



Fourth Quarter, 2008 Commentary Global Equity Growth (ADR)

Market Commentary

The worldwide economic financial crisis reached a crescendo in the fourth quarter, leading world equity markets to multi-year lows and raising questions about what 2009 will bring. A dismal fourth quarter led U.S. equities to their worst yearly loss since 1937. Despite a year-end rally, the S&P500 declined 22.0% in the fourth quarter bringing the full year 2008 return to negative 37.0%.

International equity markets also fell sharply, and weak foreign currencies made the results worse when translated to dollars. The MSCI EAFE Index declined 20.0% for the fourth quarter and 43.4% for the year. Government bond prices rose and yields fell to record lows as investors sought safety, but corporate interest rates stayed elevated on fears of deteriorating credit quality.

Economy

Economic indicators, which were already bad, uniformly plunged in the fourth quarter as the economic crisis intensified. Despite unprecedented liquidity measures from the U.S. Federal Reserve (Fed) and injection of federal monies into the banks by the Treasury, data took a turn for the worse during the quarter. GDP for the third quarter declined 0.5%, and many economists forecast a sharper decline for the fourth quarter. The unemployment rate rose to 6.7% in November and the employment trends are still negative. Sales of autos dropped sharply and the President approved emergency loans to the auto companies to keep them afloat. Housing continued to be weak. One bright spot was that energy prices continued to decline in the quarter yet consumers did not spend the savings despite record discounts by retailers during the holiday season.

The credit crunch appears to be hitting manufacturing particularly hard. Purchasing manager surveys indicated record declines in activity in December; exports have transformed from a bright spot earlier in the year to a detractor as foreign economies have succumbed to the crisis symptoms. At quarter-end the new Obama administration promised a strong fiscal stimulus package, perhaps as much as \$1 trillion, to stimulate the U.S. economy. While we believe these stimulus measures will mitigate the downturn, most indicators imply the U.S. is in for a rough year economically.

