

ABSTRACT FROM TALK STRATEGY MEETING:

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The current financial crisis is one of confidence. There is a lack of confidence in the financial system, and over the last six weeks, panic and fear have ruled the day. The presentation is broken into 3-main components:

- The unwinding of the US Financial Crisis:
 - What is the cause?
 - Easy money policies of 12-15 years ago
 - Housing for everyone!
 - Leverage cuts both ways – entering a period of deleveraging
 - Seismic swings in the market have forced hedge funds to de-leverage assets, increasing market volatility.
 - All assets are de-levering
 - Stock and bond market experience in recent weeks, month, year and decade
 - Credit markets remain stressed
 - Comparison between 1929 and 2008
 - History isn't about to repeat itself
 - The fundamental difference between the Great Depression (1929) and today is enormous policy response. In 2008, the Government has basically said "We're willing to do anything and everything!"
- Unprecedented Government Policy Response:
 - Interest rate cuts, liquidity injections, coordinated central bank actions, fiscal stimulus, support for housing, intervention in stressed institutions (Bear Stearns, AIG, etc...)
 - Government purchases of commercial paper, direct equity investment in financial firms, FDIC insurance increases
 - \$700 billion asset purchase plan - Historically, Government intervention has generally been profitable, or of little to no cost to taxpayer.
- Future Outlook & Thoughts
 - What We Expect
 - Problems for the economy will take time to work through;
 - But stocks and markets can improve - even while economy is getting worse
 - Will the recovery look like a V, W, or U; we believe a U
 - U would indicate that when we find a bottom (maybe this past Friday), we'll bounce around the low for a little while before making a sizable rebound.
 - What We're Thinking Going Forward
 - US is ahead of Europe and developing economies in dealing with the crisis.
 - Accordingly, foreign stocks likely to be weaker for some time
 - Large cap domestic companies have foreign exposure, so bring weight of international stocks may be reduced
 - Dilemma: Large Cap stocks still cheap by historical standards
 - Keys to Improved Outlook
 - Oil continues to decline
 - Inflation slows significantly (may already be dead in the intermediate term)
 - European Central Bank needs to ease a LOT more

- Mortgage Rates need to decline further
- LIBOR + short lending rates decline – currently the biggest roadblock
- Continue coordinated policy response

Questions (asked by clients at meeting):

- What was the reason for Monday's (10/13/08) strong bounce?
 - Answer: Monday was probably NOT the start of a new bull market, but it may be sign that we reached a bottom on Friday as a deep oversold condition has been created by fear in September and early-October. Again, we expect that the stock market recovery will look more like a U, rather than an abrupt V shaped recovery.
- With all the government policy response, how much is an increasing deficit by our government raising the risk of our financial system / economy?
 - Answer: The ever-expanding deficit of the US is troubling; however in the short term, the massive stimulus is not increasing the risk of a government default, or posing an immediate threat to our country's welfare. The deficit, while largely expanded recently due to government intervention is still something like 5% of GDP (fairly insignificant). At some point though, the US will need to begin repaying its creditors abroad, and inflation is the long-term (very long-term) consequence/cost of this crisis and government intervention. We need to get back to the fundamentals of running a surplus during economic boom times, and a deficit only during economic slow-downs.
- How do the various entitlement programs (social Security, medicare, etc.) get paid for and what is the effect on the recovery?
 - Answer: There has been talk in recent years of the potential for insolvency of the various programs like social security, medicare, etc. Ultimately, we believe that the entitlement programs will remain viable, but probably through increased social security taxes and value-added taxes. In the next few years however, newly elected government officials (new President or congress) will find it difficult to raise or create new taxes given the wounded economy. Raising taxes in a weak economy is NOT a good recipe for recovery. At some point when the economy has significantly improved and recovered, higher taxes may be in the cards.

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