ALTMAN INVESTMENT MANAGEMENT

INVESTMENT STRATEGY HIGHLIGHTS …. NOVEMBER, 2008

Written By: *Peter J. Altman, President*
Jeffrey S. Bauman, Managing Director
Karen Troiano, Senior Portfolio Manager

Altman Investment Management
34 Chambers Street
Princeton, NJ 08542
609.252.0048
paltman@altman-investment.com

"IF A LITTLE KNOWLEDGE IS DANGEROUS, WHERE IS A MAN WHO HAS SO MUCH AS TO BE OUT OF DANGER?

Thomas Henry Huxley (1825–1895)

GENERAL MARKET OBSERVATIONS

- **The U.S. equity markets ended the third quarter of 2008 with the Standard and Poor's 500 declining – 8.37% against a slightly better relative result for the equally dollar weighted S&P 500 Index which declined – 6.60 % over the same time period. Our performance benchmarks the S&P 500/Citigroup Value Index declined - 5.73% against a decline of – 6.11% by the Russell 1000 Large Capitalized Value Index for the calendar year.** (1) As investors continue the debate concerning the extent of the slow down in the U.S. and its collateral impact on the rest of the globe, performance statistics show that the U.S. style performance continued to focus on recession resistant sectors consistent with a slowing economy. Globally sensitive benchmarks performed far worse as dollar based investors lost 11.89% versus the Euro according to Bloomberg, with Morgan Stanley Capital International EAFE (Europe Asia and the Far East) declining -13.02% and the Emerging Markets (MSCI Emerging Markets) declining -20.90% over the same time period. Unlike the second quarter, the U.S. stock market started the third quarter on a negative note. International markets also reinforced the end of some multi-year leadership trends that persisted in the U.S. until early in 2007. Gold maintained its inverse correlation with the U.S. Dollar as the CRB (Commodities Research Bureau) and crude oil also recovered from extreme pessimism in September.

- **Small-Cap Value demonstrated some leadership in equities in the third quarter as the Russell 1000 Value Total Return and the Standard and Poor's 500 /Citigroup Small Cap Value Index had positive gains.** However, most of their strength occurred in the months of July and August, with September returns negative. On a relative basis, they still outperformed all equity benchmarks year to date and in the month of September. With the exception of the two small-cap Value Indices, the quarter was characterized by equity weakness as an asset class in the U.S. and globally. No other stock index had positive gains. Despite a better showing in the first quarter the value indices have not re-established their winning streak that began at the market top in 2000. The credit market fallout that reappeared last summer in the financial markets hit the value indices the hardest since those indices continue to be dominated by the financial companies. The credit market debacle last year gave the Russell 1000 Growth the edge to outperform the Russell 1000 Value by almost 12%. The large cap cyclical companies were clear winners last year and into the first quarter along with commodities, as the Standard and Poor's/Goldman Sachs Commodities Index soared 38% and gold jumped 31% last year.

(1) Q3 Benchmark Review, Ned Davis, Inc, Research Issue COD 200810011 October 1, 2008 and Thomson Financial –Base Line statistics.

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- **During the third quarter Value outperformed Growth on a relative basis.** The Russell 1000 Value outperformed the Russell 1000 Growth by 622 basis points in the third quarter with less drastic difference of 203 basis points between the Russell 2000 Value and Growth indices.

- **We believe that our portfolios are strategically well positioned to benefit by rising equity valuations in the second half of 2009,** as the Federal Reserve continues on a path of accommodation placing a potential of a weakened dollar and inflation on the back burner for the time being. After a year of declining equity prices in the U.S. markets, we expect a more positive bias towards stock ownership as investors begin anticipating a U.S. economic recovery in the second half of 2009.

A Long-awaited Global Response Gave Some Relief to World Markets

- At the close of the third quarter, U.S. bond and equity market selling showed no signs of abating, despite the already steep decline in stock and bond prices experienced in the prior quarters since the fall of 2007. The global markets accelerated their downward pace in September as well, once the collateral damage of the U.S. banking crisis bled into the world's major central banking system. Just as the panic selling appeared to reach a climax, not too dissimilar to the bottom experienced in the 1974 bear market, on October 10th the central bankers of the G7 nations announced a dramatic action of a coordinated rate cut and partial nationalization of the banking system. Despite the central European banks tendency, in the post war periods to fear inflation rather than deflation, this long awaited response reassured financial markets that global policy makers have finally taken decisive steps toward repairing the rapidly deteriorating banking system abroad and consistent with U.S. policy initiatives. This policy reversal appeared to be the cooperative action investors required to insure confidence and defer portfolio liquidations that has persisted unabated all year. However, the global response has been more tempered as markets outside the U.S. continued to operate under a negative cloud into the month of October with credit spreads widening and debt markets remaining clogged against a rising U.S. dollar.

- During the third quarter, amid growing fears that the world economies were embarking on a protracted recession, investors continued to demonstrate little patience indiscriminately selling long duration investments. Despite any positive news associated with current fundamental earnings reports, the "risk premium" to hold longer duration instruments soared as a result of investor fear. History shows us that investments made in times of greatest distress offer the most rewarding periods to build wealth for the long term.

An Optimistic Perspective on Today's Financial Markets

- In retrospect, it appears that the U.S. authorities' decision to allow Lehman Brothers to collapse was a grave mistake. As we are acutely aware, the decision profoundly shook confidence in the U.S. banking system, leading to the complete shut down of the interbank market. We would also add that allowing Fannie and Freddie Mac's preferred share prices to collapse, effectively wiping out large portions of tier one capital for many financial institutions, was yet another policy blunder. Consistent with a historical framework, we know that trust in the entire banking system can easily be broken by one or two bank failures, which inevitably lead to the immediate cessation of credit flows. Not dissimilar to the experiences of the 1930's, a major interruption of credit flow can potentially have devastating consequences.

- It is unfortunate that our banking system has operated under the basic premise that these institutions are "too big to fail" and ultimately protected by government at times of financial crises. John Kenneth Galbraith, author of over 30 titles spanning five decades on economic policy issues that critiqued matters between the public and private sector policies, warned us about the continuing divergence between approved belief characterized as "conventional wisdom" and what he termed "reality". In one of his last published essays in 2004, "The Economics of Innocent Fraud", Galbraith identifies that the economic and political system in the United States

cultivates its own versions of the truth with no necessary relation to reality. He concluded that in large part that which we all refer to as the ever expanding public sector is in "all practical effect in the private sector". Despite recognizing this problem that Galbraith describes, we are still faced with the dilemma of encouraging free competition in the banking system while at the same time protecting the public interest in the face of a confidence crisis. Our cautiously optimistic stance is bolstered by the fact that mark- to-market accounting rules although severe have shortened the corrective phase of this cycle. We are further encouraged by the fact that since we now understand the problems, we are closer to arriving at appropriate solutions. We would expect the end result will ultimately be an implementation of an appropriate regulatory response that promotes sounder risk management practices as well as shifting the role of the Federal Reserve Board away from the necessary monetary responses of a post-bubble clean up towards a preemptive regulatory oversight.

Positioning Fixed Income Portfolios for Long Term Growth

- The world economies have now joined the U.S. commencing a period of subdued economic growth and potentially intense deflationary pressures. We would anticipate the Bureau of Economic Analysis to officially declare that we are in recession (two consecutive negative quarters of Gross Domestic Production) and that we expect this condition will persist into next year. If history is any proxy for the future, we would expect that equity and bond prices should begin anticipating the recovery perhaps as early as the first or second quarter of 2009.

- We remain steadfast in our belief that stepping out of the fixed markets can have severe consequences to long term investment programs. We are reminded of countless examples such as the deflating technology bubble, the demise of Drexel Burnham Lambert's failure after the implosion of the junk bond market, Texas and New England bank failures and the savings and loan debacle in the late 80's. All of these examples saw significant advances in bond prices in subsequent years rewarding investors handsomely that stayed the course during the market turmoil.

- As we enter a period of global reflation, we believe that oil markets will continue under pressure. As long as global growth stays sluggish, policy reflation efforts will most likely be aimed at stabilizing banks and reviving growth overtime. Usually a dramatic fall in interest rates benefits banks and financials first, and over time the stimulative monetary impact is transferred to the broader economy. Although banks are still in crisis mode, the beaten down share prices will ultimately reward investors who can focus their sights on the longer term and emphasize the better capitalized companies in the sector. We anticipate in 2009 that the sharp fall in interest rates in the U.S. will begin lifting banking fixed income alternatives relative to the benchmarks, a trend that may take hold for the next several quarters before broadening out into the other economic sectors.

- Expecting a rally before year end, we have refocused our efforts on the profit outlook of our investment holdings with a heightened sensitivity to our non-financial profit exposure as we enter a global recessionary period. We are assuming that November marks the bottom in equity and bond prices for the broad market and that this drop culminates as one of the most severe drops in the averages than prior peak-to-trough declines experienced in past crises. The correction in the non-financial stocks has been more severe in the current cycle than in other banking crises as our moderate decoupling theory was held hostage by the fact that the U.S. consumer is still considered an important engine of growth for the world economies. On a positive note, the U.S. non-financial sectors' weak bond performance in the third quarter has likely discounted a deeper recession than in past global housing busts.

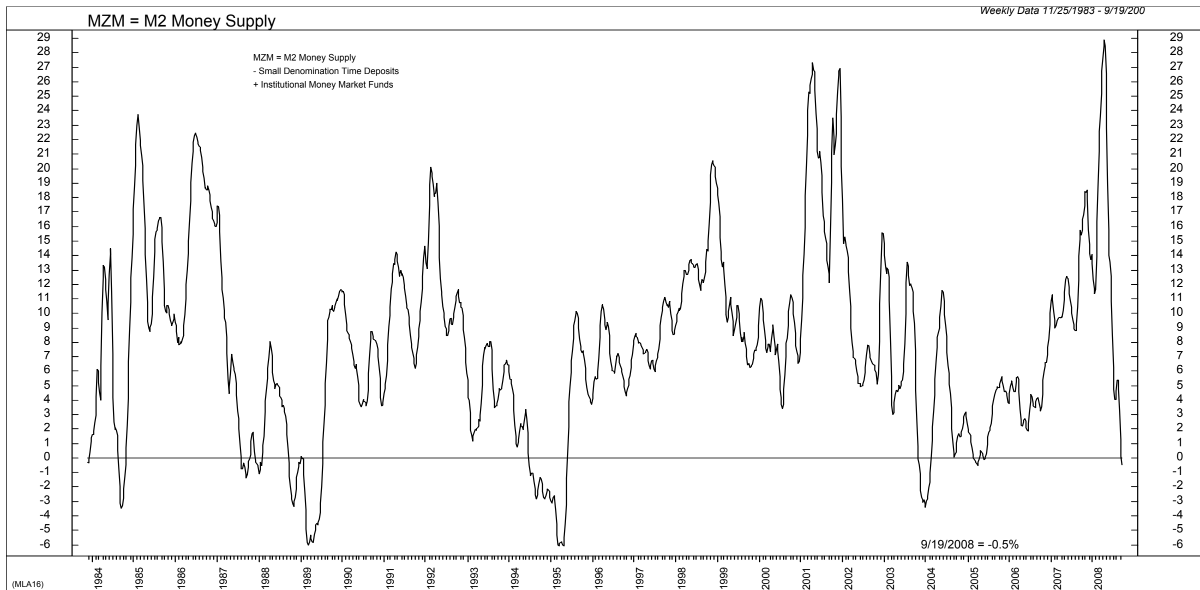
THE U.S. ECONOMY

- **The statistical data for the September – November period suggest that the decline in the economy is worsening such that fourth quarter real gross national product (GDP) in 2008 and the first quarter of 2009 could fall at annual rates of 3% - 4%.** This has pushed most economists to move the potential recovery to either the latter half of 2009 or 2010. Despite the news media highlighting all the negative statistics and making comparisons with the Great Depression, the Chairman of the Federal Reserve, Ben Bernanke, invalidated these comparisons in a recent speech in Austin Texas. We however, are more optimistic than consensus. We believe the current credit freeze and the 50% decline in most stock indices from their October, 2007 highs coupled with double digit declines in housing prices have been more than priced into the financial markets and are not necessarily the precondition for a deteriorating economic landscape in the coming months.

