BEACON POINTE RESEARCH

BAILING OUT?

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CONFIDENTIAL – PROPRIETARY

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Bailing Out?

Our message to clients in these turbulent times is to stay focused on the long term and remain invested in the markets. We know it has been a painful experience and we are aware of all the fears and uncertainty out there. This has truly been an unprecedented period in the equity and credit markets, and it is possible that things will get worse before they get better. That being said, **now is not the time to panic**. We at Beacon Pointe see our role as: 1) to serve as a resource to you to answer any questions, provide information, and advise on specific issues; 2) to maintain a continuous dialogue with investment managers to monitor risks, exposures, and performance in client portfolios; and, **most importantly** 3) to enable clients to focus on their long-term goals, strategic allocations, and diversified portfolios. This is, after all, why clients hire Beacon Pointe – to keep them **prudently** invested in the market when it proves the most difficult.

In a recent letter to clients, Jim Rothenberg of Capital Group said: "The emotions of the moment always distract us from our purpose… **Staying on course is the right plan**… When the market is in turmoil, we think you turn to us not to do something different, but to do what we have always done: pay attention to risk, rely on a thorough and global research effort, and invest for the long term. Investing is always full of ups and downs, but over time, well-diversified portfolios managed by prudent organizations can provide the answers for the needs of many. We **need the courage to stay focused**, not solely on the markets, but on the research process that has been the backbone of our shareholders' success for decades." We at Beacon Pointe whole-heartedly agree.

Today the Dow fell below 10,000 for the first time since October of 2004. Major equity indices have lost over 30% since their October 2007 highs. In historical perspective, this indicates that we are likely closer to the end than the beginning of the bear market, as shown by the chart below:

B.I.G. Tips **10/3/08**

Bespoke Investment Group

The current bear market for the S&P 500 has now registered a decline of 29.31% over 356 calendar days. Since 1940, the average bear market has lasted 380 calendar days and declines 30.59%. So as far as bear markets go, we're currently just about inline with the historical average. While no bear market ever seems normal, after Monday it's hard to consider this bear anything even resembling normal.

Historical S&P 500 Bear Markets: 1940-Present

Bull/Bear	Start Date	End Date	Start Price	End Price	Decline	Days
Bear	1/2/1940	6/10/1940	12.63	8.99	-28.82%	160
Bear	11/7/1940	4/28/1942	11.39	7.47	-34.42%	537
Bear	5/29/1946	5/19/1947	19.25	13.77	-28.47%	355
Bear	6/15/1948	6/13/1949	17.06	13.55	-20.57%	363
Bear	8/2/1956	10/22/1957	49.74	38.98	-21.63%	446
Bear	12/12/1961	6/26/1962	72.64	52.32	-27.97%	196
Bear	2/9/1966	10/7/1966	94.06	73.20	-22.18%	240
Bear	11/29/1968	5/26/1970	108.37	69.29	-36.06%	543
Bear	1/11/1973	10/3/1974	120.24	62.28	-48.20%	630
Bear	11/28/1980	8/12/1982	140.52	102.42	-27.11%	622
Bear	8/25/1987	12/4/1987	336.77	223.92	-33.51%	101
Bear	3/24/2000	9/21/2001	1527.46	965.80	-36.77%	546
Bear	1/4/2002	7/23/2002	1172.51	797.70	-31.97%	200
				Average	**-30.59%**	**380**
Current Bear						
Bear	10/9/2007	9/29/2008	1565.15	1106.42	-29.31%	356

Credit markets are practically frozen. LIBOR spreads show that banks are unwilling to lend. Small businesses, large corporations, and municipalities in the U.S. are having trouble securing short-term financing. The global financial system is deleveraging. Fears abound about risks to global economic growth, credit creation (the lifeblood of free economies), and the stability of corporate earnings. On a daily basis, print and broadcast media bombard us with news, rumors, and speculation by pundits who paint a Depression-like scenario. It's easy to get scared.

