

Financial Markets Commentary

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This report was written by Diana Joseph while at a prior firm.
Her viewpoint remains the same.

The Markets: December 31, 2008

FOURTH QUARTER, 2008 RETURNS

Investors entered the quarter hoping that things could not get any worse, but they did. The fourth quarter was a bloodbath for most any asset class. Fourth quarter equity losses in the U. S. exceeded 20%. Losses ranged from 30-40% on average across foreign bourses and oil, commodities, and real estate experienced declines ranging from 30-50%. In fact, the quarter accounted for at least fifty percent of the year's losses across a wide swath of investments including most U.S. and foreign equity strategies. Safe notes, bonds and cash provided an anchor to windward, again justifying their use in any rational asset allocation. Equities of all ilks plunged in October, tried to rally back in November only to plummet to a new low. The markets based and rallied into the quarter's close. Ultra safe notes and bonds generally performed inversely to equities. Forced selling across a number of cascading scenarios drove the action, in fits and starts, all year [Source: Barron's Lipper Mutual Fund Quarterly, IDC, MSCI Barra].

In the U.S. "value" marginally outperformed "growth" across market capitalizations while larger companies lost a little less than mid and small caps. Large cap value lost 21.72%, while large cap core was down 21.99% and large cap growth fell 23.25%. Midcap value fell 24.96% while midcap growth fell 26.97%. Small cap value and core fell 25.94% and 25.95% respectively, while small cap growth declined 26.59%. Internationally, the return spread was much tighter but value outperformed growth with core fluctuating around the middle. International large cap value fell 20.95% versus international large cap growth's 21.68% loss. International smid value declined 23.11% while international smid core lost 22.52% and international smid growth dropped 24.59%. Convertible arbitrage and distressed securities provided no relief, falling 38.11% and 24.28% respectively. High yield debt lost 18.31% in the quarter which return includes positive yields approaching 10% [Source: Barron's Lipper Mutual Fund Quarterly, IDC, MSCI Barra].

The Markets: December 31, 2008

FOURTH QUARTER, 2008 RETURNS (cont...)

Yes, Virginia there were some bright spots. Dedicated short funds appreciated 4.6 % in the quarter while U.S. Treasury securities appreciated substantially and in direct proportion to their maturity. Short U.S. Treasuries appreciated 2.94% while intermediate U.S. Government securities rose 4.58%, both far in excess of virtually nonexistent stated yields. Ditto for municipal securities as measured by benchmarks. The Barclays 5-year Municipal Bond Index climbed 3.93%.

A complete listing of quarter-to-date returns appears on page 4.

The Markets: December 31, 2008

QUARTER-TO-DATE RETURNS

Equity Indices – United States

| | |
|-----------------------------------|---------|
| Standard & Poor's 500 Index | -21.96% |
| Dow Jones Industrial Average | -18.39% |
| NASDAQ | -24.61% |
| Russell 2000 Growth Index | -27.45% |
| Russell 2000 Value Index | -24.89% |
| Russell 3000 Value Index | -22.41% |
| Lipper Small Cap Core Funds Index | -25.95% |

Equity Indices – Foreign

| | |
|---------------------------|---------|
| MSCI EAFE + Canada Index* | -21.53% |
| MSCI Emerging Markets | -27.94% |
| MSCI Europe | -23.22% |
| MSCI Latin America | -34.80% |
| MSCI BRIC | -30.63% |

Fixed Income Indices

| | |
|---|---------|
| Barclays Capital Intermed Gov/Cr Index | 4.84% |
| Barclays Capital 5-Year Muni Bond Index | 3.93% |
| Lipper Intermediate Muni Funds | 0.48% |
| Merrill Lynch Municipal 1-3 Year | 2.27% |
| Merrill Lynch Municipal 3-7 Year | 4.22% |
| Lipper High Yield Taxable Funds Index | -18.36% |