- **There are a number of considerations to keep in mind regarding future economic activity.** The policy mistakes of the 1930's should not be repeated. I am reminded of Bernard Baruch's message, as perhaps one of the wisest men to walk the halls of American business and finance and a counselor to many U.S. presidents, after he foresaw the danger signals that preceded the stock market crash of 1929. "Mankind has always sought to substitute energy for reason, as if running faster will give one a better sense of direction. Periodically we should stop and ask ourselves if our efforts are focused upon the crux of the problem- the things that must be settled if there is to be a manageable solution- or if we are expending our energies on side issues which cannot yield a decision, no matter what their outcome"(1)

- **We can make the following observations concerning the blunders of the 1930's to correct The U.S. economic crisis.** These include a significant decline in the money supply, protectionist legislation, such as the Hoot-Smawley Tariff Act, (June 1930) which raised tariffs to record levels on most imported goods, and an attitude referred to as "moral hazard" towards a banking bailout. This moralistic view suggests that those that may have been potentially responsible for the crisis should some how not go unpunished.

Table I



Source: Ned Davis Research

- Although the Fed response has been accommodative pushing M-1 money supply up at a 28% annual rate over the past three months, it may require more stimuli relative to the current drop. See Table I prepared on September 19th.

- **Since the velocity of money has collapsed, there would appear to be few inflationary risks in the monetary expansion at present.** In addition, there appears to be little appetite for protectionist legislation in view of the widespread belief that globalization is an important concept for expanding trade. Emerging markets according to Morgan Stanley's Capital International Research was responsible for as much as one third of global GDP, with China accounting for 20% of the emerging market share. Since these are creditor countries with high savings rates and foreign exchange surpluses as well as fiscal surpluses, they have the financial means to stimulate economic recovery with consistent and sound policies. In addition, the new administration has already confirmed a policy initiative of significant infrastructure spending including bailouts with reform attached. However, this will ultimately lead to huge fiscal deficits on the order of $1.5 to $1.7 trillion for fiscal 2009. Steven Roach, the chairman of Morgan Stanley Asia and former Chief Economist, recently pointed out that "a critical distinction must be made between providing assistance for the innocent victims of recession and misplaced policies aimed at perpetuating an unsustainable consumption binge".

- **Treasury bond interest rates are at fifty-year lows allowing the federal government to borrow at historically low interest rates.** Although we have included some of the current economic statistics below, which are indeed sobering, there is some news that is positive for future growth.

(1). Bernard Baruch, *My Own Story*, (New York: Holt, Rinehart and Winston, 1957), p.263

ECONOMIC STATISTICS

- **Consumer sentiment, released by the University of Michigan, rose 0.3 points to 57.9 at the mid- month reading better than the consensus estimates for a decline to 56.0.** Despite the recent improvement from the low of 56.4 in June, sentiment is still below the trough of the last two recessions. The drop in energy prices is likely responsible for the increase in sentiment over the past two months. However, housing weakness, turbulent financial markets and rising unemployment continue to feed consumer pessimism about our economic future. Inflationary expectations fell to 2.9% from 3.9% on a year-over-year basis, while longer–term inflation expectations are dropping rapidly. We would expect inflation rates to be closer to 1.5% by mid year 2009.

- **Although energy prices have dropped precipitously, they have done little to stimulate vehicle purchases in the face of unemployment prospects.** The index of buying conditions for vehicles has fallen to the lowest level in about 25 years. Only just a few months ago consumers complained about high gas prices and the fuel inefficiency of the current models, now this issue has faded into the background and consumers are more worried about the uncertainty of future job market and income prospects as the primary reason to postpone plans to purchase a vehicle.

- **Nonfarm payrolls fell for the 10th straight month in October contracting to 240,000. Economists were expecting job losses at 200,000.** More importantly September's losses were revised to -248,000 from -159,000, half of the downward revisions coming from the government sector. These downward revisions have not been seen in quite some time. According to Ned Davis Research, there have been only seven other times when payrolls have declined for ten consecutive months: September 1944, July 1949, June 1958, February 1961, May 1982, April 1991, and December 2001. All except the first (during WWII) were associated with recession, and only the last three exceeded ten-year to date, job losses have totaled 1.2 million. The unemployment rose 6.5% from 6.1%, the most since March 1994. In the past six months the consensus estimate has climbed 1.55 percentage points.

- **The Leading Index dropped 0.8% to its lowest level since April of 2004, on the backdrop of large declines in stock prices, building permits and consumer expectations.** The annualized sixth month rate of change fell -4.7%. This contraction signal suggests that the U.S. may have dropped into a recession in the first half of the year before officially falling into recession in October. The year-over-year comparison for the Leading Indicators is off 3.5%, a drop similar to readings in April 2001.

- **The Coincident Index increased for the first time in eight months**, rising 0.2% but remained close to its lowest level in two years. Weighed down by patrols further exacerbating the economy are what we call capitalized profits (the ratio of adjusted after-tax profits to corporate bond yields) which are also estimated to have fallen to levels we experienced in early 2004 and breaking its long term uptrend.

- **Import prices dropped a record 4.7% in October, greater than expectations of 4.0% decrease.** A 16.7% plunge in petroleum prices, the most since April 2003 and the third largest decline since 1988, led the way. Excluding all fuels, prices were still off 0.8%, the most since July 2001, led by a 3.1% drop in industrial supplies and materials (mainly metals), and the most severe drop in over seven years. Food prices also dropped, slipping 1.6% comparable to the February drop in 2006. From a year ago, import prices have eased to 6.7%, the least in over a year and down over two thirds from its 21.4% peak in July. While petroleum prices are most culpable from the deceleration, the growth in prices ex-fuel has also noticeably slowed. The CBO forecasted a budget deficit of $237.2 in October reflecting $115 billion in TARP expenditures for bank recapitalization, 21.5 billion in spending on agency MBS exceeding the original forecast of $232 billion. This monthly report caused the 12 month total deficit to surge to a record $635.1 billion from a $454.8 billion in September, or 4.4% of GDP, the highest since December 1992.

- **Retail sales dropped 2.8% in October, the most since 1987 and more than the 2.4% decline expected as consumers curtailed spending on virtually everything except necessities**. On a trend basis, retail sales have fallen 1.3% from a year ago and the largest year-over-year decline since 1967. Motor vehicle and parts sales are off a record 18.45% causing its market share to fall 16.6%, the smallest share since June of 1980 according to Ned Davis Economic Research.

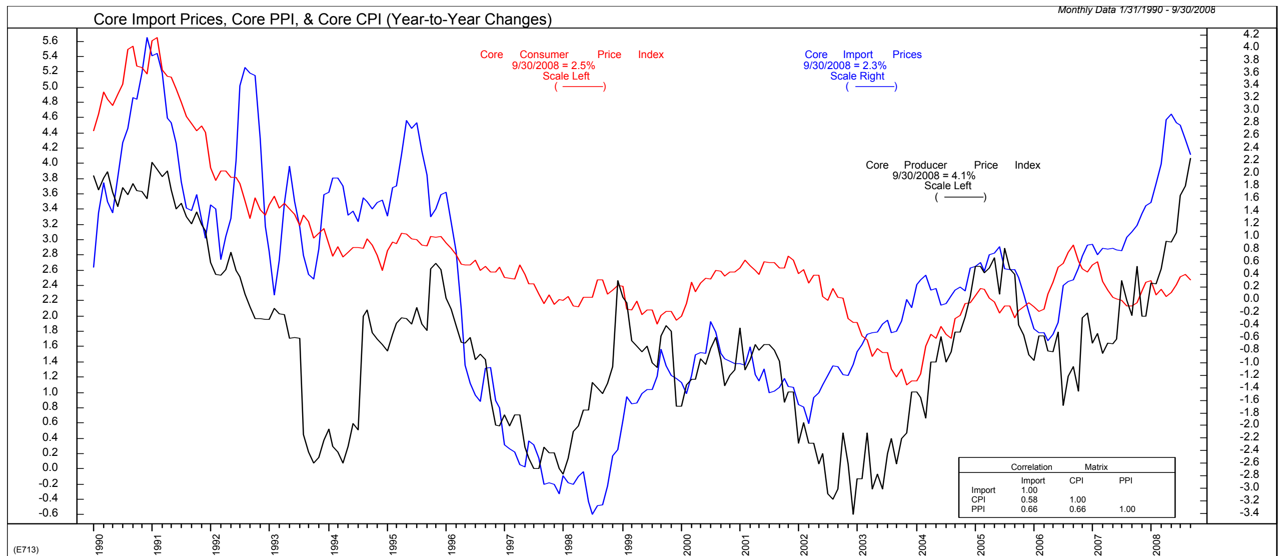
- **Industrial production rebounded 1.3% in October,** the most in nine years as the output rebounded after Hurricanes Gustav and Ike and a Boeing strike halted activity in the prior month. This was followed by a revision for September downwardly to -3.7%, the most downward revision in 62 years from -2.8%. Despite the hurricanes and the strike, the Fed said production fell around 2/3 of a percent in both September and October from a year ago. Output is down 4.0%, a rate of decline consistent with prior recessions. Motor vehicle sales were at a 10.5 million seasonally adjusted rate in October versus 16 million a year ago. Consumer goods are off 3.8% on a trend line basis (the worst we've seen in close to 25 years according to economists).

- **About 10 million people were unemployed in October or 6.5% of the workforce**. This is an increase of 2.8 million over the last twelve months. The unemployment rate has not started to turn up yet. We are predicting unemployment rate will rise to 7.5 -8.0% range by next summer.

- **Both the ISM Manufacturing Index and the Non-Manufacturing Index fell to 38.9 and 44.4 respectively in October with numbers under 50 representing recession.** Construction spending is down 6.6% year-over-year through September. Retail sales fell 2.8% in October and are down 4.1% from year-ago levels. Industrial production is down 4.1% from year-ago levels with capacity utilization at 76.4% versus approximately 82% a year ago. Finally, housing starts, home sales and home prices are still falling while the leading indicators are down 3% from year-ago levels in September.

