive our newsletter, please have them give us a call or check us out at www.sargentbickham.com.

Many happy returns,



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