INVESTMENT OUTLOOK

2nd Qtr 2008

Did you ever play with a Slinky as a kid? I did. I can remember standing at the top of my friend's stairs, unleashing the Slinky to "walk" down the stairs, one at a time. The Slinky was nothing more than a torsion spring with no compression or tension. Torsion springs help support automobile suspension components which allows the car to move smoothly over rough, rocky roads.

Isn't that exactly what the Federal Reserve was aiming for with its multiple interest rate reductions and new liquidity facilities? Trying to give us a smooth ride in this credit crisis?

The Fed's execution is admirable, but these credit potholes require larger and stronger torsion springs than they ever imagined. This year we have been very constructive on the non-cumulative Preferred stock shares issued by the banks and brokerages. They yield over 8% and until the Bush tax reductions are phased out in January 2011, these shares are taxed at 15%. Who are the issuers? The usual suspects: Merrill Lynch, Citibank, Deutsche Bank, Bank of America, to name a few.

Because the balance sheet "hits" keep on coming to these companies (due to their sub prime slime) they must continue raising capital. As a result, we've seen the value of our Preferreds have declined.

Top 5 Bank Losses vs. Capital Raised
($ in billions)

Bank	Losses	Capital raised
Citigroup	$54.6	$44.1
Merrill Lynch	46.1	17.9
UBS	38.2	29.2
Bank of America	20.7	20.7
HSBC	19.5	3.5

Source: Bloomberg

But here's the question you must ask and answer: *Do you really think the Federal Reserve will allow a Merrill, Citibank, Fannie Mae, Freddie Mac and Bank of America to go under in this weak environment?* Thus causing a domino effect to the rest of the financials. I don't think so. In fact regulators recently loosened capital requirements for Fannie Mae and Freddie Mac in order to help revive the mortgage market. Over the July 12th weekend, the Treasury Secretary made their importance perfectly clear.

It's dangerous to say never in an environment where we've seen unthinkable events happen. But I am certain of this one. If you would like to read the latest Merrill Lynch report on the importance of Freddie Mac and Fannie Mae preferred shares to the regional banking system, email us.

So, where do we begin in the muni bond space? My previous *Investment Outlook* talks about the municipal bond insurers and has turned out to be correct: All are finished except FSA, Berkshire Hathaway and Assured Guaranty. A cup of Starbucks coffee costs more than one share of AMBAC. A gallon of gas costs more than one share of MBIA Inc. and these very companies have insured many of your municipal bonds. The story is over for these and other municipal bond insurers. And these changes are precisely the reasons why you have seen more sales, purchases and rebalancing in your municipal bond portfolios since October than you've ever seen before.

Because of the municipal bond tumult, Forbes Newsletter Division asked my to write a monthly electronic newsletter called, *The Forbes Tax Advantaged Investor* (www.forbesnewsletters.com).

The final category to discuss is corporate bonds; both investment grade and high yield. With revenues, earnings and the general business malaise, corporations are struggling. Take a look at the stock market and that pretty well sums it up.

With bank loans and lines of credit hard to obtain (hence the term, *credit crisis*) many corporations are, and will be, challenged. We see additional spread widening and downgrades. There are many moving parts to monitor and execute on.

As always, we will do our level best to keep you apprised of any changes. Stay cool during this long, hot summer. Call me directly with any questions or for a conversation.

All the best,
Marilyn