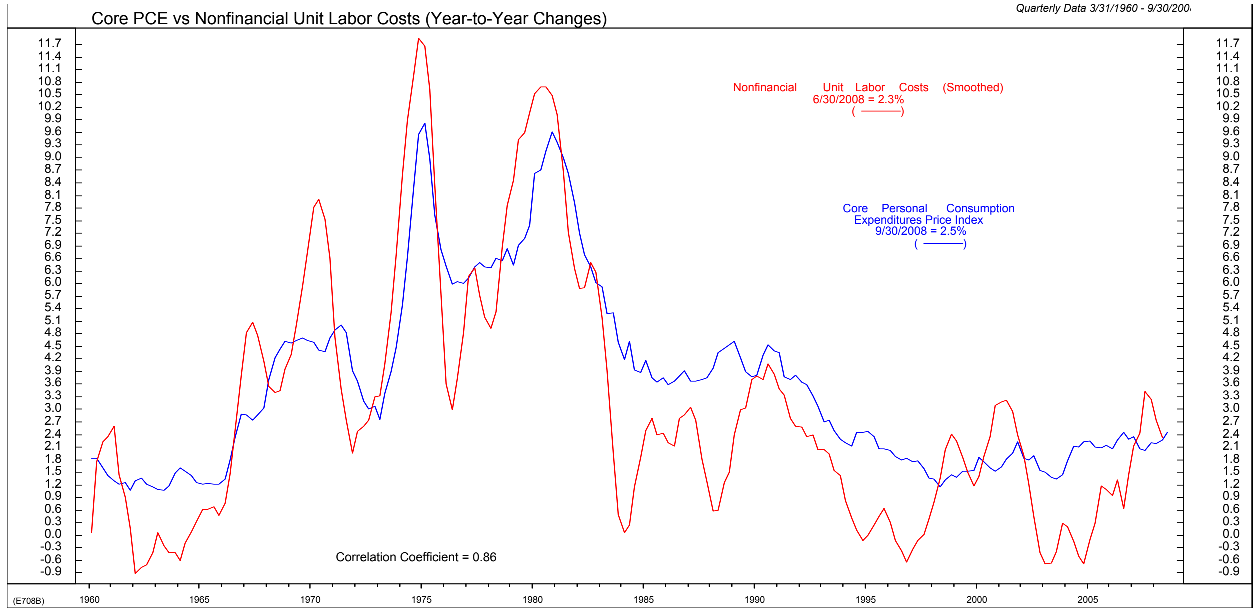
- **On the positive side productivity is up 2% for the third quarter, and inflation is starting to fall rapidly with the consumer price index (CPI) falling 1% in October and the producer price index (PPI) declining by 2.8%.** Personal income is up 3.9% over year-ago levels through September and will be helped by falling inflation statistics. Also the balance of trade at -56.5 billion in September, while still enormous, is improving and the U.S. dollar has rallied significantly over the past six months. Finally, the personal savings rate in September was 1.3%, up from negative territory a few months ago.

<u>Table II</u>



Source: Ned Davis Research

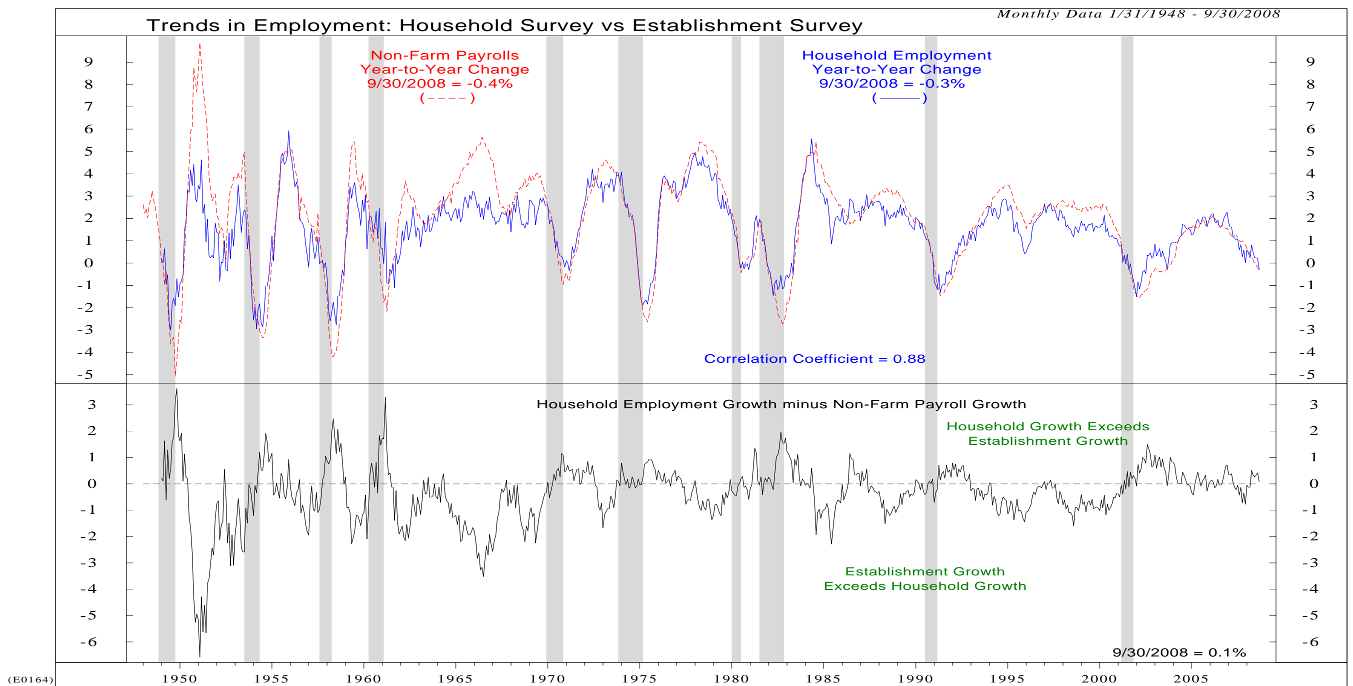
Table III



Source: Ned Davis Research

➢ **The main reason for being positive about the future is a change in economic policies**. The Troubled Asset Relief Program (TARP) has been redirected to build bank capital, support consumer access to non-bank credit and attempt to reduce home foreclosures. There is still $350 billion in the $700 billion program which will be left for the incoming administration to manage. We are acutely aware that the collapse in bank stocks since TARP was initiated suggests that there are still risks of bankruptcy in the financial sector.

Table IV



Source: Ned Davis Research

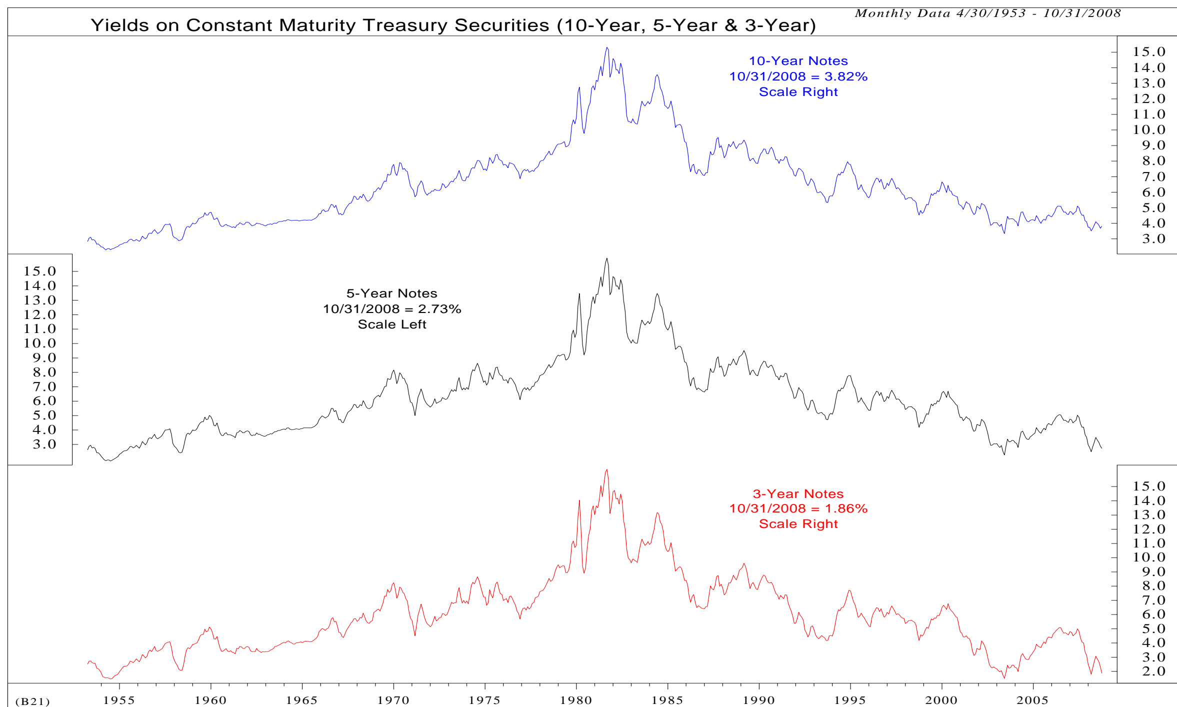
- **Our view is that real GDP will grow at an estimated 0.7% in 2008 and 1.5% in 2009, which compares to 2% in 2007.** Corporate profits are expected to fall 20% in 2008 and increase 5% in 2009. The CPI should end the year at 2.5% and remain at that level in 2009. The primary uncertainty is whether or not the economic policies of the Obama Administration can bring about an economic recovery in the second half of 2009.

THE U.S. FIXED INCOME MARKET

- **Poor market psychology, forced liquidations, and deleveraging continue to erode consumer and business confidence.** These self-reinforcing factors point to reduced economic activity in the future. However, lower inflation expectations, improved bond market fundamentals, and another Fed rate cut could temper these negative factors. The current crop of government programs forms the best combination yet to return stability to the market, but improvement will take time. With normalization, expect a flatter Treasury curve and disinversion, a more normal sloping yield curve. Worsening fundamentals present an opportunity for quality collateralized products to prove their mettle and outperform no secured debt. Auto asset backed securities have exhibited good credit performance and are well set for the rough seas ahead. Corporate credit will be tested by balance sheet issues and increased defaults. A heavy investment-grade pipeline could provide further pressure, while high-yield issuance might be squeezed out by the elevated spreads in investment grade. We remain cautious and defensive but see value in some sectors and industry groups. The muni market is beginning to be tested by a larger new issue calendar, but weaker issuers are essentially shut out. Yields are still at record levels as a percent of Treasuries and swaps.

- **HIGH GRADE CORPORATES:** We continue to be cautious on investment-grade bonds, which will be pressured by balance sheet strains, lack of demand, and the potentially heavy pipeline. Crowded short and defensive trades did not protect in the current sell off, as liquidations and redemptions are picking up speed. Long term we think some sectors appear attractive, especially for the top U.S. financials.

