BEACON POINTE ADVISORS

BEACON POINTE RESEARCH

PEAKS AND VALLEYS

SEPTEMBER 2008

CONFIDENTIAL – PROPRIETARY

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Strength in Adversity

There is no reason to sell at the bottom. As I have stated in past market swoons: In order to get to the top of any mountain you must be prepared to walk through a few valleys along the way. This is the only way you can get to the next peak… The danger with running with the herd is that your ultimate destination is the slaughter house. I prefer to graze on the greener grass of strength in adversity. The market is setting up an enormous future opportunity. It's like a rubber band; the more we stretch it, the more powerful it will fly when released.

Chuck Carnevale, Great Companies, Inc.

Regardless of the market environment de jour, Beacon Pointe has always advocated a long-term investment perspective, portfolio diversification, and prudent manager selection with an emphasis on proven investment managers with intense focus on fundamental research and capital preservation. These guiding principles protect our clients' assets in tough market environments, and still allow client portfolios to capture the unique investment opportunities that invariably follow market bottoms.

We agree whole-heartedly with Mr. Chuck Carnevale (quoted above) – disciplined investors who remain committed to their long-term strategic asset allocations and are willing to ignore the noise and frenzy of "market valleys" are most likely to be rewarded by eventually reaching the "market peaks". Investing, as we were vividly reminded over the past year, is an emotional rollercoaster. None of us, given the choice, would like to lose money in our portfolios over a calendar year. At the same time, we also seek strong annualized returns over the long run.

As the following table shows, investors with low tolerance for risk typically have conservatively structured portfolios – they are not likely to experience negative returns in any single year and their long-term annual returns are on average 5%-6%. Many other investors, however, may gravitate to the "aggressive" portfolio structure, given its realized and expected return of 9%. However, such long-term returns come with at the price of higher risk – "aggressive" investors should be able to stomach negative annual returns (25% of the time based on the last 12 years) and as much as a 19% loss in a single year. For investors, discipline is the key requirement for reaching their long-term targets.

1996-2007	Conservative	Moderate	Aggressive
Average Annual Return	6.3%	8.2%	8.9%
Best Year	11.5%	22.0%	33.5%
Worst Year	1.5%	-8.5%	-19.0%
# of Negative Years	0 of 12	3 of 12	3 of 12
Long-Term Return Estimate	5.2%	7.4%	9.1%

Source: Charles Schwab & Co., Inc.

Recession/bear market talk has dominated media headlines over the past several months. The National Bureau of Economic Research has not made a pronouncement about a recession yet. Indeed, we won't know for a long time the official start and end dates of the recession. But the bear market is real and it seems to "spell" recession. We, therefore, assume that we are experiencing a recessionary bear market. Looking back at the past 60 years, bear markets appear to lead recessions by a few months. Stocks, as measured by the S&P 500 Index, lose 23% on average during these bear markets. More importantly, over the 12 months following the recessionary market trough, stocks have advanced, on average, by 33%.

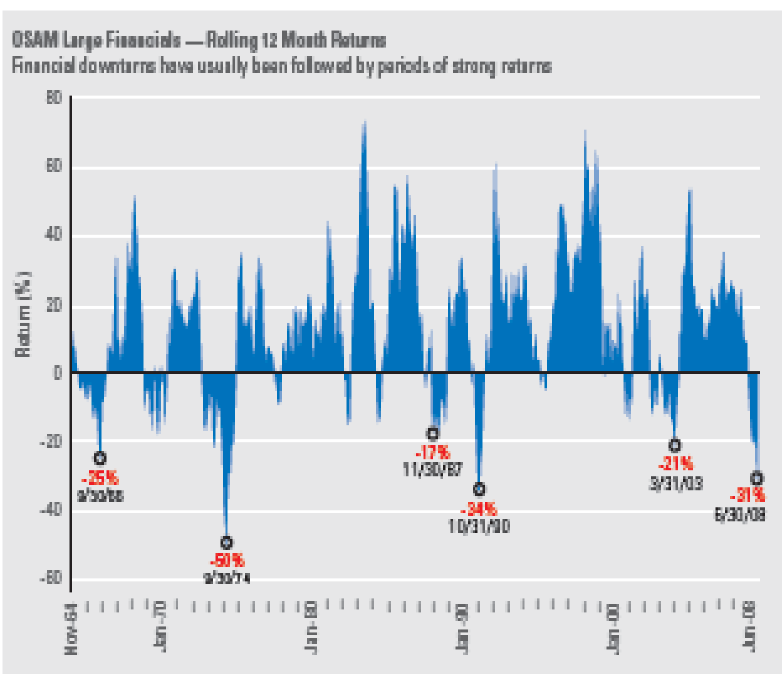
Markets always recover, but only those who stay invested benefit from the upturn.

