

MEMORANDUM

To: **Wurts & Associates Clients**
From: **Eric Petroff, CFA, Director of Research**
Date: **September 30, 2008**
Re: **Panic & Wisdom**

Panic: A sudden feeling of fear or anxiety, especially among many people, that comes on suddenly, is overwhelming, appears to be uncontrollable, and may seem to be unfounded.

Wisdom: The ability to make sensible decisions and judgments based on personal knowledge and experience.

A herd mentality overcame markets yesterday as Congress defeated the first bailout proposal, with equities losing more than 8% and three month t-bills trading at a yield just slightly in excess of 0%. From an historic standpoint, such events are rare, but not unprecedented. In fact the S&P 500's return for September did not even fall into the top ten worst loss months in history. One must keep in mind a single day's market activity is indicative of nothing but the power and pervasiveness of the herd mentality. We would also remind everyone the market is behaving exactly as we described a few weeks ago as risky assets are re-priced to a point investors perceive fair compensation for the associated risks. The S&P 500 was up 5.3% today. So clearly markets continue to function and many investors believe equities are a good deal at current prices.

Nonetheless, institutional investors are currently faced with two very serious questions, one is short term and the other is long term. The short term question of course, is whether or not to succumb to panic by abandoning asset allocation targets and rebalancing guidelines in an attempt to time volatile capital markets. The long term question however, is what are the long term implications of recent events and how do we respond to them through asset allocation policy.

In our opinion, succumbing to panic simply does not fall under the definition of serving as fiduciaries. We know our clients would agree with this. So the question of whether or not to engage in short term market timing activities really is not a question at all. As mentioned in our previous client memorandum, we continue to believe disciplined rebalancing offers the highest probability of bolstering long term expected returns. Such a concept is by no means rocket science. It is merely common wisdom to buy an asset for a lower, rather than higher price.

So instead of droning on about our fiduciary duties, the merits of rebalancing, and the need to stay the course, we will focus this memorandum on our best ideas to proactively add value to clients' portfolios. Because we can do nothing about the past, nor can we wisely do anything about the very near term, focusing on the future is the best use of our collective efforts.

Our upcoming Quarterly Research Report will provide complete insight into our best ideas in this regard. However, a brief preview of our efforts is discussed below. Please be aware we will

be hosting a research conference call in a few weeks to discuss all of our findings; specific call details to be announced soon.

Strategic Implications of Current Events

Public Equities are Attractively Priced – Whether you are looking at price to earnings ratios, dividend yields, or even more esoteric measures such as Tobin's Q Ratio, public equities are more attractive now than they have been in years. This has obvious implications for the mix between equities, fixed income, and alternative investments.

Credit Risk is Well Rewarded – Credit spreads relative to US Treasuries have blown out in recent periods. This fact has implications for the composition of fixed income portfolios, or the type of active management strategies employed.

Treasury Inflation Protected Bonds (TIPs) are Highly Attractive – As of the writing of this memorandum, the implied rate of inflation for 10 year TIPs was about 1.6%! If actual inflation over the next ten years exceeds 1.6%, then TIPs will outperform nominal Treasuries. History and an analysis of capital markets conditions tells us this is an almost certain event.

A Great Environment for Distressed Debt Investing – Given the downturn in economic growth and credit markets, distressed debt strategies are very, very attractive. There are many venues to gain exposure to these strategies such as mortgage, commercial real estate and corporate debt instruments. Existing private equity allocations should overweight these strategies.

Some Hedge Fund Strategies Will Suffer – Arbitrage and absolute return strategies will likely experience a drag on returns because of their substantial use of leverage in costly credit markets. Conversely, more directionally biased strategies should outperform due to a lack of costly leverage and more attractive equity market valuations.

Time to Begin Accumulating Real Assets – An examination of macroeconomic and capital markets conditions strongly portends a forthcoming environment of high inflation. During times of high inflation, real assets tend to perform very well in relation to other asset classes. These strategies involve real estate, energy, infrastructure, and even select clean-tech mandates.

Finally and most importantly, we cannot stress enough one very simple concept...when the facts change, your opinion should change.

Clearly the facts of capital markets are rapidly changing around us. This is why Wurts & Associates is dedicating substantial efforts to analyzing capital markets, their prospective long term trends, and how to best reflect our conclusions through asset allocation policy.

Though we understand recent market volatility is unsettling at both a personal and institutional level, we all know panicked decisions are rarely wise decisions. So now is the time to remain objective and forward looking because we cannot control investment markets, but we can control how we react to them.