<u>Table V</u>

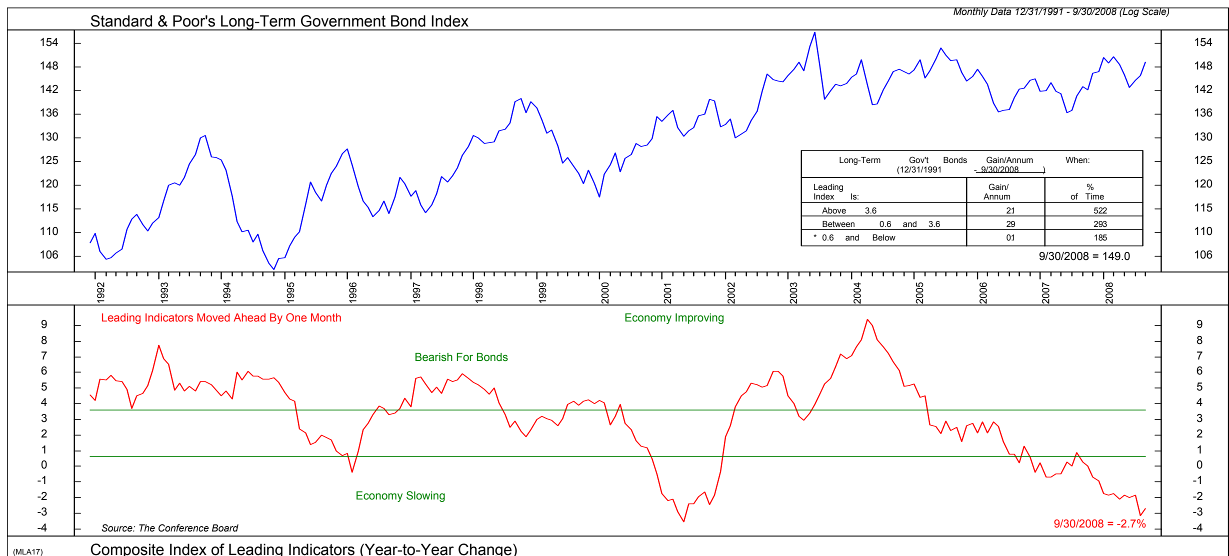


Source: Ned Davis Research

- **MUNICIPALS:** The muni market is beginning to be tested by a larger new issue calendar, particularly in upper medium-quality credits. The market is still essentially closed to weaker issuers. A strong case can be made that munis remain cheap despite the rally. Short-term yields will drop further, steepening the curve. Muni yields as a percent of Treasuries and LIBOR swaps are still at record levels tens years and in; they are near records on the long end.

- **CREDIT CONCERNS:** Federal Reserve policymakers lowered the target rate in the end of October by another half point. Rapidly fading inflation pressures and especially harsh financial conditions suggest considerable scope for additional accommodation as well as further aggressive fiscal steps. Collapsing consumer confidence appears to be reinforcing the economic downturn, with labor market weakness poised to intensify. Failure to stabilize financial conditions could introduce more severe tail risks of debt deflation. See Table VI for the Lead Indicators graphed against the Standard & Poor's Long-Term Government Bond Index.

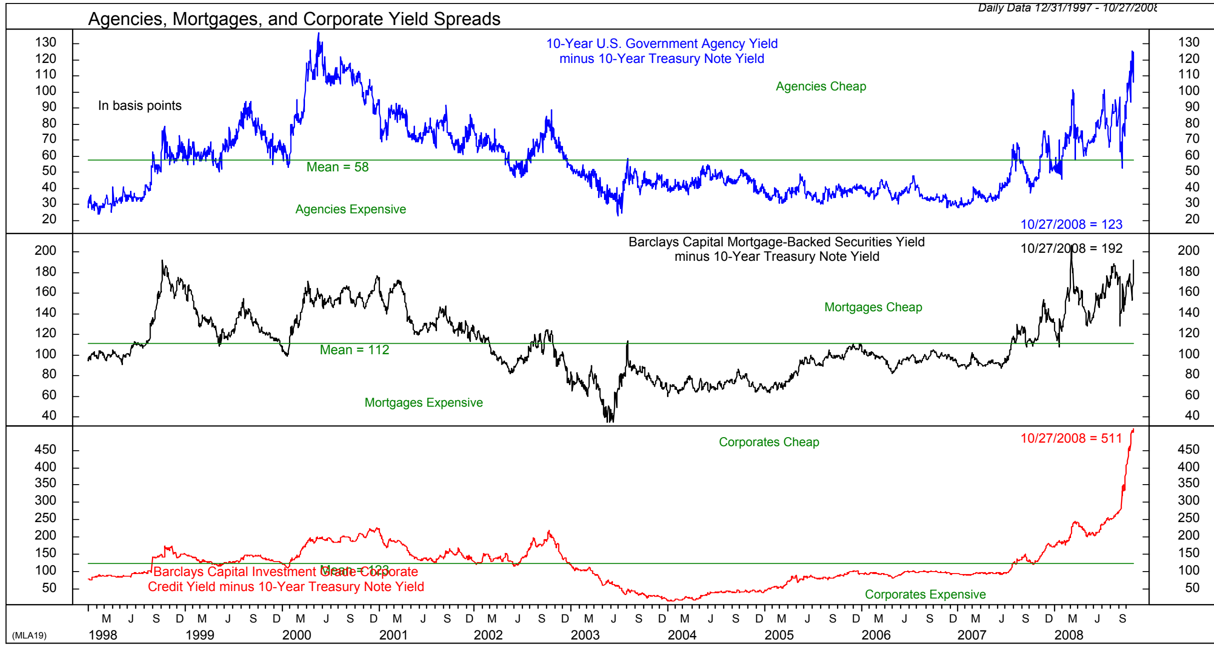
Table VI



Source: Ned Davis Research

- **Both domestic corporate bonds and U.S. agency mortgage pass-through securities easily out performed 1-10 year Treasuries during the 2nd quarter.** In that quarter longer term interest rates rose on worries of higher inflation and a weaker dollar. However, the bond markets in the third quarter reversed direction as higher interest rates assumptions were far too aggressive considering the drag from declining confidence, deteriorating economic indicators and a weaker job market. At current levels, in the near term, we believe that short and long term rates will probably rise with prospects for U.S. short-term rates moving up faster and potentially flattening the yield curve. While the Federal Reserve and the ECB are unlikely to raise rates this year, that's largely contingent on ratcheting back price pressures. See Table VII for a representation of agency, mortgages and yield spreads.

Table VII



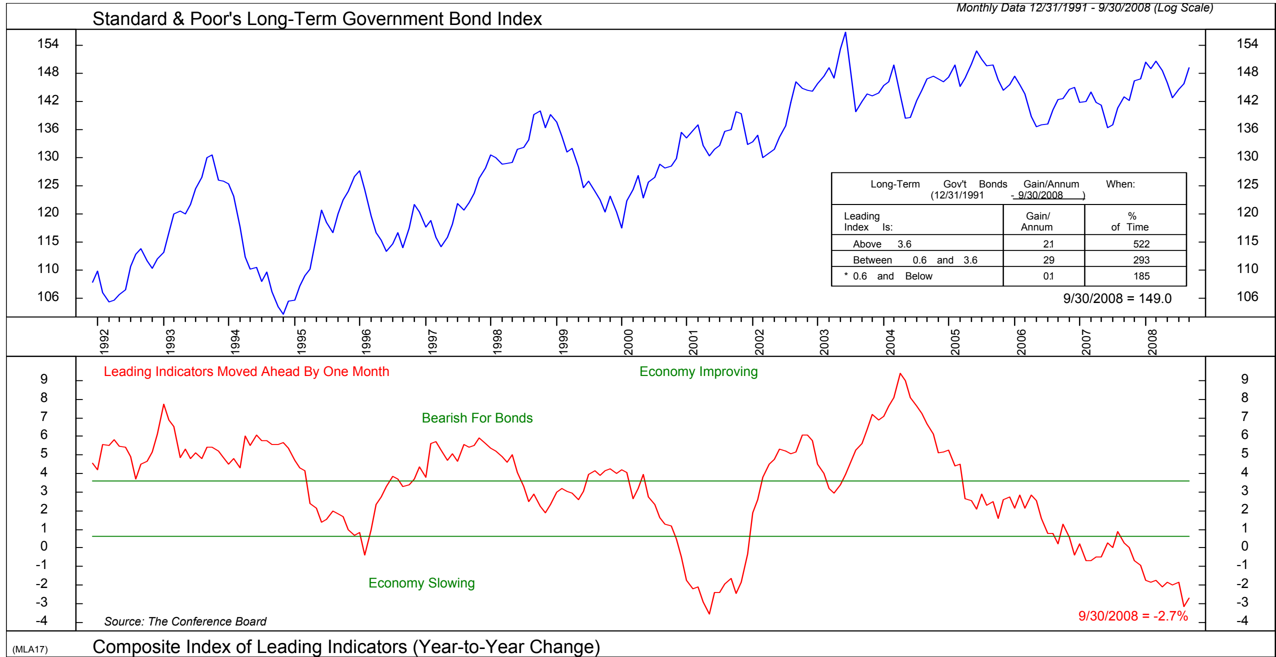
Source: Ned Davis Research

- **We continue to believe that possessing a good defense in the current climate makes good sense – stick to high-quality securities and selected opportunities in the corporate sectors.** In addition, bond investors should garner sufficient liquidity premiums for even high-quality investments that might be subject to longer-than-expected impaired market conditions (i.e., asset-backed and structured investments). We do not advocate that investors sell high-quality holdings into the unattractive valuations typical of these fragile markets as long as those investments remain consistent with long-term investment objectives.

- **The pressure on munis comes from several sources including the continual stream of bond insurer downgrades. While specific ratings vary greatly, the rating level means little for any of the insurers except the three that remain triple A: FSA, Assured Guaranty, and Berkshire Hathaway.** For any other insurer, bonds are trading based almost exclusively on the underlying credit strength of the issuer, and in some cases, identical bonds trade to a lower yield without bond insurance than they do with it. While the increases in yield are fairly modest, they have come during a period when Treasury yields were actually declining. As a consequence, muni yields as a percentage of Treasury yields have bounced back fairly sharply. Indeed, all along the yield curve muni yields as a percentage of Treasuries are almost at peak levels. On long maturities in particular, the extra yield is impressive, in our view. For 30-year maturities, the average yield as a percentage of Treasury yields for high-grade munis for the past 12 years is 90.5%. At the close of business on July 1, 2008, the ratio was just under 105%. In the five-year range, the average ratio is 77.8%, and the current level is right at 100%.