US stock performance around recessions

Start	End	Months between market peak, and start of recession	Months between start of recession and market trough	Months between start of recession and earning trough	Starting PE Valuation	Peak to Trough Decline in S&P 500 (%)	S&P 500 12 Months After Recessionary Market Trough (%)
Q4 1948	Q4 1949	-4m	+9m	+12m	9	-15	25
Q2 1953	Q2 1954	-4m	+5m	+6m	11.1	-12	28
Q3 1957	Q2 1958	0m	+5m	+12m	13.8	-19	38
Q2 1960	Q1 1961	-7m	+3m	+12m	16.6	-11	29
Q4 1969	Q4 1970	-5m	+8m	+12m	17.7	-30	37
Q4 1973	Q1 1975	-10m	+11m	+21m	18.4	-46	32
Q1 1980	Q3 1980	0m	+2m	+12m	7.5	-7	33
Q3 1981	Q4 1982	-4m	+12m	+18m	9.3	-24	52
Q3 1990	Q1 1991	-1m	+3m	+15m	16.8	-16	29
Q1 2001	Q4 2001	-5m	+20m	+12m	29.2	-46	22
Average		-4m	+8m	+13m	14.9	-23	33
Average Ex-73,01		-3m	+6m	+12m	12.7	-17	34

Source: Morgan Creek Capital Management, LLC "Credit Crisis: What Inning Are We In?" (July 2008)

To further illustrate this point, we look at the battered financial services sector. At the epicenter of the current crisis, financial companies have seen their market capitalizations plummet and their survival called into question. Already the list of casualties is long – Bear Stearns, Lehman Brothers, IndyMac, Fannie Mae, Freddie Mac, and AIG, to name the largest. While there are more firms which may not survive, whether due to their excessive risk taking or a complete loss of confidence from investors, the financial sector as a whole is crucial to the U.S. economy; the strong players will come out even stronger on the other side of this crisis. They now have unprecedented opportunities to acquire rivals at bargain prices, to gain market share, and to benefit from stimulative economic policy in the form of excess liquidity and lower rates. Financial sector downturns are nothing new, as the following chart shows, and they are usually followed by periods of very strong returns.



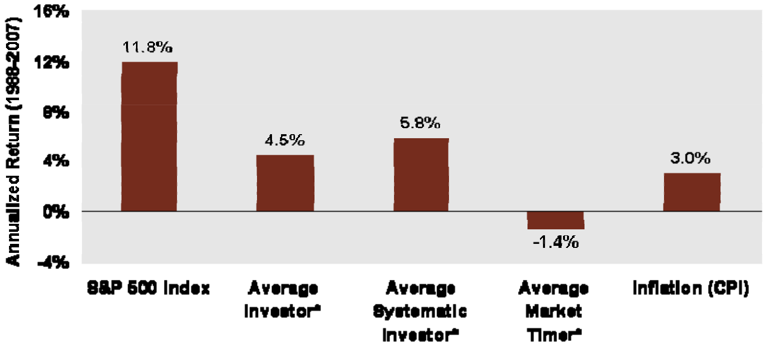
Large Cap Financials Worst Rolling 1-Year Returns (%)			
12 Months Ending	Return	Subsequent 1-Yr Return	Subsequent 3-Yr Return*
Sep-74	-49.98	30.07	20.73
Aug-74	-44.04	34.99	19.66
Jul-74	-38.06	27.83	15.32
Oct-74	-35.56	8.54	9.66
Oct-90	-34.33	60.71	32.28
Sep-90	-33.25	48.74	30.75
Jun-08	-31.09	--	--
Dec-74	-29.00	13.78	11.52
Nov-74	-28.45	15.8	12.18
Nov-90	-25.82	33.73	24.99
Sep-66	-24.99	33.44	17.64
Jun-74	-24.31	26.57	12.09
Aug-66	-22.98	27.26	17.03
Aug-90	-22.26	29.31	24.53
Nov-73	-21.56	-28.45	0.04
May-08	-21.45	--	--
Mar-03	-21.39	53.3	29.38
Dec-90	-21.33	45.07	24.72
Feb-75	-20.89	16.18	4.269
Jan-75	-20.41	12.8	4.51
Minimum	-49.98	8.54	9.66
Maximum	-25.82	60.71	32.28
Mean	-34.96	30.47	19.68
Median	-33.79	30.07	19.66

Source: OSAM Research, Compustat
*Subsequent three year returns are annualized.

Source: O'Shaughnessy Asset Management: Opportunities in Financials (July 2008)

Market Timing Doesn't Work

In theory, optimal returns could be achieved by investors who get out of the market at the top and reinvest in the market at the bottom. In practice, this is virtually impossible. Beacon Pointe has always believed that our clients should not attempt to time the market. Research from DALBAR, Inc. found that mutual fund investors, on average, generate returns that are less than half of the overall market, due to frequent trading and poor market timing decisions.



Source: DALBAR, Inc.