However, 2008 is not 1929. Eighty years ago, the U.S. government was in a tightening mode and had no interest in supporting the orderly functioning of the financial system and limiting systemic risk. Today, the Fed and the Treasury are clearly committed to do whatever is necessary to prevent collapse and a repeat of the infamous Depression. The proof is in the Fed's aggressive rate-cutting over the past year; in the numerous and unprecedented liquidity enhancing facilities; in the government's involvement with a number of troubled entities (Bear Stearns, AIG, Fannie Mae, Freddie Mac, Wachovia, etc.); and with the passage of the fiscal stimulus earlier in the year and the Troubled Asset Relief Program (TARP) bill last week. This policy response is swift, decisive, and unprecedented. The last initiative, in particular, should be a game-changer for the U.S. financial system. We expect to see some early results over the next couple of months – as banks are able to unload some of the most toxic assets off of their balance sheets, they should be in a position to start lending again. The benefits should be seen in both more orderly credit markets, and more clarity in equity markets with regards to book values, earnings power, and valuations.

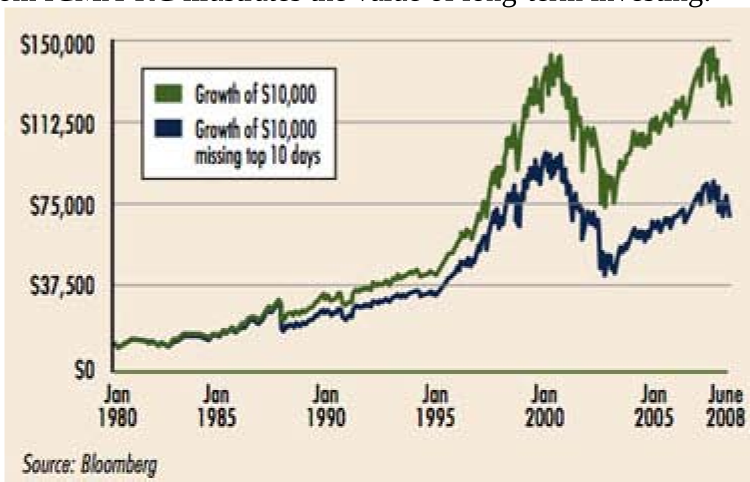
Beacon Pointe has heard from many of the investment managers we respect and work with that valuations are indeed attractive. Inflation fears have subsided and input cost pressures are less of a worry going forward. The dollar continues to strengthen and many corporations are still growing their earnings on a year-over-year basis.

We also believe that many of the conditions for a market bottom are already present. John Pritchard, CFA, of Knightsbridge Asset Managements points these out:

- Greatly increased stock market volatility (the VIX reading is up to levels seen only four other times during the last 10+ years, a level from which forward returns averaged 15% over three months and 20% over six months);
- Capitulation that is typically necessary before a bear market ends (the S&P 500 decline of 8.8% on September 29th was the ninth largest one-day decline on record and other than October 1987; one has to go back to the 1920s-1940s to see the other seven biggest one-day declines);
- Cash on the sidelines (cash as a percent of the market is elevated to the point last seen at the March 2003 market bottom);
- Compelling valuation (stock earnings yield exceeds bond yield by a wide margin and, measured by a number of valuation metrics – revenue, cash flow, book, earnings, etc. – the market is as cheap as it has been in at least ten years); and
- Sentiment (consumer and investor pessimism are at extremes that historically have delivered above average forward stock market returns).

While no two bear markets are alike – and the contemporaneous one looks and feels different from the ones we have experienced before – historically, the point of maximum uncertainty and fear tends to mark the market bottom. We do not claim to call the bottom here today (in fact, we have always said that timing the market doesn't work), but we strongly feel that clients should not be "bailing out" now. Rebounds following major market bottoms often are steep and significant and missing them would impair investors' long-term return potential.

The following chart from ICMA-RC illustrates the value of long-term investing:



The value of long-term investing is an important principle to remember as volatility impacts the market. Although the value of stocks may change suddenly, consider your portfolio and how it relates to your goals before making any changes. Decisions based on short-term performance, or in an attempt to time the market, could backfire… If $10,000 had been invested in the Standard & Poor's 500-stock index on January 1, 1980, it would be worth $121,029 on June 30, 2008. If the same investment missed the ten best-performing days, it would be worth $70,745. Missing the ten best days out of 7,192 days would slash your total return by 42 percent.

The investment managers in our universe are finding many opportunities among the ruins of the past few weeks. If they had cash right now, the overwhelming majority of them would choose to deploy it in the markets. The "worst days" we experienced in September and so far in October represent serious challenges for clients and investment managers alike, but these days are already in the past. Looking ahead, we know that the U.S. economy and markets will survive, that a bull market will follow the current bear, and that investors who persevered and remained patient will benefit from the "best days" to come.

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