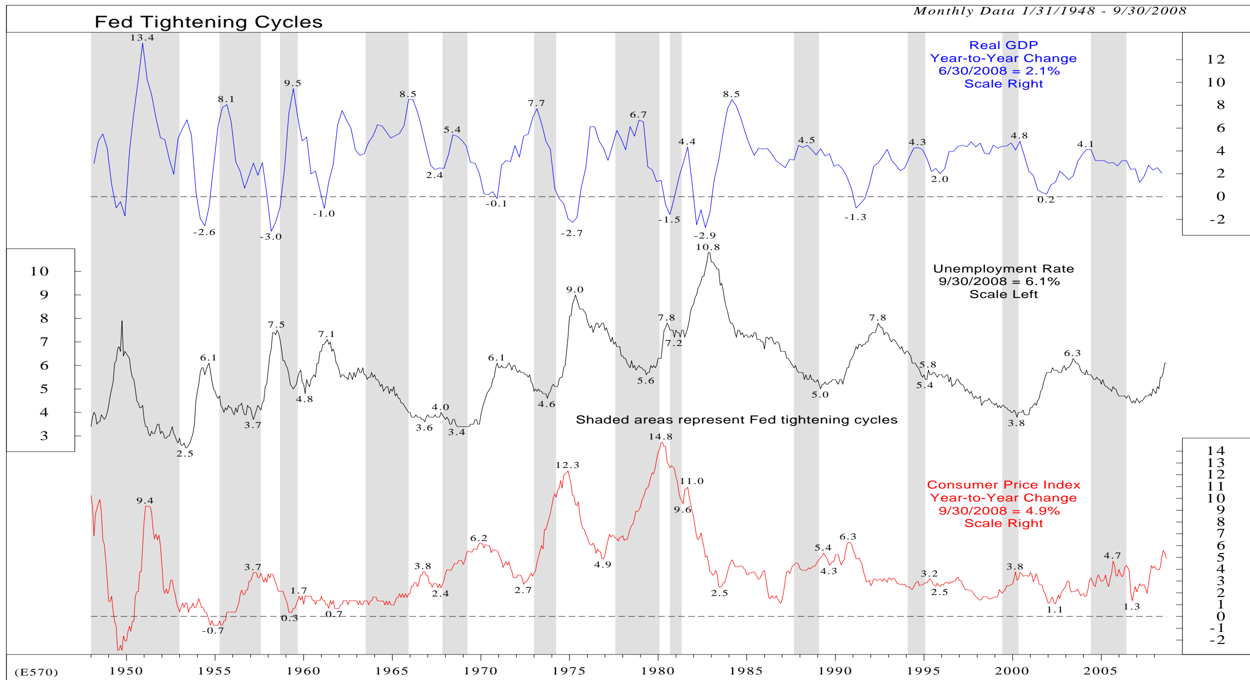
- **A number of factors contributed to the cheapening of munis in comparison to Treasuries:** (1) a renewed flight to quality as global and U.S. investors became more worried about the U.S. economic outlook; (2) downgrades of previously triple -A bond insurers and the resultant jettisoning by money market funds of variable-rate paper guaranteed by these insurers; (3) purchases of some of the high-yielding VRDNs by buyers who otherwise would have been focusing on the long-term market; and (4) a handful of liquidations of leveraged positions because their funding source was no longer money market fund eligible.

Table VIII



Source: Ned Davis Research

Table IX

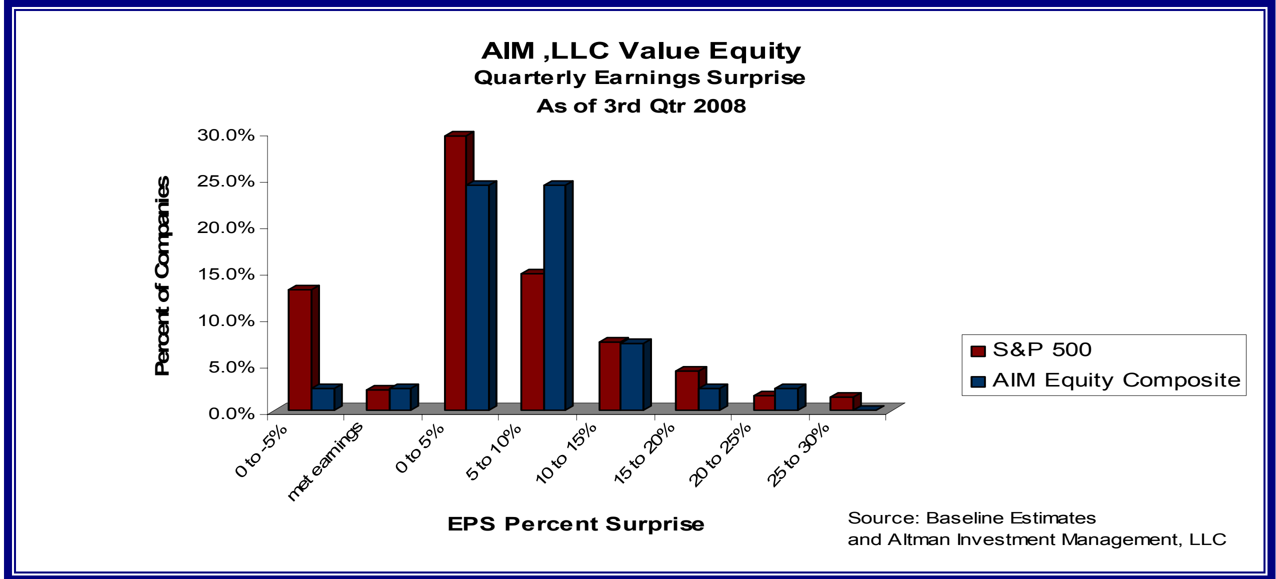


Source: Ned Davis Research

AGGREGATE PORTFOLIO ANALYSIS

- **The Standard and Poor's 500 quarterly earnings reports in aggregate missed street expectations in the third quarter by as much as 12%, driven down by the Financials and Consumer Discretionary sectors with the strength coming from Energy, Materials and Industrials.** The markets appeared to have been taken hostage with multiple compressions against a backdrop of credit disruptions and an imploding housing sector, despite declining prices particularly in the energy sector.

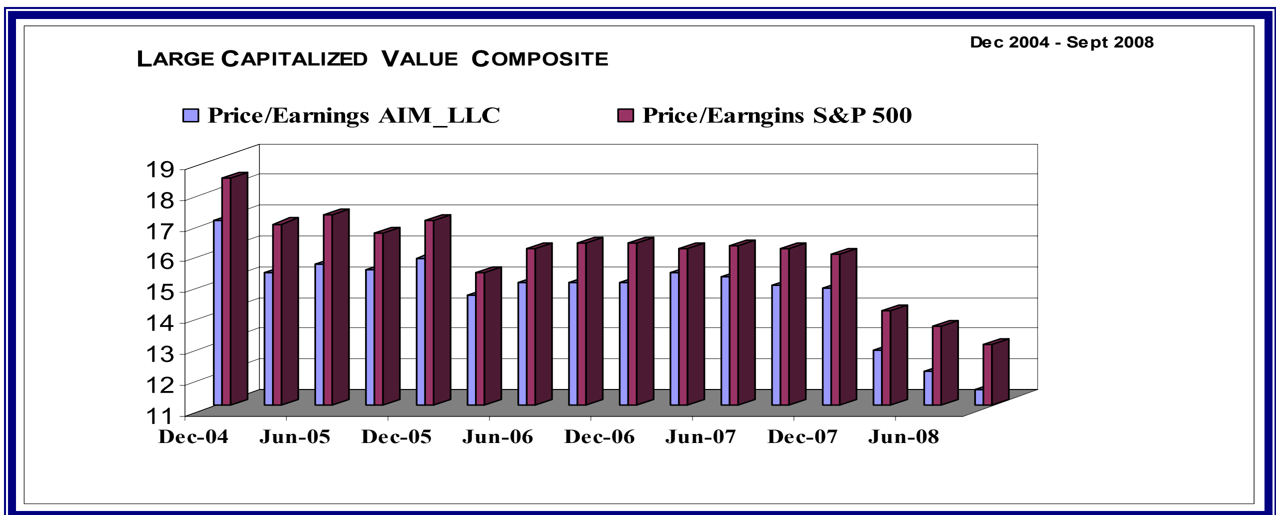
Table X



Source: Altman Investment Research, Bloomberg & Thomson Financial

The chart above illustrates the percentage of investment holdings within our value portfolio that exceeded street estimates during the third calendar quarter of 2008. Most notably, 75% of our investments exceeded street estimates against 65% of the companies in the S&P 500 that exceeded street estimates. Year over Year growth in earnings was +3.37% for our composite versus a decline of -11.75% for the S&P on a share weighted basis. Looking at top line sales, 61% of our investments exceeded street estimates as compared to only 54% for the S&P. Turning to bottom line net income, the figures were 75% and 62% respectively.

Table XI



Source: Altman Investment Research, Bloomberg & Thomson Financial

Do Earnings Really Matter?

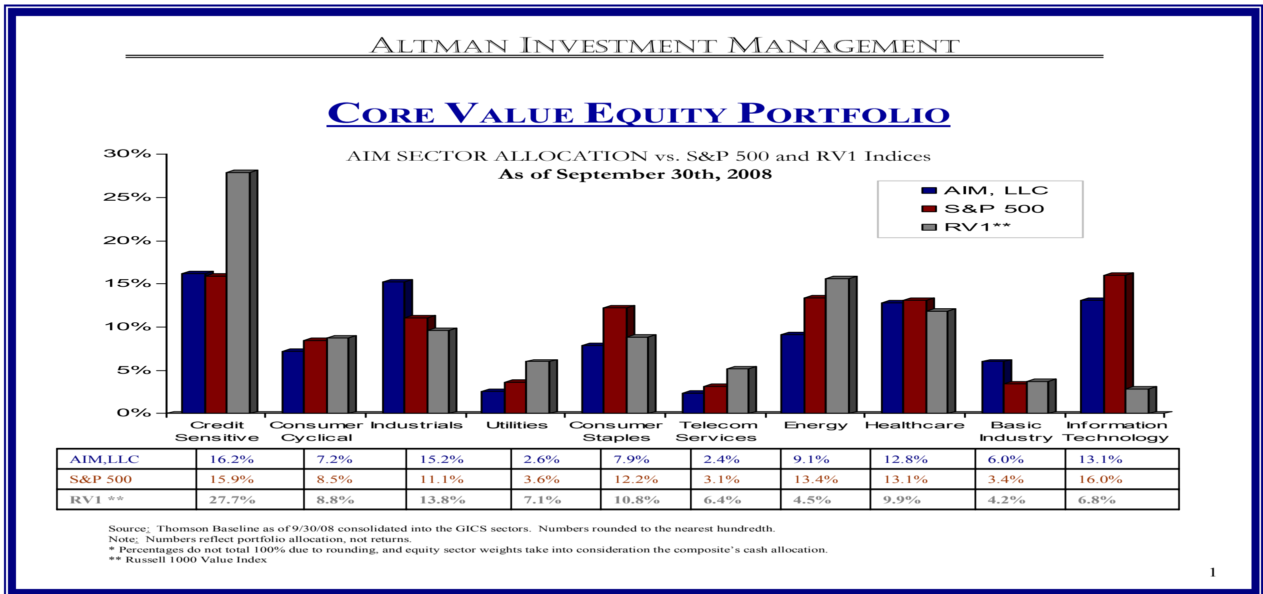
- **Our aggregate portfolio profit performance surpasses the S&P 500's reported records during both the second and third quarters.** In turbulent markets we can not put enough emphasis on the fact that the financial markets are inefficient in either reflecting a company's current and/or future earnings power. This inefficiency as evidenced by extreme volatility of the financial markets especially at cusp reinforces our first step in the selection process. Our methodology begins with a quantitative approach that screens large universes of stocks for both absolute and relative valuations over longer time periods than what is traditionally used to gain a more accurate reading on what we might expect as owners of businesses. In determining a "reasonable price" (1) at which a common stock might be bought, we lean very heavily on average earnings experienced over a number of past years to establish an upper limit to pay for the shares in relationship to this earnings experience. This methodology is not solely dependant on mathematical calculations but weighs heavily on narrowing the universe of companies that may qualify for further discovery. Our experience analyzing companies over the past 30 years utilizing this technique has proven successful in focusing our security analytical efforts on a narrowed universe of companies that may qualify for investment, and creates the essential structure for an efficient research effort.

Asset Allocation Strategy

- **During the third quarter we lowered the overall portfolio's exposure to Consumer Cyclicals** selling shares in the media, commercial storage, credit card and restaurant businesses. We dropped our 20% overweight position in the sector to 15% underweight anticipating a harder landing for U.S. consumption. We used the sources of funds adding to the consumer staple sector doubling our representation in the sector despite the relative high valuations of the aggregate against top and bottom line earnings generation.