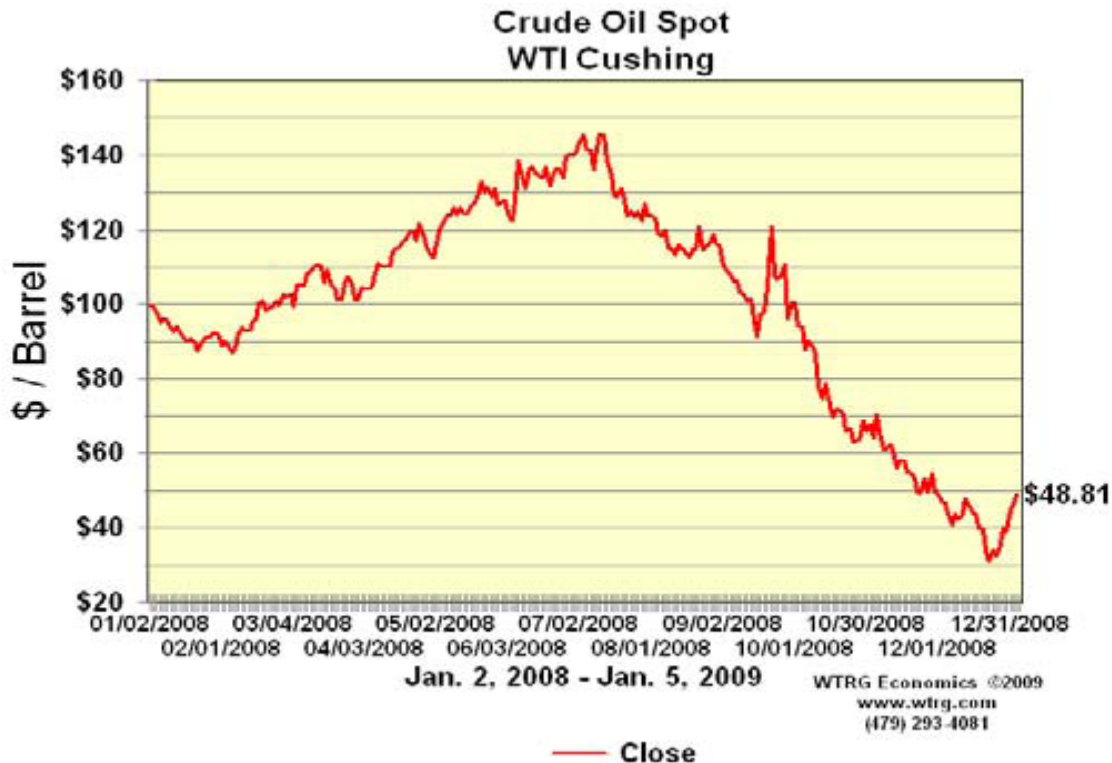
Inflation

Price declines especially in the commodity and energy areas led to an outright drop in aggregate prices in the quarter, and the Fed changed its tune from concern about inflation to concern that a deflationary spiral a la Japan might afflict the U.S. After inflation peaked with a 5.5% year-over-year rise in the Consumer Price Index in July, prices reversed with a vengeance in the fourth quarter. The three months ending in November saw the CPI **fall** at an annualized 10.2% rate and left prices only 1.1% above their year ago levels. Core prices, excluding food and energy, also decelerated to a 0.4% rate of increase for the three month period ending in November, well below the 2.0% level that the Fed has highlighted as a level they are comfortable with. Oil prices plunged from \$100 at the end of September to \$45 at the end of December. Many other materials' prices (copper, grain, steel, etc.) also fell in the quarter. The Producer Price Index (PPI) also staged a stunning reversal this past fall. After posting a number of large increases earlier in the year, producer prices gave up all those gains in four months this fall and are now on a par with year ago levels.

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A number of observers have expressed concern that the Fed is fueling future inflation given the hundreds of billions of new liquidity it has added to the financial markets. However, the credit crunch and the forced reduction of debt that our economy is experiencing has historically been associated with deflation. Given the distressed economic conditions we currently are experiencing, we think inflation is not a near-term concern although we acknowledge that longer term, it may reappear.



Corporate Profits

The dire economic statistics have prompted analysts to revise down profit estimates for the fourth quarter of 2008, mainly on weakness in the Finance, Material, Energy, and Consumer Discretionary sectors. At the beginning of the quarter, analysts expected profits to be up over 40% compared with the poor fourth quarter of 2007; however, by the end of the quarter, those analysts had revised down their expectations to flat growth from a year ago. We think reported profits, which include one-time write offs not usually incorporated in analyst estimates, could be even worse than these estimates. For the full year 2008, analysts currently expect the S&P 500 Index to earn \$66.00 (operating) which would put the S&P 500 Index at approximately 13.8 times earnings last year. Operating earnings for 2009 are currently projected to be \$76.78 which would put the S&P 500 Index at about 12 times earnings. However, many strategists have theorized that earnings could be much worse than analysts' expectations (which are usually over optimistic and don't include "extraordinary losses"). Earnings estimates have been proposed as low as \$40 to \$60 for the S&P500 for 2009. While uncertainty is unusually high and results will be dependent on the ultimate course of the economic crisis, we are trying to take the long-term view and base our decisions on estimates of earnings that companies would experience in a more normalized environment. We believe as investors get more confident that the crisis has stabilized that less emphasis will be placed on worst case scenarios.

Interest Rates

Following the rapid deterioration in economic indicators, the Fed took extreme action in revising down its Fed funds target to between 0.0% and 0.25%. As the scope for monetary policy to influence

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economic activity is de minimis at this level of interest rates, the Fed has resorted to unconventional policies collectively referred to as “quantitative easing” to deal with the crisis. Essentially, the Fed has continued to expand the quantity of money despite the price of money (the interest rate) being at its lower bound of 0%. One problem for the economy is that despite the extraordinarily low risk-free rates, rates on securities with only a modicum of risk have stayed stubbornly high. The Fed has started to directly purchase mortgage-backed securities issued by the effectively nationalized Fannie Mae and Freddie Mac. This served to bring down mortgage interest rates for high quality borrowers and should allow some troubled homeowners to refinance at favorable rates. Extreme risk aversion by investors led to unprecedented demand for government bonds which drove the 10-year U.S. Treasury bond to a 2.25% yield at year-end while corporate bond and municipal bond yields remained at relatively high levels. Since the crisis started in the credit markets, we have been watching these risk spreads closely to determine when the markets start to normalize.

