MARKET COMMENTARY

Maintaining Perspective: Guiding you through the crisis

September 19, 2008

During the past two weeks both international and domestic markets have been overwhelmed with a crisis of confidence related to the widespread exposure of financial institutions to securitized mortgage backed investments and other collateralized debt obligations. As the stress on the credit markets increased, the illiquidity of most financial securities grew to the point where the availability of capital in the broad markets diminished and all forms of fixed income instruments sold off due to market participants fleeing to the safety of the US Government and Treasury market. This rush to the Treasury market was so intense at one point on Thursday that short-term treasury bills were paying 0% interest and still receiving additional funds.

Fundamental events during the past week only increased the environment of fear and panic as Lehman Brothers went into bankruptcy on September 15th, Merrill Lynch was forced into a marriage with Bank of America on September 15th, and American International Group was effectively taken over by the government in exchange for an $85 billion two-year bridge loan on September 16th. At the same time the credit rating agencies were creating very strict timetables with few options that would force numerous other financial companies into credit downgrades based on continued illiquidity.

On September 19th, the Federal Reserve and the Treasury Department, in conjunction with the leaders of Congress, put forth a comprehensive program to remove much of the toxic debt instruments from the balance sheet of major financial companies, add major liquidity to the market, support money market net asset values over the near term, and end the use of short selling aimed at the financial industry for the next ten days in order to buy time for the development of the final package.

The unprecedented volatility that has been created by the wave of risk and fear that has overtaken the financial markets is part of a de-leveraging process following the excessive use of debt that has been created within the mortgage related securities market over the past six years. The process is likely to continue to be messy as this de-leveraging continues in the months ahead.

When we step back and look at the current economic environment, it is our consideration that the current government proposals will, in fact, create a return to moderate financial liquidity and allow the financial industry time to gradually work through their remaining cash flow issues. Although the environment that has been created has increased economic risks going forward, it should be understood that the general equities market is typically viewed as a discounting mechanism and its valuation is normally driven by what is perceived to be the outlook six to nine months out as opposed to current headlines. The actions that have taken place today are expected to significantly improve the financial health of the country one year out and should therefore have a gradual positive effect on overall valuation levels following the initial bounce.

At the market close on Wednesday, the S&P 500 was valued at 1,156, off over 21% for the year-to-date and 25% from 2007 highs. At that level, the general market was valued at 13 times estimated normalized earnings for 2009. All major international stock markets are now officially in bear market territory — defined as a decline of over 20% — and are now in a position to register a significant rally. While the markets continue to be viewed as volatile over the near term, portfolio performance will depend on broad diversification among high quality companies purchased at attractive valuations so that the longer term growth potential of the portfolio is maintained even during unprecedented negative economic pressures. Several individual issues have clearly been a disappointment during this period of stress, but the overall portfolio performance has been very credible in relation to the general market averages and appreciation potential of the equity portfolios currently is viewed as material over the next six to twelve months.

S&P500 Index - 1,230

20 North Waterloo Road Devon , Pennsylvania 19333 *p* 610.975.9700 *f* 610.975.0050 www.davidsontrustcompany.com

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