Dow Jones Hedge Fund Indices

| | |
|--------------------------|---------|
| Convertible Arbitrage | -38.11% |
| Distressed Securities | -24.28% |
| Equity Long/Short (U.S.) | -10.40% |
| Equity Market Neutral | -4.40% |
| Event Driven | -20.84% |
| Merger Arbitrage | -5.16% |

Other Indices

| | |
|-------------------------------------|---------|
| Dow Jones AIG Comm. Futures Index | -30.12% |
| Dow Jones AIG Petroleum Index | -56.19% |
| Dow Jones AIG Precious Metals Index | -1.66% |
| Lipper Real Estate Funds | -38.71% |

Source: MSCI Barra; IDC, Dow Jones, Bridge, Lipper, Bloomberg

* MSCI EAFE + Canada Index return does not include reinvested dividends.

The Markets: December 31, 2008

THE BACKDROP: PUNCH DRUNK

The unwinding of the great global leverage juggernaut proceeded apace. In January the Treasury extended 1.5 billion of TARP funds to Chrysler Financial and extended a loss-sharing agreement with Bank of America. By December the second tranche of TARP funds were needed and a 775 billion stimulus package had been proposed. In between the relentless drumbeat of novel rescue attempts and acronyms (TARP, TLGP, TALF) was heard. Each week another corporation, shopping center, or bank hit the skids or failed. Names such as AIG, Fannie Mae, Freddie Mac, all three U.S. automakers and General Growth Properties hit the skids. The numerous failures included American Home, Bear Stearns, Circuit City, Indymac Bank, Lehman Brothers, and Linens-N-Things.

Credit markets seized up and have not thawed much. Housing inventory continues to build as prices continue to fall. Leveraged global corporations are dying a little every day. The government temporarily guaranteed money market funds and commercial paper of those deemed too big to fail, temporarily boosted FDIC insurance limits and arranged shotgun weddings of financial institutions to themselves or to Uncle Sam. The Federal Reserve cut its key interest rate to a range of 0% - .25%. Global governments became serial announcers of novel rescue packages after dusting off and using most remedies relied upon in past financial crises to little avail. Bernie Madoff made Ponzi look like a piker and highlighted the benefits of due diligence and separation of custody and management of assets. Significant world events were dwarfed by the global progression of the deleveraging monster. Barack Obama was elected President of the United States. His message of cohesion appears genuine and injects rays of hope. Reappraisal of risk is no longer nascent and belated risk-awareness, basic risk/reward analyses, and forced liquidation continued to pressure valuations.

The Markets: December 31, 2008

FULL YEAR, 2008 RETURNS

It was a brutal market year, globally. According to Bloomberg T.V. roughly 29 trillion was lost across global markets in 2008. Only those with a diverse allocation which included safe notes/bonds, money markets and short positions and/or nimble strategists survived relatively unscathed as the asset deflation we have long predicted proceeded apace. The Standard & Poor's 500 skidded 37.03% and the Dow Jones Industrial Average plunged 40.54% which marked both indexes largest losses since 1931 [Source: IDC, The Wall Street Journal]. Peak to trough losses were greater. Volatility (as measured by the VIX and its predecessors) reached historic highs [Source: Stockval]. The dollar fell somewhat in the year's first half, but rallied in the second. Oil rose over 50% before falling to a 60% loss by year-end [Source: Stockval].

In the third quarter FMC I “anticipate[d] continued volatility in markets globally.” I said that “[w]e may also experience more fierce bear market rallies. However, it is doubtful that a new long-term bull market will begin in the near future.” This observation has proved correct. In the U.S. “value” and “core” strategies had almost identical returns across capitalizations and bested “growth”. Small caps lost the least. Large cap core and value shrank by 37.23% and 37.36% respectively while large cap growth plunged 40.70%. Midcap core and value both lost more than 38% while mid cap growth plummeted 44.49%. Small cap losses in all three styles ranged from 25.94% to 26.59% [Source: IDC, Barron's Lipper Mutual Fund Quarterly]. Foreign markets were routed. MSCI EAFE plus Canada fell 45.21%, emerging markets submerged 54.48% and the BRIC countries plunged 60.27%. Hedge fund strategies proved my oft repeated observation that they do not perform well in periods of macro distress. Convertible arbitrage fell 49.80% while distressed securities lost 37%. Equity market neutral and merger arbitrage did hold up well, falling only 8.33% and 7.73% respectively [Source: Stockval].