International

The financial crisis spread into a real economy crisis for the rest of the world as economic indicators in developed and emerging markets also sharply declined in the fourth quarter. Europe saw all of its major economies decline during the quarter and the European Central Bank, which had been the most reluctant central bank in the world to ease, reduced interest rates sharply and showed more flexibility as inflation indicators declined. The U.K., which led the world in its rescue of their banks, also saw the Bank of England reduce policy rates to record low levels and announce plans for a large fiscal stimulus. Japan, whose export-oriented economy also is in recession, announced a large fiscal package to stimulate its economy. Theories that the developing economies of the world could decouple and grow independently of the developed world went up in smoke as the economies of China, India, Russia and Brazil all showed signs of a sharp slowdown. Fears of a currency crisis particularly plagued Russia as they were forced to devalue the ruble in the midst of sharply falling energy and commodity prices. The crisis led to big currency movements in the quarter with European and Emerging Market currencies sharply falling while the more stable dollar and yen rose. As monetary policy around the world has largely done what it can to combat the financial crisis, attention has turned to plans by governments to stimulate their economies with lower taxes and government spending. Large stimulus plans have been announced in the U.S., U.K., China, France, and Japan. Notably absent is Germany and some of the European economies which are constrained by E.U. rules against budget deficits. Hopefully, these economies will adopt a more stimulative fiscal stance since all measures seem needed to mitigate the effects of this global downturn.

Investment Strategy

Domestic Equity

U.S. equities capped a terrible year with a poor quarter; our portfolios in general outperformed the benchmarks. Most beneficial to performance has been the higher levels of cash in our portfolios. Also helping stem the decline in the quarter and year was emphasizing defensive sectors like Consumer Staples over more cyclical sectors like Finance and IT. Stock selection was marginally positive in a year dominated by sector and macro forces. However, some good selection in Financials, Staples and Industrials were additive to performance. Hurting performance in the quarter and year was our exposure to Energy and Materials which fell dramatically when global growth prospects dimmed in the financial crisis. Throughout the year we raised cash slightly, increased our exposure to more defensive sectors, especially Health Care, and reduced our exposure to Energy, Industrials, Information Technology, and Materials. In this difficult environment, we believe our emphasis on larger capitalization, higher quality, and steady growth-oriented companies is prudent. Top performing stocks for the quarter include: Annaly Capital, Aon, Exxon Mobil, and AT&T. Disappointments for the quarter: Bank of America, Transocean, Electronic Arts, and Freepport-

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Summit Managers Commentary

McMoran. For the year, top performers were: Wal-Mart, Kroger, Johnson & Johnson. Disappointments for the year: General Electric, National Oilwell Varco, GameStop, Freeport-McMoran. Most recent purchases or additions: Abbott Labs, Aon, Berkshire Hathaway, Coca-Cola, Consolidated Edison, Eli Lilly, Everest Re, General Mills, Johnson & Johnson, and Zimmer. Most recent Sales/Trims: Burlington Northern, Exxon, Flir, Freeport-McMoran, MEMC, Mosaic, Seaspan, and Spectra.

International Equity

International equities had a very weak quarter as economies deteriorated and currencies (other than the yen) fell versus the dollar. While our portfolios benefited from a higher level of cash and overweights to Consumer Staples and Telecommunication Services and an underweight to Financials, we slightly underperformed the international index for the quarter mainly due to allocations to the Energy, Industrials, and Material sectors. For the year, however, our portfolios outperformed the benchmark due to raising cash and efforts to become more defensive. An overweight to Switzerland benefited portfolios, but an underweight to Japan and an allocation to Emerging Markets proved detrimental. Top performing stocks for the quarter include: France Telecom, Roche, Sanofi Aventis, and Turkcell.

Disappointments for the quarter: Rio Tinto, ING, Keppel, and Petrobras. Top performers for the year: Novartis, France Telecom, and Nestle. Disappointments for the year: Rio Tinto, Keppel, and Acergy. Most recent purchases or additions: Aegon, British American Tobacco, Deutsche Telekom, Foster's Brewing, Fujifilm, GlaxoSmithKline, Nestle, NTT, Promise, Takeda Pharmaceuticals, Tokio Marine, Unilever, and Zurich Financial Services. Most recent sales or trims: Barclays, BHP Billiton, ING, KB, Komatsu, Lenovo, Nexen, Orix, Philippine Long Distance, Rio Tinto, Silver Wheaton, Sun Hung Kai.

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