Table XII

GICS Sector Allocation Summary



	Credit Sensitive	Consumer Cyclical	Industrials	Utilities	Consumer Staples	Telecom Services	Energy	Healthcare	Basic Industry	Information Technology
AIM,LLC	16.2%	7.2%	15.2%	2.6%	7.9%	2.4%	9.1%	12.8%	6.0%	13.1%
S&P 500	15.9%	8.5%	11.1%	3.6%	12.2%	3.1%	13.4%	13.1%	3.4%	16.0%
RV1 **	27.7%	8.8%	13.8%	7.1%	10.8%	6.4%	4.5%	9.9%	4.2%	6.8%

Source: Thomson Baseline as of 9/30/08 consolidated into the GICS sectors. Numbers rounded to the nearest hundredth.
Note: Numbers reflect portfolio allocation, not returns.
* Percentages do not total 100% due to rounding, and equity sector weights take into consideration the composite's cash allocation.
** Russell 1000 Value Index

Source: Altman Investment Management Research, Thomson Financial and Bloomberg.

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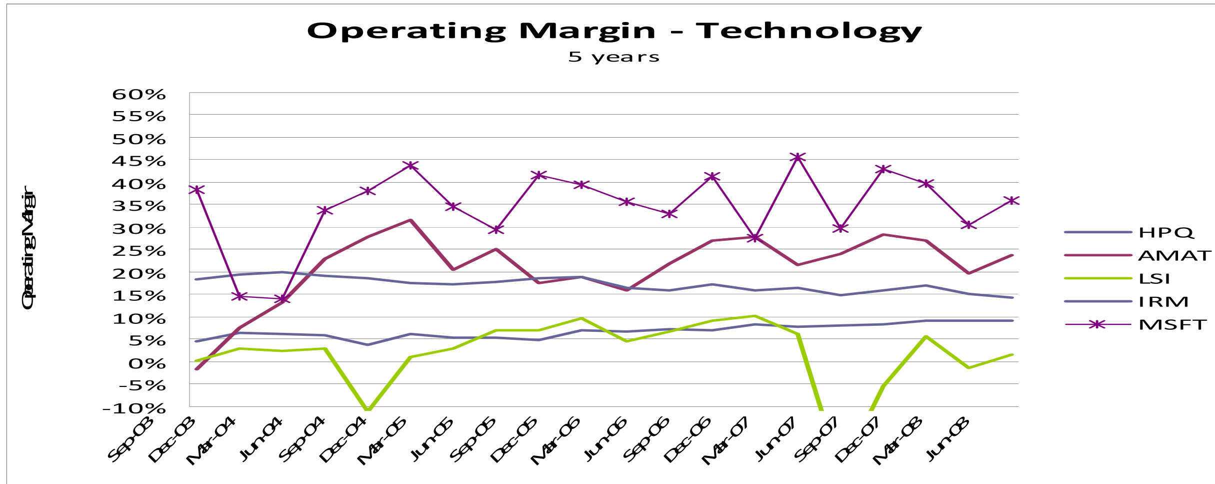
(1) Security Analysis, Fourth Edition Copyright @1962 by Benjamin Graham, David Dodd and Sidney Cottle.

TECHNOLOGY

Table XIII



Source: Altman Investment Research, Bloomberg & Thomson Financial (Base Line)

- **SIA July data was weak entering the typically-soft summer months, with total semi month over month revenue down -18.6%, in line with the 10-year average of -18.5%, with declines in ASPs and units of -9.6%** the **and -10% month over month, respectively.** Overall, ASPs remained firm on a year over year basis, seeing an increase of +1.1%. Monthly declines were led by ongoing weakness in memory, but with industry shipments generally subdued. In general, against the uncertain current global economy, and in a backend-weighted quarter, we believe investors are likely to focus on the sell through rates exiting 3Q and into 4Q. We would expect weaker SIA data to impact semi investor sentiment; thus, we remain selective in our picks.

- **Total Semiconductor revenues were down -18.6% MoM (vs. the 10-year average MoM -18.5%)** and up 4.9% QoQ & up 2.4% YoY. Total semi unit shipments were -10% Month over month, +3.9% quarter over quarter, and +1.2% year over year. Microprocessors revenues were lower, after a stronger June, down -44.3% MoM, broadly in line with the 10-year average July MoM decrease of -41.6%. Units were down -33.8% MoM, +3% QoQ, and +6.4% YoY. Memory: DRAM revenues were down -6.4% MoM, with -6.0% decrease in units, as ASPs were a touch lower by -0.4% MoM. YoY DRAM revenues declined -8.6%.

- **Discrete memory chips revenues were down -12.6% MoM, vs the 10 year July average of -16.4%.** Unit shipments decreased -10.7%.

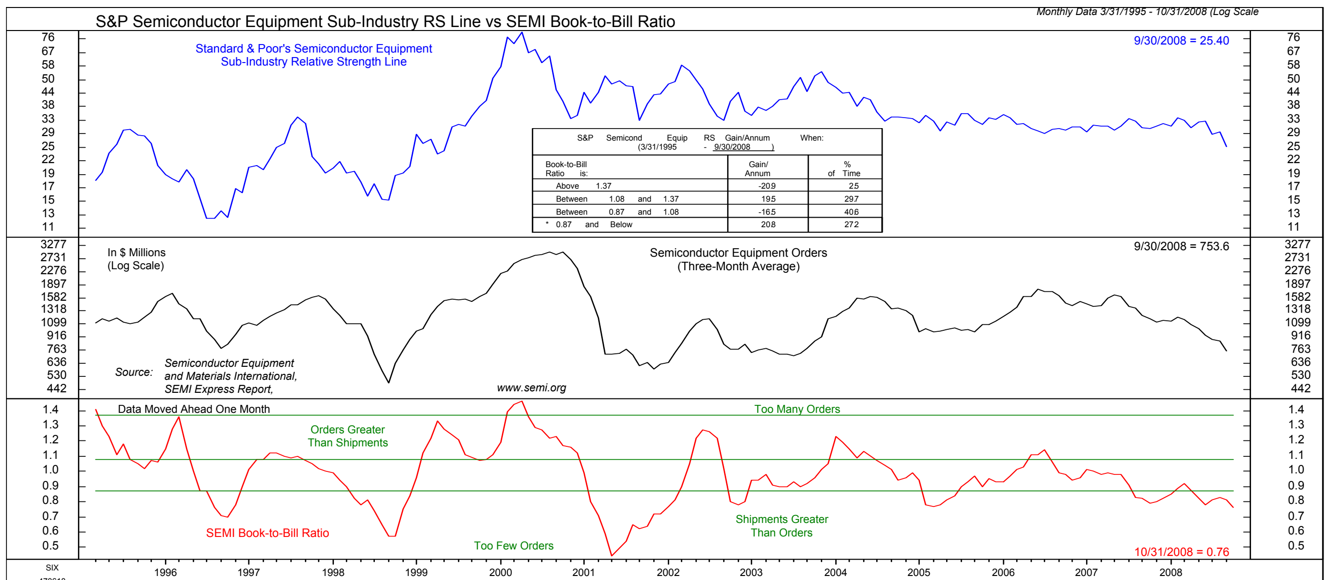
- **Against the current global economy, we believe investors are likely to focus on the sell through rates exiting 3Q & into 4Q.** We recognize that weak sell-through could ultimately prompt the need for further inventory reductions & for sales & earnings revisions for 4Q & 1Q09. Amidst the broad market carnage and a weak economic picture, the tech sector continues to demonstrate operating resilience. Yesterday's industrial production report revealed that tech production continues to expand at a robust pace in absolute terms and especially relative to the production slump in non-tech output. This is attributable to decent demand and the absence of three kinds of typical technology industry excesses: capacity, investment and inventories. Still, certain groups are more cyclically-exposed and investors should continue to favor defensive tech (software and data processing) and early-cycle (semi and semi equipment) groups versus the more aggressive tech groups (computer hardware, communication equipment and electronic equipment and instruments). *Bottom Line:* The profit backdrop remains supportive for technology stocks, but investors should remain selective until cyclical risks abate.

- **The PC & Consumer Segments are the Weakest:** In terms of end markets, we believe that PC and consumer segments have been the weakest segments with wireless handsets subdued while communications has been mixed with flattish wireless and wire line infrastructure demand in 4Q balancing slower Enterprise Networking. Industrial demand also appears mixed, with military a bright spot at year end, but the broader industrial applications, such as test, measurement and automotive segments, have weakened. Regionally Emerging Markets Soften: Regionally, weakness in core North American and European markets appears to have been compounded in October and November by incremental softness in Asia, Latin America, Japan and Eastern Europe.

- **Street estimates are being reduced once again, valuations are already at new trough levels and the absence of major inventory challenges would appear to suggest support is likely at current levels, even if any catalysts may not appear until 2Q/3Q09.** Nearer term we are more encouraged by updates from Nvidia relative to very modest expectations. We are maintaining our estimates for our semiconductor holdings at this early stage in January and await quarterly results.

- **We recognize the sensitivity of the sector to macro economic forces both domestically and internationally.** As the fundamentals in the sector begin to show signs of improvement in the next several quarters of 2009, we anticipate increasing our weighting above the current Standard and Poor's 500 allocations. Within the sector we continue to favor the Semiconductors because the supply/demand forces appear to be improving. As global semiconductor capital expenditure growth in the industry contracts, it sets the stage for a cyclical upturn in the relative performance of semiconductor shares. In addition to reducing expenses, lean capital expenditures have typically heralded tighter supply conditions going forward, triggering an improvement in industry pricing power. The missing link at this point in the cycle is a decisive improvement in demand. However, the massive reflationary stimulus in the system should work to rekindle demand forces later in 2009. Meanwhile, the group's attractive valuations and early cycle tendencies warrant holding on to our industry position ahead of such an improvement.