High yield debt fell over 18% as capital values fell and markets seized up. The Barclays Capital Intermediate Gov/Credit Index rose 5.08% as investors flocked to safety. Precious metals had a wild ride but closed the year down only 4.06% [Source: Stockval].

The Markets: December 31, 2008

YEAR-TO-DATE RETURNS

Equity Indices – United States

| | |
|-----------------------------------|---------|
| Standard & Poor's 500 Index | -37.03% |
| Dow Jones Industrial Average | -31.93% |
| NASDAQ | -40.54% |
| Russell 2000 Growth Index | -38.54% |
| Russell 2000 Value Index | -28.92% |
| Russell 3000 Value Index | -36.25% |
| Lipper Small Cap Core Funds Index | -36.21% |

Equity Indices – Foreign

| | |
|---------------------------|---------|
| MSCI EAFE + Canada Index* | -45.21% |
| MSCI Emerging Markets | -54.48% |
| MSCI Europe | -48.20% |
| MSCI Latin America | -52.78% |
| MSCI BRIC | -60.27% |

Fixed Income Indices

| | |
|---|---------|
| Barclays Capital Intermed Gov/Cr Index | 5.08% |
| Barclays Capital 5-Year Muni Bond Index | 5.78% |
| Lipper Intermediate Muni Funds | -1.31% |
| Merrill Lynch Municipal 1-3 Year | 5.16% |
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| Convertible Arbitrage | -49.80% |
| Distressed Securities | -37.00% |
| Equity Long/Short (U.S.) | -18.40% |
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| Merger Arbitrage | -7.73% |

Other Indices

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|-------------------------------------|---------|
| Dow Jones AIG Comm. Futures Index | -36.61% |
| Dow Jones AIG Petroleum Index | -53.67% |
| Dow Jones AIG Precious Metals Index | -4.06% |
| Lipper Real Estate Funds | -39.92% |

Source: MSCI Barra; IDC, Dow Jones, Bridge, Lipper, Bloomberg

* MSCI EAFE + Canada Index return does not include reinvested dividends.

The Year to in Review: 2008

HOW DID WE DO?

Our Forecasts

We did very well on the big things and pretty well on the small. The headings for various sections of the Fourth Quarter, 2007 FMC really said it all. “Spending, GDP and the Economy: The Consumer is Weary, Business is Wary and the Government is Too Late to the Rescue” was prescient and continues to express my view of the financial and economic times. Ditto for “Residential Real Estate-Still Sinking” and “Commercial Real Estate-The Boat is Listing”. I highlighted the importance of confidence to the effective functioning of our financial system under the title, “The Storm is Here”. “The financial system is based upon confidence, the dollar, after all, is a green piece of paper. We accept it has value so long as we are confident that it has value. Similarly transactions occur with ease in our global financial system because all players are confident of the contract, deal or trade being honored on the other side. Liquidity and transparency are prerequisites for the global economy. Both are in the nascent stages of reappraisal. In recent years irrationality has ruled as investors of all ilks traded off the chance of tiny return improvements for vastly greater amounts of risk. We are witnessing the shakeout of this unbridled confidence. Asset deflation will proceed, hopefully slowly.” [Fourth Quarter, 2007 FMC pg 17]. The lumbering tanker of mass psychology has finally begun to turn.

Our Strategies and Composites

The All Cap Value and Growth and Value Blend equity strategies trounced their benchmarks. The Diversifier outperformed its hedge fund benchmarks but underperformed Treasury bills + 3%. The Diversifier is a wonderful alternative to hedge funds as it features liquidity, transparency, and securities held in an individual’s own name.

Most client accounts were broadly diversified and had sizeable fixed income and money market positions which greatly aided performance.