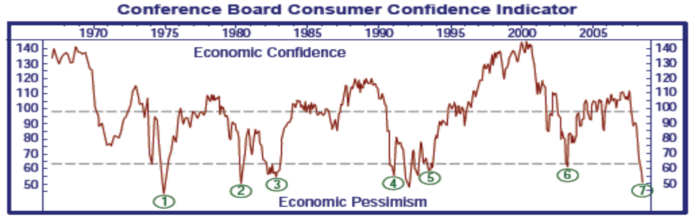
As we have pointed out in previous client letters, the market is a discount mechanism and a leading (not coincidental) indicator. If you are not invested, odds are that you will miss the bulk of the upward move that typically takes place well before the headlines turn positive and consensus turns bullish. We only have to look back to 2002-2003 for a reminder – investors who were scared by the challenging market of 2002 and chose to remain on the sidelines the following year, ended up missing out on spectacular and broad-based gains (with some asset classes advancing 40%+ in 2003). In that cycle, economic indicators did eventually confirm the turnaround, but by then the bull market was well on its way.

Stress and Pessimism Create Opportunities

Without the benefit of hindsight, no one really knows if the current episode in the crisis represents the trough (or final "valley") before the market begins its ascend to a new "peak". We do know, however, that many contrarian indicators are turning very positive. Valuations are attractive, investor sentiment is overwhelmingly negative, and consumer confidence is at record lows.

BULL MARKETS START WHEN CONFIDENCE IS LOW!

Conference Board Consumer Confidence Indicator

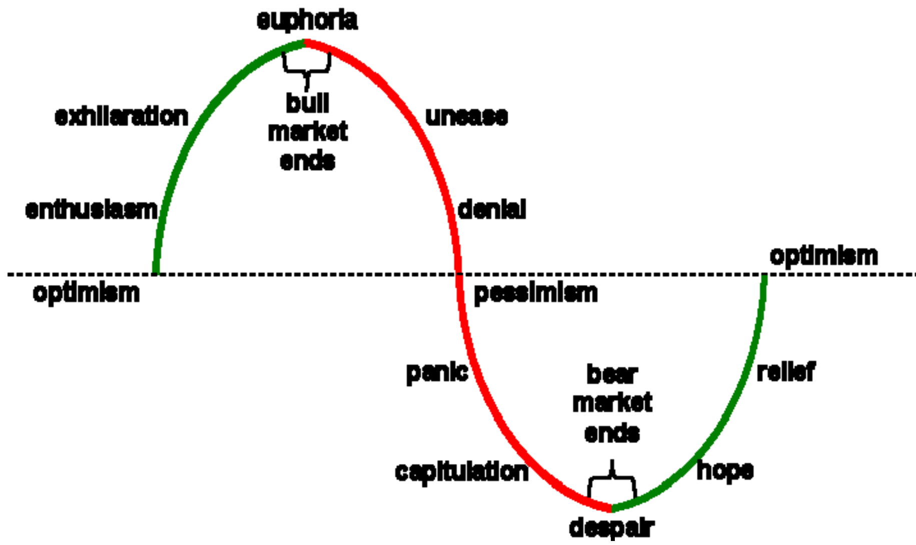


	Low Confidence Bull Market Start	Bull Market Length/Months	Dow Jones Average Percent Gains
1	1974	19	+75%
2	1980	13	+28%
3	1982	60	+250%
4	1990	45	+74%
5	1994	60	+158%
6	2002	60	+99%
7	2008	?	?

History Shows Buying When Consumer Confidence Is This Low – Significant Stock Market Profits Follow!

Source: Pring Turner Capital Group "Time To Be Optimistic" (July 17, 2008)

The chart above shows that, historically, low consumer confidence has coincided with the start of strong runs for equities. Of course, this is also the time when it is hardest for investors to stay the course. Investor psychology is prone to its own cyclical swings, often leading investors to sell or buy at (what later turns out to be) the worst possible time.



Source: Ms. Liz Ann Sonders, Chief Investment Strategist of Charles Schwab

In order to avoid bad decisions, investors should focus on the long-run, remain committed to their strategic asset allocations, maintain diversified and well-balanced portfolios, and let their experienced investment managers take advantage of the opportunities created by market dislocations.

Conclusion and Recommendation

Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria.
Sir John Templeton

Notwithstanding the increased volatility and negative returns experienced by investors in most asset classes and economic sectors, Beacon Pointe is confident that patience and discipline will reward our clients in the future. While the present unraveling of the housing and credit bubbles is painful, it is also healthy and necessary in order for the financial system to rebuild itself in a more prudent and efficient form. At the same time, pessimism and fear far outweigh fundamentals as market drivers, creating severe dislocations and an abundance of investment opportunities for the long-term investor. Beacon Pointe strongly believes that you should stay invested in order for your portfolio (and wealth) to benefit from these opportunities.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.