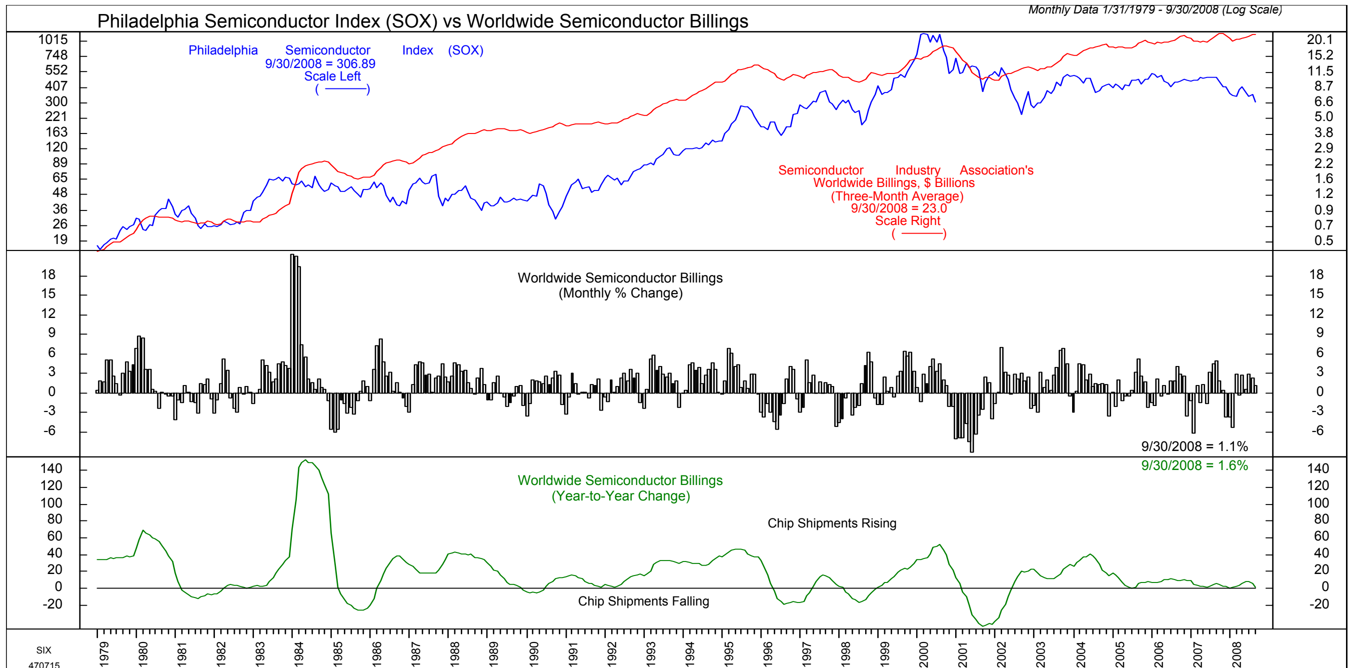
Table XIV



S&P Semicond Equip RS Gain/Annum When: (3/31/1995 - 9/30/2008)		
Book-to-Bill Ratio is:	Gain/ Annum	% of Time
Above 1.37	-20.9	2.5
Between 1.08 and 1.37	19.5	29.7
Between 0.87 and 1.08	-16.5	40.6
* 0.87 and Below	20.8	27.2

Source: Ned Davis Research

Figure XV



Source: Ned Davis Research

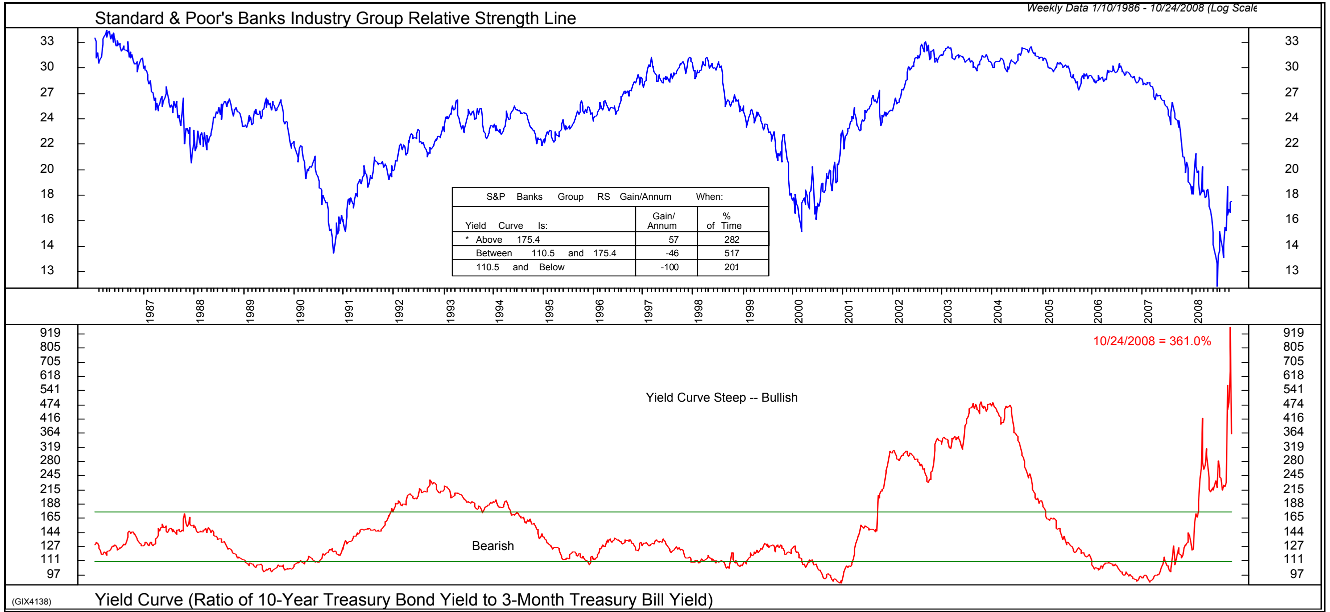
FINANCIAL/CREDIT SENSITIVE

- **In contrast with the S&P insurance index's relative stock performance, the group's advance/decline line continues to grind higher.** This divergence underscores that pockets of strength exist within the group, but are being masked by asset write-downs at a few large cap insurers. Importantly, there are encouraging signs that profit conditions are set to improve. First, consumer prices for motor vehicle insurance are rapidly gaining momentum, to the benefit of profit margins. Secondly, elevated gas prices have discouraged driving activity, which raises the likelihood of fewer insurance claims, a boon for earnings. Third, relative business confidence for the insurance group remains near its cycle high (see the June 18th *Insight*), signaling that the profit environment is relatively favorable for the defensive group. We remain overweight insurance stocks, and maintain the underweight in the banking group versus S&P sector weight.

- **We remain concerned that the financial stocks will not be able to sustain a relative advance without a narrowing in financial credit spreads.** The credit environment continues to deteriorate due to rising bankruptcy fears which have become a reality with selective issues. A bottom in financial securities awaits a trough in collateral values, and the message from the credit market is still ominous. Credit spread widening is aggravating capital adequacy concerns and threatens to keep selling pressure on financials in the near run. There are a few glimmers of hope on the horizon as the nationalization of the GSEs should help to stabilize the secondary mortgage market and eventually underpin housing prices. Additionally, global policymakers are likely to become more accommodative, which should ultimately help to restore confidence in the credit markets. However, we believe we should avoid the temptation to bottom-fish until credit spreads crest. In terms of industry sub-groups, the REITs look the most vulnerable, as the group appears to be ignoring the mounting risks in the commercial real estate market.

- **The CMI offers little encouragement for an imminent recovery in financial profits.** The drag from elevated financial stress and slow money creation are dominating the improvement in net interest margins. The stabilization in credit spreads will likely help to lift the CMI going forward. On a positive note, the pace of industry consolidation and layoffs has accelerated in recent months, which should help restore profitability. A streamlined cost structure is imperative to improving the outlook for return on equity given reduced demand prospects.

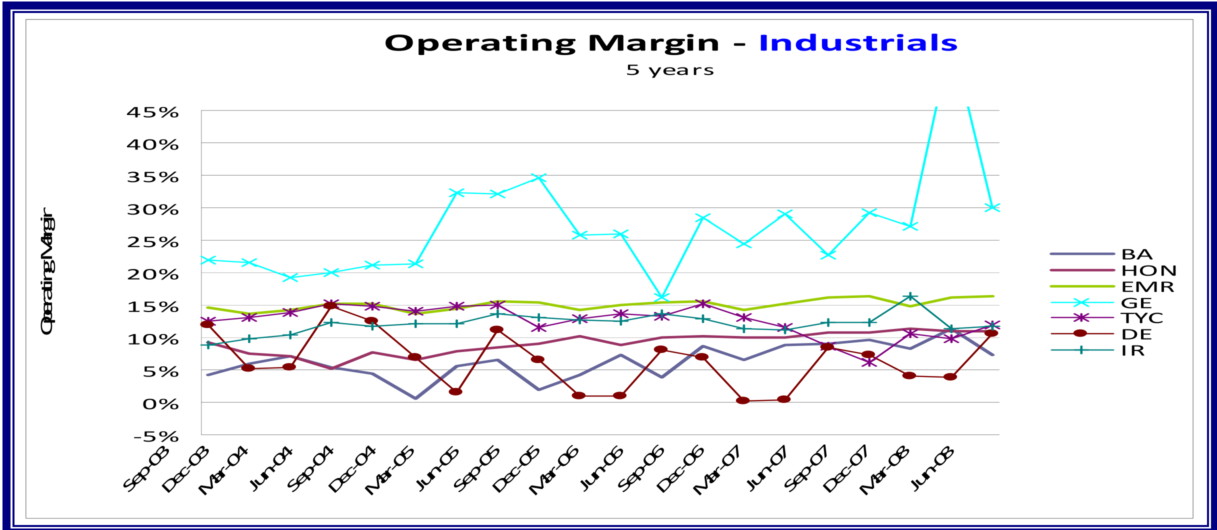
Figure XVI



Source: Ned Davis Research

THE INDUSTRIAL SECTOR

Table XVII



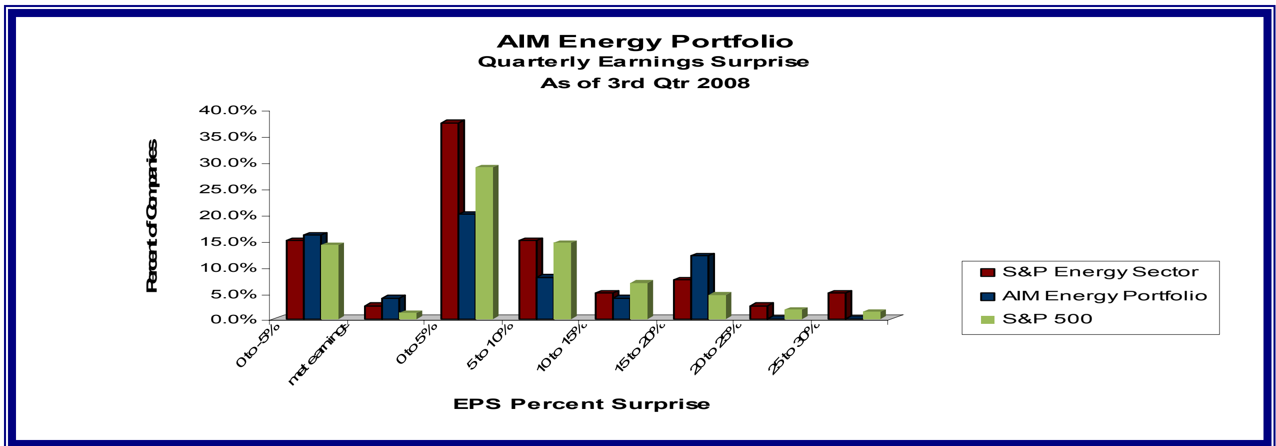
Source: Thomson, Bloomberg and Altman Investment Research estimates.

- **The near term profit outlook for machinery companies has yet to confirm the anticipated U.S. recession in 2009.** As recently as the beginning of Q3, order book rates remained full. The latest employment report corroborated the pick-up in machinery demand, with hours worked accelerating notably. The latter has traditionally been a harbinger of positive net earnings revisions. Global machinery orders continue to buck the downtrend in global leading economic indicators, underscoring that the industry is benefiting from infrastructure demand and that pricing power gains should continue to stick. Meanwhile, profit margins will feel some relief from lower commodity input costs, as well as diminished wage pressures. Although we would conclude that the relative bull market may be aging in the industrials, we believe the group still has more upside potential. The unemployment rate soared to 5.5% from 5.0% in May, the biggest increase since February 1986, to its highest level since October '04. Soft labor markets help to support why we are avoiding the Employment Services sub-industry.