The Year to come: 2009

Spending, GDP and the U.S. Economy

“It is certain that the United States leverage juggernaut is slowing. Any resurrection crafted through emergency measures will only postpone the inevitable and increase its magnitude. There is a 60% probability that we will see a recession within the next six quarters. Two quarters of negative GDP growth is unpleasant but, if it was the only large problem facing us, eminently surmountable. **Unfortunately, we see the convergence of several big cahunas which have the potential to prolong and deepen the pain.** Asset deflation, derivatives accidents, the great leverage unwind and burgeoning realization of counterparty risk are all wrapped up in one package.” This paragraph appeared in the Fourth Quarter, 2007 FMC – Look Ahead for 2008 [pg 11]. It was prescient. All of the big cahunas did converge and the financial system spiraled downward pausing sporadically to absorb creative rescue attempts. The maelstrom burst into the real economy this year. Economic growth slowed at an ever increasing pace but fell off a cliff in the fourth quarter [Source: Federal Reserve].

As well, asset deflation accelerated all year, culminating in a 15.3% decline in household net worth [Source: Barron’s]. 2.5 million jobs were lost in 2008, the most since 1945 [Source: Bureau of Labor Statistics (BLS), The Wall Street Journal]. The unemployment rate rose to 7.2% while involuntary part-time workers rose by over 3 million people in 2008, to 8.0 million [Source: BLS]. Moreover, continuing unemployment claims rose to 4.5 million the highest since December, 1982 [Source: Reuters]. The National Bureau of Economic Research’s Business Cycle Dating Committee announced in late November 2008 that recession began in the U.S. in December, 2007 [Source: Barron’s].

The Conference Board Consumer Confidence Index plunged to 38, a new all-time low, in December. The Present Situation Index fell to 29.4 from 42.3 in November [Source: The Conference Board]. Sara Lynn Franco, Director of the Conference Board Consumer Research center remarked that, “[T]he Confidence Index decline reflected the rapid and steep descent of economic conditions that occurred in the fourth quarter of 2008.” [Source: The Conference Board]. Sentiment usually leads spending. In the Second Quarter 2008 FMC we forecast that “consumer spending (this time) will... be an historical outlier and will actually decline” and that “[s]ince consumer spending is roughly 60% of the entire U.S. economy it is likely that if we are not already in a recession, we will be shortly.” [Source: Second Quarter 2008 FMC pg 9].

It is noteworthy that the Consumer Sentiment Index appears to be basing. The tricky question is what happens when basing sentiment meets a continuously deteriorating economic backdrop? Lower demand translates into slower buying. Industrial production fell at an 11.5% annualized rate in the fourth quarter [Source: Reuters]. Unfortunately, the confluence of wealth destruction, unemployment and uncertainty about the financial system seems destined to create a multi-year quagmire.

The Year to come: 2009

Spending, GDP and the U.S. Economy (cont...)

It is likely that GDP will contract more than 5% in the Fourth Quarter.

The situation is no better abroad. The World Bank is predicting a decline of 2.1% in global trade for 2009. This would mark the largest synchronized decline since World War II [Source: The Wall Street Journal]. New orders plunged to the lowest level in 60 years [Source: Institute for Supply Management, The Wall Street Journal]. Global economies will continue to slow for at least the next two years.

