MARKET COMMENTARY

Maintaining Perspective: Committed to the Long-Term

September 29, 2008

During the past month, the market has 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. The environment of fear and investor panic has only been magnified by the bankruptcy of Lehman Brothers, as well as the forced combination of Merrill Lynch into Bank of America and Wachovia Bank into Citigroup. On September 19th the Federal Reserve Bank and the Treasury Department, in conjunction with members of congress, put forth a $700 billion comprehensive program to remove much of the toxic debt instruments from the balance sheets of major financial companies, add significant liquidity to the market, and support money fund net asset values over the near term.

While this bill has been expanded and negotiated over the past ten days, investor expectations had been that the final draft would be approved this week and serve to lessen the dangerous lack of liquidity that is currently hobbling the financial markets. The House of Representatives voted down the bill on September 29th based on partisan disagreement over the specific issues contained in the legislation. The defeat of this $700 billion refinancing bill has shocked the financial markets and resulted in a 106 point decline of the S&P 500, representing the largest one day market decline in the over eight years. The real pressure is being felt by the credit markets, with short-term Treasury securities yielding less than 30 basis points in the market. This is an unprecedented flight to quality and indicative of the fear present among investors.

> "*...focused on high quality, best-of-breed companies that have market position and balance sheet strength to work through periods of economic weakness…*"

In assessing the current environment it is our view that the "Troubled Asset Relief Program" will be passed in a modified version at some point this week. The eventual passage of this legislation, following additional debate and negotiation, should in fact facilitate a return to moderate financial liquidity and allow the financial sector time to gradually work though the remaining cash flow issues.

While the economic and financial market uncertainty remains historically high, it should be of some comfort that Davidson Trust Company's portfolios have largely shown positive relative performance during these periods of high risk. Davidson Trust Company has historically focused on high quality, best-of-breed companies that have the market position and balance sheet strength to work through these periods of economic weakness and build on their longer-term fundamental records. While several individual stocks have clearly been a disappointment during this rapid economic deterioration, the overall portfolios have recorded very credible performance in relation to the general market averages and diversification has limited specific risks during the decline. It is our view that this current period of market volatility and investor concern should not be used as a rationale for lessening your normal asset allocation but rather a time to remain committed to the longer-term focus.

During the current period of market weakness and extreme investor uncertainty, the application of historic perspective may bring some increased comfort to the equity investor. While current economic trends don't necessarily signal a recession, the risk of one occurring shouldn't be ruled out given the cross currents of financial pressure and high energy prices. Since the end of World War II there have been ten recessions. While earnings pressure was present in all of them, the market tends to discount the economic weakness once it has been recognized. The general equity market, as measured by the S&P 500, typically shows a significant market value rise following the market lows within each cycle in anticipation of the eventual recovery. Six months after recording the stock market low in the cycle, the market has risen by an average increase of 24%. One year after the low point within the market, the S&P 500 has risen by an average gain of 32%.

S&P500 Index - 1,106

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