DAVIDSON TRUST COMPANY

QUARTERLY REVIEW

WINTER 2008

ECONOMIC OUTLOOK

The sharp increase in general market volatility experienced since mid 2007 that was triggered by the deterioration in the sub-prime mortgage area is expected to moderate gradually throughout 2008. Though the magnitude of the problem has largely been identified, it will take the next year for the peak level of adjustable rate mortgage resets to cycle through the mortgage market and time will also be required to recycle much of the short-term mortgage backed security debt. The Federal Reserve's decisive actions in cutting the Discount Rate and the Federal Funds Rate over the past four months has gone a long way toward restoring liquidity to the financial system and should allow the financial markets to gradually absorb the near-term damage.

IT IS ESTIMATED THAT THERE IS AN ADDITIONAL $1.2 TRILLION IN ADJUSTABLE RATE MORTGAGES DUE TO RESET OVER THE NEXT YEAR AND IN SPITE OF THE GOVERNMENTAL PROGRAMS ANNOUNCED TO DATE, THIS TREND SHOULD PLACE A DAMPENING EFFECT ON BOTH CONSUMER SPENDING AND CONFIDENCE AS WE MOVE THROUGH THE YEAR.

Although the recent economic pressure created by the sub-prime mortgage area has slowed economic growth temporarily, it is currently not viewed as serious enough to push the economy into a recession. The net impact of the recent financial pressure is more likely to move the economy into a mid-cycle slowdown that should be relatively temporary in nature. Estimated Real GDP growth for 2007 is likely to be in the area of 2.2%. While the rate of gain is down significantly from the 3.3% growth experienced in 2006, the positive gain is viewed as healthy given the magnitude of the sub-prime shock and the maturity of this economic cycle that is currently in its seventh year. Real Consumer Spending should average 2.1% for the full year, Governmental Spending is expected to be in the area of 2.3%, and Corporate Spending should continue to grow at a rate of close to 3%.

During the first half of 2008, the continued financial uncertainty and consumer caution, coupled with a decline in residential construction activity and slowing corporate business investment spending, should result in lackluster GDP gains in the area of 1.5%. These near term pressures should gradually be overcome by a number of continuing positive trends. Interest rates remain relatively low on both a real and nominal basis and the Federal Reserve Bank is continuing to provide a high level of liquidity within the system. Unemployment rates remain at relatively low levels and real wages have shown positive growth over the past year. The domestic economy is slowing while our major international trading partners are growing at a faster pace and the dollar's decline should result in continued economic growth from increased export demand. Economic growth should recover during the second half of the year with full year 2008 Real GDP gains expected to be in the area of 2.4%. Consumer Spending is expected to grow at a rate of 2.3% and Corporate Investment Spending should increase by 2.7%. Governmental Spending is likely to increase at a rate of 2.5% as investments in improved infrastructure continue and politicians on both sides of the isle play to the wishes of their constituents prior to the fall elections.

OUR THOUGHTS ON

The Housing Bubble

In the third quarter of 2007 Real Gross Domestic Product, which is the output of goods and services produced by labor and property in the United States, grew at an annual rate of 4.9% after having grown at a rate of 3.8% in the second quarter. Much of this growth was due to a large increase in exports. The sunny third quarter GDP report described exports rising by 16% on an annual basis with exported goods up 23%. While there are many monetary, economic, and political factors that impact exports the key factor was the cheaper U.S. dollar. Since the end of 2005 the Euro has appreciated against the U.S. dollar by over 20% while the Chinese Yuan has increased in value 10%. The falling dollar has clearly been good news for both U.S. exporters and for U.S. manufacturers that compete against imported products. At this moment we see no reason why this good news won't continue through 2008.

ACCORDING TO THE BUREAU OF ECONOMIC ANALYSIS THIRD QUARTER REPORT THE 4.9% INCREASE IN GDP:

"…primarily reflected positive contributions from exports, personal consumption expenditures (PCE), private inventory investment, nonresidential structures, federal government spending, equipment and software, and state and local government spending that were partly offset by a negative contribution from residential fixed investment. Imports, which are a subtraction in the calculation of GDP, increased."

There are two key points in this paragraph; first, residential fixed investment did detract from economic growth which has been difficult to ignore given the media's current obsession with housing. Second, the additional surge that exports provided was enough for the third quarter GDP number to still be at an unusually high level in spite of the deflating housing bubble. In 2008, we believe that rising exports will become an increasingly important story as the weaker dollar continues to create marketing opportunities both abroad and domestically. We believe that exports/imports could add 1.25% to GDP growth in 2008.

Housing still accounts for approximately 16% of GDP. That 16% is further broken down into Residential Fixed Investment 5% and Housing Services 11%. By our estimates residential real estate prices across the country could decline another 15% over the next three years back to 2004 levels with formerly hot real estate markets continuing to suffer and less speculative markets seeing less contraction. Although housing services through rent equivalents will feel most of the effect (but not all) of bubble deflation, the more direct impact from falling home prices will be felt in residential fixed investment where lower prices, fewer new homes, and falling turnover will be a drag on growth. This detraction should be approximately 1% in 2008 with most in the first half of the year. In the long run we don't foresee persistent price declines as we forecast that rising wages and stable real estate prices will, over time, bring home prices back into balance with personal income.

In summary, we expect that the economic benefit from rising exports, a direct result of a more competitive dollar, will allow the United States to survive the deflating housing bubble. And the recent run-up and fall in home prices will in the long run be yet another example of a too-good-to-be-true market reverting back to its mean.