The Year to Come: 2009

A LOOK AHEAD

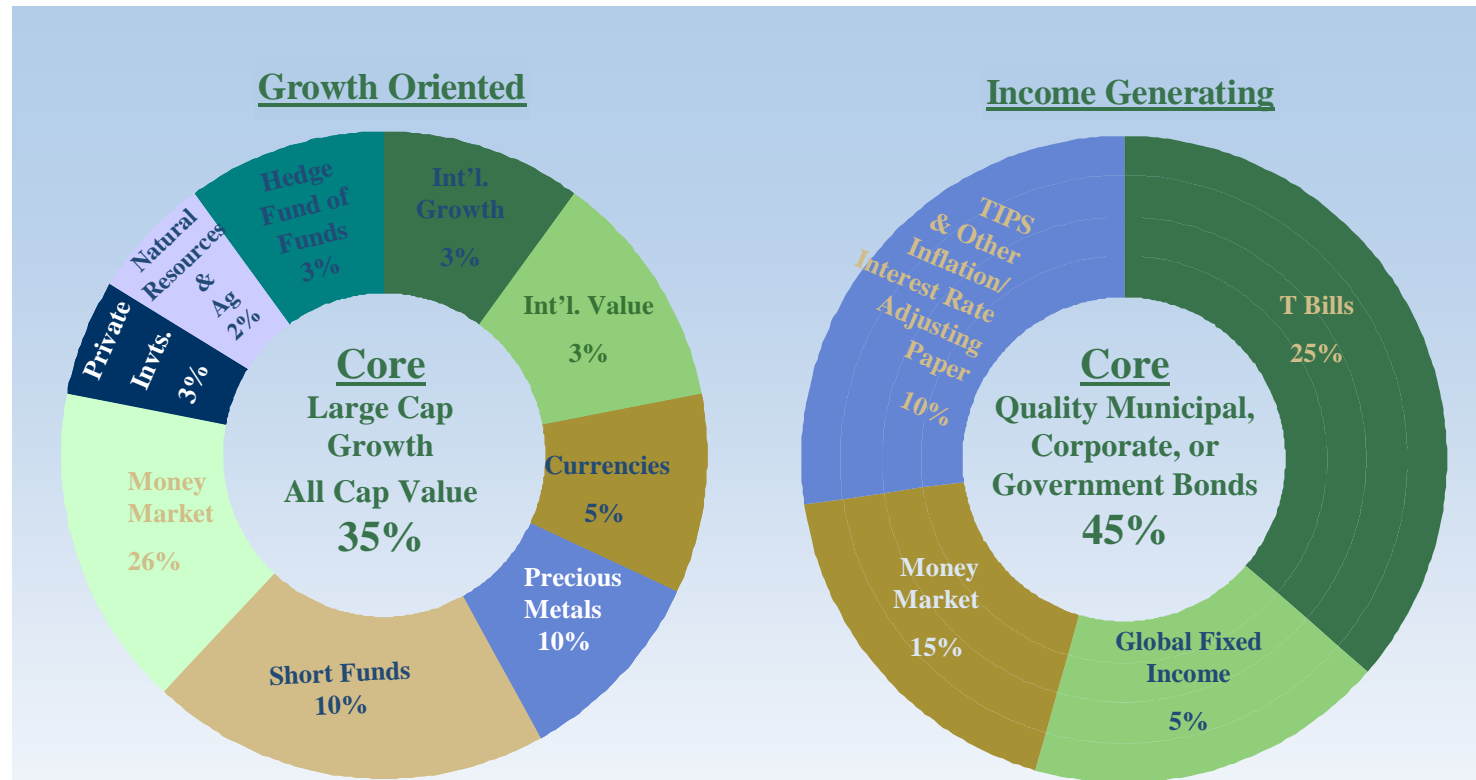
- Global economic growth will decline in a ragged fashion and remain subdued for at least several years. Massive amounts of stimulus may move the needle temporarily but will not stem the decline.
- Consumers worldwide will spend less on things they do not need and will save more. This will be economically painful but will build a sustainable foundation for the future.
- We will continue to focus on the return of money not the return on it, in core fixed income. Higher quality corporate and municipal paper have become tempting but we are only nibbling at this juncture. High yield paper will not be attractive until the pace of looming defaults slackens.
- Residential real estate will remain moribund for years. There are significant supply and demand imbalances which can only be eliminated by further price declines of 10-20% and time.
- Commercial real estate is destined for a prolonged slump because businesses everywhere are facing headwinds and reducing headcount.
- The dollar appreciated in 2008 as investors flocked to “quality”. The printing presses are running full bore in an attempt to pay for promised guarantees and stimulus designed to salvage the economy. However there is a risk that all of the other overleveraged, underfunded countries in the world will follow our lead resulting in competitive currency debasement. I favor holding a basket of non-U.S. currencies, some commodities and precious metals as a hedge.
- Precious metals are a finite resource. They must be taken from the ground. We have favored these positions for sometime, adding to or selling pieces opportunistically. We are inclined to add overtime in an attempt to hedge the dollar.

