Third Quarter 2008 Client Newsletter
Yanni & Associates Investment Advisors, LLC

Investment Review

The stock market (S&P 500) declined -8.37% for the quarter and -19.29% year-to-date. Perhaps as bad, the volatility has certainly continued in the markets particularly as we enter the fourth quarter. When the original "bailout package" failed to pass in the House, we witnessed the market collapse more than it fell the day after September 11th. Then, the following day saw the Dow Index, leap up approximately 500 points. Other quarterly returns can be summarized as follows:

S&P Midcap	-10.87%
S&P Smallcap	-8.32%
Morgan Stanley's EAFE (International Stocks)	-20.50%

Investment Forecast:

Economy – While not official yet, the economy is clearly in a recession. The unemployment rate for two of the past three months has risen slightly above expectations to a 6.1% rate. During the Great Depression, the unemployment rate was as high as 25%. Also during the Great Depression, housing defaults peaked around 50%. Today, we are no where near those levels and the home defaults are fairly regionalized. Currently, approximately one of six homeowners, who have not paid off their house, owe more on the mortgage than the house is currently worth. We do believe housing prices in many places will probably continue to decline. We also believe the United States is in much better position to handle this current credit & banking crisis and <u>will not be headed towards another depression</u>. Perhaps, in this order, the government (and markets) will need to figure out how to:

1. Unfreeze the credit markets for day-to-day lending for banks and businesses.
2. Properly value and deal with the complex mortgages / distressed securities that were bundled, sold, and re-sold to a variety of investors with many being banks.
3. Properly handle the mortgages on homes where that mortgage is now worth more than the home and / or where the homeowner is financially unable to pay that mortgage. The government will need to do this with the least amount of defaults or tax-payer damage.

We do believe it will take few weeks, not months for this credit crisis to unwind, but we believe that will be the first step towards market stability and economic recovery. Recently, a revised "bailout package" has been approved by Congress. We have been in favor of this Bill being passed by Congress as opposed to no-action being taken. However, we believe this Bill will not have an immediate correction for all of the housing-related issues nor have an immediate guaranteed turn-around effect on the markets. Upon implementation, we do believe it will also help the markets stabilize a bit with restoring investor confidence, but will mainly aid banking institutions. We are still a bit skeptical that this Bill will fully address homeowner issues as well as measures to handle future housing price declines. The government is also using many other creative mechanisms beyond this bailout package and interest rate reductions to aid in stabilization. It has unfortunately, been disconcerting that most of these non-traditional government interventions have thus far, not been successful.

Early into the fourth quarter, we have now witnessed the credit markets' freeze spill over internationally. As a result, the first few days of the fourth quarter have seen sizable declines in global stock markets. It is our opinion that foreign economies will lag in their turnaround, but eventually will also follow. Global coordinated government efforts to begin to unwind the credit crisis have already begun.

Equities – We are maintaining our underweight to equities due to the continued volatility in the markets. If personal risk tolerances and other circumstances permit, we are advising clients to maintain their current underweighted equity positions. Even in a positive scenario where the credit markets begin to restore themselves to normal fashion, we still believe the economy is poised for sluggish growth. Under that scenario, the stock market may bottom-out and start to rebound (certainly not fully recovering its losses immediately) followed by continued tremendous volatility as the government and markets continue to handle the other lingering issues listed above. Given the recent tremendous volatility, we are also advising clients with cash to remain patient and selective before committing it to new equity positions.

There have been a variety of portfolio changes during the third quarter that have included selling the Global Natural Resources Fund early in the third quarter. There have been signs that foreign economies are slowing more than the U.S. and thus, foreign demand for commodities will slow. Also as a result, we trimmed back on international stocks reversing our overweight for the past 15 months to now a slight underweight / neutral stance for international stocks. We have invested part of our remaining international exposure into a currency hedged international fund. Also, we purchased a Bullish Dollar ETF and early in the fourth quarter, we have purchased a Gold ETF as a recession hedge. While we still do anticipate volatility to continue well through the Presidential election and inauguration, we make note that from a timeline perspective we are at the average midpoint for past recessions (approximately 11 to 18 months).

Fixed Income – Early into the fourth quarter, the Federal Reserve has lowered both the Federal Fund’s target rate and discount rate by 0.5%. Many other foreign banks have also lowered interest rates. Last quarter, the “general consensus” was that the Federal Reserve would start raising rates around year-end. There has been a significant “flight-to-quality” as many investors have been allocating funds to short-term Treasuries. Within the last month, the demand for 30-day Treasury Bills has been so high that it’s recently pushed-down the yield from over 1.5% to less than 0.1%.

Our Actions and Recommendations Can Be Summarized As Follows:

- We continue to underweight stocks relative to bonds.
- We continue to overweight “growth” stocks relative to “value” stocks.
- We continue to overweight “mid / large” capitalization stocks relative to “small” capitalization stocks.
- We are now underweighted / neutral international stocks relative to domestic stocks.
- We continue to favor shorter maturity / duration fixed-income vehicles.
- We have invested smaller portions of our client portfolios into a variety of niche investments. Some of these niche ideas include Treasury Inflation Protected Bonds (TIPS), an exchange-traded fund (ETF) that invests in developing “clean technology”, pollution control, and energy & resource consumption, etc. . . , new recommendations including a hedged currency international fund, a Bullish Dollar ETF, and a Gold ETF (4Q08).

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