EQUITY MARKET

During the next few months, while the magnitude and final parameters of the sub-prime problem are identified and discounted, the investment community is likely to spend more of its time focusing on the escalating political rhetoric as we approach the November Presidential elections. While this refocus on the changing political landscape will result in a new array of economic uncertainties and financial risks, the market has shown over time that it has the ability to adjust to these new variables.

During the past four years, the market has been able to adapt to a number of financial, economic and geopolitical concerns. The economy has been sufficiently strong and diversified to maintain its positive economic growth through each of these events despite that many of the issues were troubling over the short-term. During this same period, the underlying earnings power of the general market averages, as measured by the S&P 500, has grown by more than three fold.

Based on current consensus earnings, the equity market, as measured by the S&P 500, is being valued at 15 times estimated 2008 earnings of $93. This valuation level, while no longer historically inexpensive, is in line with past market average valuation levels and in our view remains an attractive entry point for those investors willing to look beyond the current period of uncertainty to the longer term potential that exists within a well diversified investment portfolio.

FIXED INCOME MARKET

Like the scales of justice, the Federal Reserve is playing a delicate balancing act. They are balancing between dropping rates to add liquidity and confidence to the financial markets, and holding or raising rates because of concerns of impending inflation.

For years we have exported our inflation to countries like China and India in the form of job creation for them and loss of jobs in the US (Americans seeking the least expensive goods and services). Now that their wages and costs of living are increasing, their disposable income is climbing, and their GDP has out paced that of the US for several years, our exported inflation is due to return. Perhaps you have noticed an increase in energy prices, imported goods, and groceries? We are a global economy no longer standing alone and neither are our interest rates and liquidity needs.

The housing market concerns have made their way throughout the globe. As our overnight lending rates have fallen, one by one our trade partners are following suit with their rates. The Federal Reserve is currently working in a global forum with multiple countries to provide adequate liquidity so banks will not shrink away from lending funds and will, hopefully, increase their lending programs to keep all economies stable.

So where do we see fixed income rates for the near term? It's a mixed bag. As sub-prime and liquidity concerns continue to hit the headlines, corporate spreads are widening vs. Treasury securities, followed by agency spreads and munis. Yes, you read that correctly. Right now a two year municipal security can be purchased at a rate of 3.05%, while a Treasury of the same maturity is available at 3.02%. The municipal security is indeed cheaper than the Treasury and carries a tax exempt status. Needless to say, we continue to be heavy buyers of municipal bonds. The question is, how long will this scenario continue?

THE "RISK" IN THE MARKET IS MOSTLY PERCEIVED RISK. The credit ratings and our opinions regarding those securities have not changed fundamentally. There exists a global flight to quality and regardless of what anyone says, when the global economic chips are down, everyone runs to US Treasury securities and the US dollar as a safe haven. Treasury securities have been the big performers the past few months, becoming more expensive with every headline.

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Sub-prime is not the only psychological risk out there. The unrest in the Middle East could raise greater concerns again. Oil hit $100 a barrel recently. Economic releases around the globe are evidence of a slowdown. Point being…the U.S. Federal Reserve and our legislators cannot control the world, but they are striving to make a global effort to benefit all.

The way the Street reads current market conditions, the Federal Reserve is likely to drop rates 25 basis points at the next two meetings. It is not likely they will make the same mistake twice, dropping rates too low and too quickly without a pause in mid 2008, resuming their attention toward looming inflation concerns the latter half of this year. We continue to buy on a relative value basis, reviewing credit strength and following trading patterns to benefit all of our clients' objectives.

AT THE FIRM

WITH THE TURN OF THE CALENDAR IT IS AN EXCITING TIME FOR DAVIDSON TRUST COMPANY!

We are very excited to begin 2008 implementing the business succession plan that began well over five years ago when the management team of the company was expanded. As we announced on December 11, we entered into an agreement to sell a majority stake in Davidson Trust Company to a non-affiliated investor, Boston Private Financial Holdings ("Boston Private"). Boston Private is a Boston-based holding company which has acquired interests in a number of banks and trust companies, money management firms, and financial planning firms, all of which cater to the high net worth investor market. The firm and its affiliates share a reputation for outstanding service and performance offered to affluent and institutional investors. They will allow us to operate independently, but with the benefit of their collective knowledge and resources. We anticipate completing the transaction during the first quarter of 2008 subject to the necessary regulatory approvals. We expect the transition to be uneventful and seamless. As a long-term partner with substantial name recognition and resources, we know we are positioning the firm for long-term continued growth.

It is with great anticipation that we welcome Al Clay, the former Chief Executive Officer of Pitcairn Trust Company, as Chief Executive Officer of Davidson Trust Company. This decision was made with the interests of our valued clients first and foremost, and the governing principle of our decision to add a new partner is in the best interests of our clients, our loyal associates, our culture, and our independence as investment managers.

Jim Davidson will remain as Chairman of the Board with an ownership interest and will be involved with the company on a daily basis. Our entire team will be continuing with the firm in their same roles. Our colleagues with whom you work will not change, nor will the quality and level of our services to you.

As always, we encourage you to call us so that we may address any questions or concerns you may have. It is our promise that we will continue to run the company as it has been run for the last 34 years and look forward to our continued relationship with all of our clients and friends. We wish you and your families much health and prosperity throughout the coming year!

Davidson Quarterly Review is a publication of Davidson Trust Company.

DAVIDSON TRUST COMPANY

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