Conclusion

Once-in-a-lifetime opportunities are being created in a host of asset classes/investments. However, it is impossible to forecast when demand will exceed supply so as to elevate prices. Hence, the need to identify a catalyst for value realization before each purchase.

Asset Allocation

DIVERSIFIED ALLOCATION EXAMPLE December 31, 2008



These Asset Allocation Wheels are examples of allocations that may be appropriate for some investors. An investor's particular goals, circumstances, and risk tolerance will dictate the appropriate allocation for that investor. The Allocation Wheels are presented here only to reflect how diversification may look under a given set of circumstances. All investments have some risk. Some of these strategies have more risk than traditional investments.



Asset Class Returns

Twenty-Two Year View of Asset Class Returns

Annual Returns Relative to Key Indices (1987-2008) Ranked in Order of Performance (Best to Worst)

| 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Int'l Value | Small Cap Value | Large Cap Growth | Fixed Income | Small Cap Value | Small Cap Value | Int'l Value | Int'l Value | Large Cap Growth | Large Cap Growth | Large Cap Growth | Large Cap Growth | Small Cap Growth | Small Cap Value | Small Cap Value | Fixed Income | Small Cap Growth | Small Cap Value | Int'l Value | Small Cap Value | Large Cap Growth | Fixed Income |
| 24.63% | 29.47% | 36.40% | 8.96% | 51.19% | 29.14% | 32.56% | 7.78% | 38.13% | 23.98% | 36.52% | 42.15% | 43.09% | 22.83% | 14.03% | 10.26% | 48.53% | 22.25% | 13.50% | 23.48% | 11.81% | 5.24% |
| Large Cap Growth | Int'l Value | Large Cap Core | Large Cap Growth | Small Cap Value | Large Cap Value | Small Cap Value | Large Cap Growth | Large Cap Core | Large Cap Core | Large Cap Core | Large Cap Core | Large Cap Growth | Fixed Income | Fixed Income | Small Cap Value | Small Cap Value | Int'l Value | Large Cap Value | Int'l Value | Int'l Value | Small Cap Value |
| 6.50% | 28.27% | 31.69% | 0.20% | 41.70% | 10.53% | 23.84% | 3.13% | 37.58% | 22.96% | 33.36% | 28.58% | 28.25% | 11.63% | 8.44% | -11.43% | 46.02% | 20.69% | 7.10% | 23.47% | 8.62% | -28.92% |
| Large Cap Core | Large Cap Value | Large Cap Value | Large Cap Core | Large Cap Growth | Small Cap Growth | Large Cap Value | Large Cap Core | Large Cap Value | Large Cap Value | Small Cap Value | Int'l Value | Int'l Value | Large Cap Value | Small Cap Growth | Int'l Value | Int'l Value | Large Cap Value | Large Cap Growth | Large Cap Value | Small Cap Growth | Large Cap Value |
| 5.25% | 21.67% | 26.13% | -3.10% | 38.37% | 7.77% | 18.60% | 1.32% | 37.00% | 21.99% | 31.78% | 20.00% | 26.96% | 6.08% | -9.23% | -15.94% | 39.17% | 15.71% | 5.26% | 22.24% | 7.05% | -36.85% |
| Large Cap Value | Small Cap Value | Small Cap Value | Large Cap Value | Large Cap Core | Large Cap Core | Small Cap Growth | Large Cap Value | Small Cap Growth | Small Cap Value | Large Cap Value | Large Cap Value | Large Cap Core | Large Cap Core | Large Cap Core | Large Cap Value | Large Cap Value | Small Cap Value | Small Cap Value | Large Cap Core | Fixed Income | Large Cap Core |
| 3.68% | 20.37% | 20.17% | -6.85% | 30.47% | 7.62% | 13.36% | -0.63% | 31.04% | 21.37% | 29.99% | 14.68% | 21.04% | -9.11% | -11.71% | -20.85% | 31.77% | 14.31% | 4.71% | 15.77% | 6.97% | -37.03% |
| Fixed Income | Large Cap Core | Fixed Income | Small Cap Growth | Large Cap Value | Fixed Income | Large Cap Core | Small Cap Value | Small Cap Value | Small Cap Growth | Small Cap Growth | Fixed Income | Large Cap Value | Int'l Value | Large Cap Core | Large Cap Core | Large Cap Core | Large Cap Core | Small Cap Growth | Small Cap Growth | Large Cap Core | Large Cap Growth |
| 2.76% | 16.61% | 14.53% | -17.41% | 22.56% | 7.40% | 10.08% | -1.55% | 25.75% | 11.26% | 12.95% | 8.69% | 12.72% | -14.17% | -11.88% | -22.10% | 28.67% | 10.88% | 4.15% | 13.35% | 5.48% | -38.44% |
| Small Cap Value | Large Cap Growth | Small Cap Value | Small Cap Value | Fixed Income | Large Cap Growth | Fixed Income | Small Cap Growth | Fixed Income | Int'l Value | Fixed Income | Small Cap Growth | Fixed Income | Large Cap Growth | Large Cap Growth | Large Cap Growth | Large Cap Growth | Large Cap Growth | Large Cap Core | Large Cap Growth | Large Cap Value | Small Cap Growth |
| -7.11% | 11.95% | 12.43% | -21.77% | 16.00% | 5.07% | 9.75% | -2.43% | 18.47% | 6.05% | 9.65% | 1.23% | -0.82% | -22.08% | -12.73% | -23.59% | 25.65% | 6.13% | 4.88% | 9.07% | -0.17% | -38.54% |
| Small Cap Growth | Fixed Income | Int'l Value | Int'l Value | Int'l Value | Int'l Value | Large Cap Growth | Fixed Income | Int'l Value | Fixed Income | Int'l Value | Small Cap Value | Small Cap Value | Small Cap Value | Int'l Value | Small Cap Growth | Fixed Income | Fixed Income | Fixed Income | Fixed Income | Small Cap Value | Int'l Value |
| -10.48% | 7.89% | 10.54% | -23.45% | 12.13% | -12.17% | 1.68% | -2.92% | 11.21% | 3.63% | 1.78% | -6.45% | -1.49% | -22.43% | -21.44% | -30.26% | 4.11% | 4.33% | 2.43% | 4.33% | -9.78% | -43.38% |

Index Descriptions

The Lehman Aggregate Index is the Lehman Brothers Aggregate Bond Index, an unmanaged market-weighted index that consists of U.S. Government and agency securities, mortgage-backed securities issued by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association and investment-grade (rated BBB or better) corporate bonds, all of which will mature within 30 years.

The Morgan Stanley Capital International (MSCI) EAFE Index is an unmanaged index that measures the total returns of developed foreign stock markets in Europe, Asia, and the Far East.

The Russell 2000 Growth Index consists of those small-cap companies that have higher price-to-book ratios and higher forecasted growth value.

The Russell 2000 Value Index consists of those small-cap companies that have lower price-to-book ratios and lower forecasted growth values.

The S&P 500 Index is an unmanaged index that consists of the common stocks of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange.

The Russell 1000 Growth Index consists of companies that have higher price-to-book ratios and earnings potential.*

The Russell 1000 Value Index consists of companies that have lower price-to-book ratios and earnings potential.*

Source: IDC; Morgan Stanley; Russell; Standard & Poor's Corp.; Bloomberg

* As of 1/1/05, the Russell 1000 Growth and the Russell 1000 Value replaced the S&P/Barra Growth and the S&P/Barra Value respectively. Through 2004 on this chart, the S&P/Barra indices were used for Large Cap Growth and Large Cap Value.