THE ENERGY SECTOR

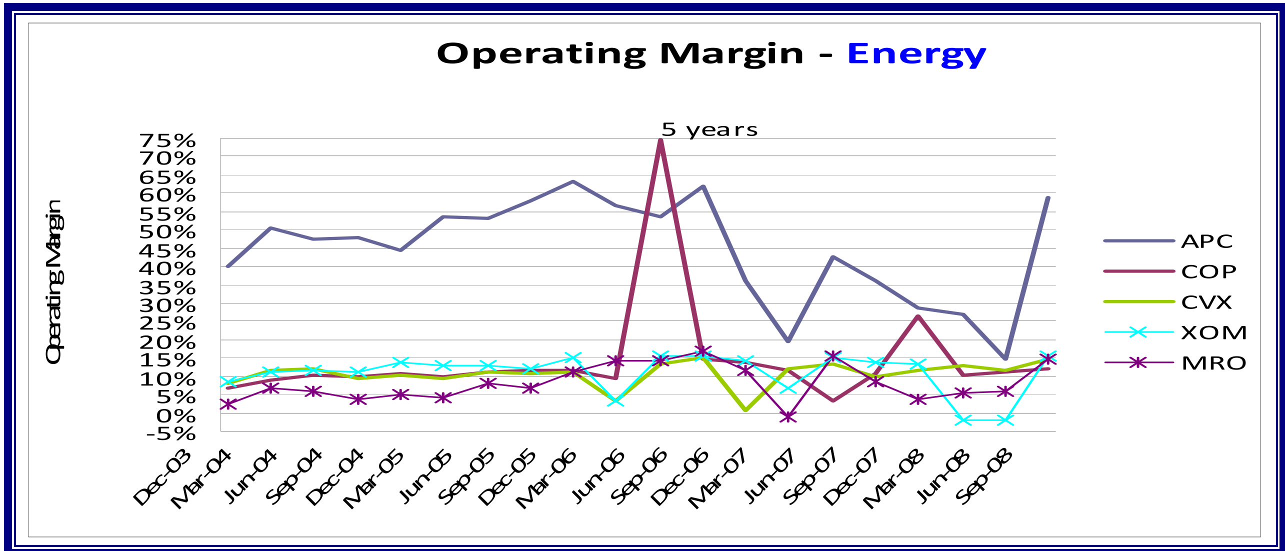
- The chart below illustrates the percentage of investment holdings within our AIM Energy Portfolio that exceeded street estimates during the 3rd calendar quarter of 2008. 100% of the companies in the AIM Energy Portfolio, 100% of the companies in the S&P Energy Sector Index and 88% of the companies in the S&P 500 Index have reported as of 11/06/2008.

Table XVIII



Source: Altman Investment Research, Bloomberg & Thomson Financial (Base Line)

Table XIX

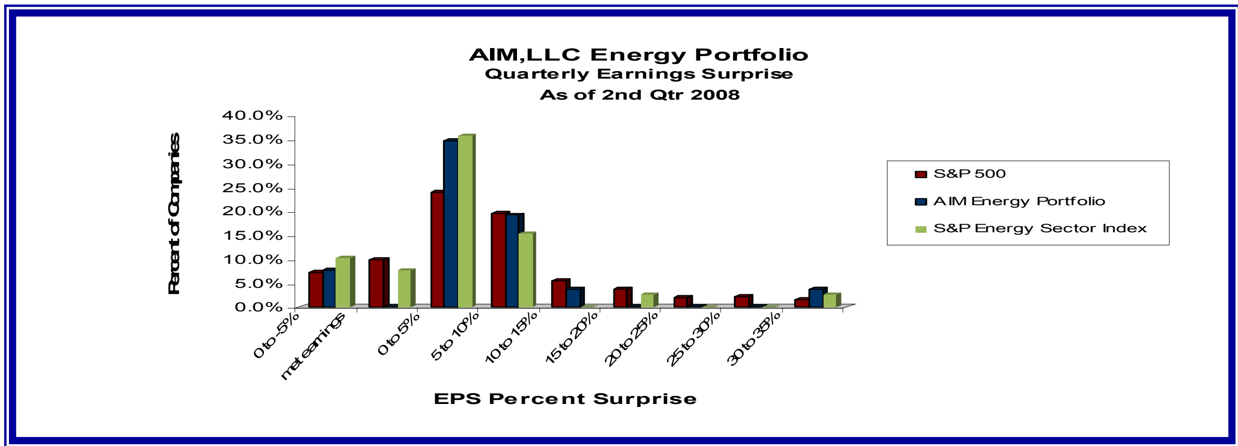


Source: Altman Investment Research , Bloomberg & Thomson Financial (Base Line)

Energy Valuations: Are the Oil Stocks really Cheap?

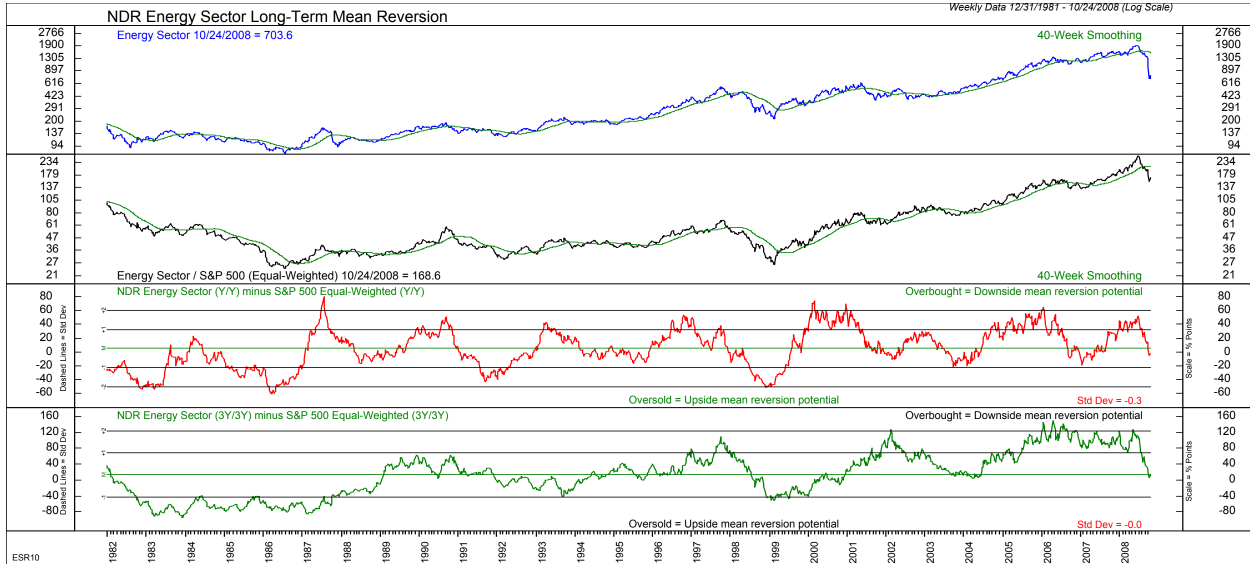
- **On an absolute basis, oil stocks are without a doubt very cheap.** The group that we cover is trading at an average cash-flow multiple of 2.8x based on admittedly ambitious consensus cash flow expectations, compared with a 5-year average multiple of 6.1x, and a 10-year average multiple of 5.9x. Indeed, on average these companies are trading at multiples that are only 48% of their 10-year average multiples. However, there are two things to point out from this data. First, not all companies' multiples have compressed equally. Among the Exploration and Production (E&P) group, a few companies are trading at around 30% of their 10-year multiple, but OXY and Devon stand out as having receded less than the others. Both of those names are above 60% of their 10-year P/CF multiple. Secondly, while E&P valuations have been hit harder than the broader market, most of the decline is not specific to the E&P industry. Indeed, while E&Ps are trading at 48% of their historical multiples, the S&P 500 is not faring much better, trading at 57% of its 10-year price to cash-flow multiple .

Table XX



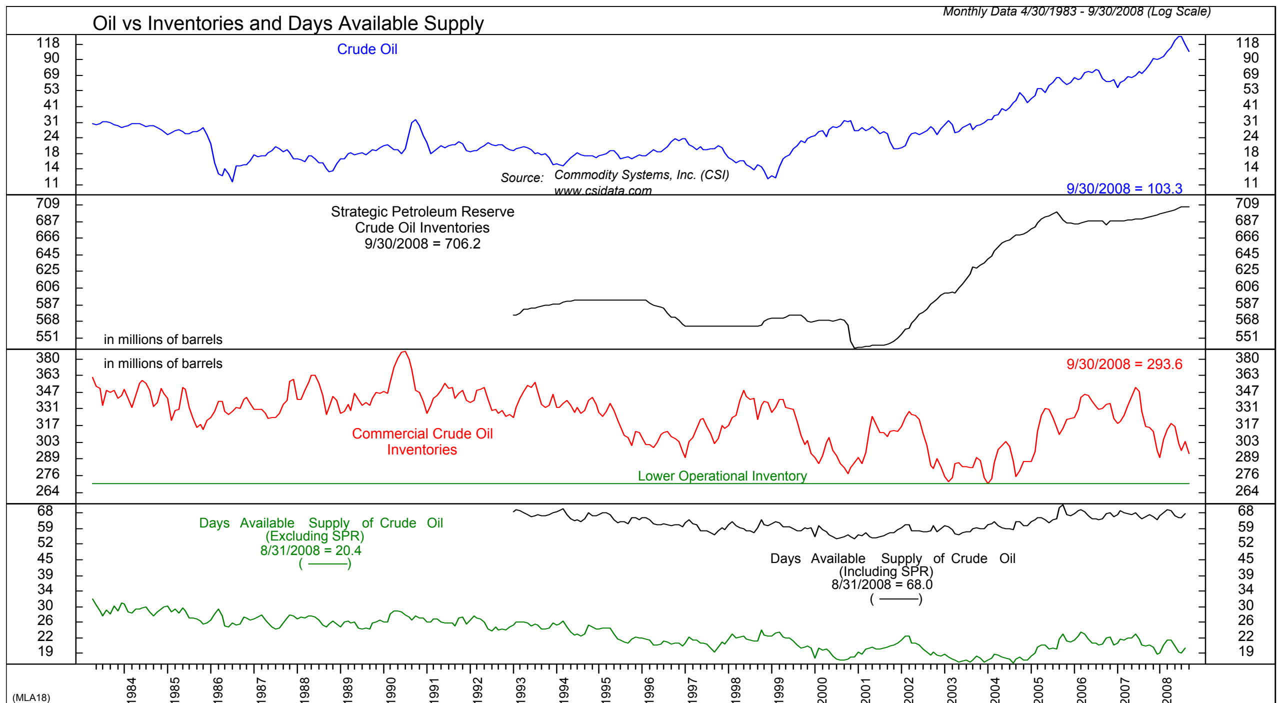
- **Table XX illustrates the percentage of investment holdings within AIM Energy Portfolio that exceeded street estimates during the 2nd calendar quarter of 2008.** Most notably, 76% of our investments exceeded street estimates. Similarly, 67% of the companies within the S&P Energy Index beat street estimates with 7.6% meeting estimates. Within the overall S&P index, 68% of the companies exceeded street estimates with 10% meeting estimate**.**

Table XXI



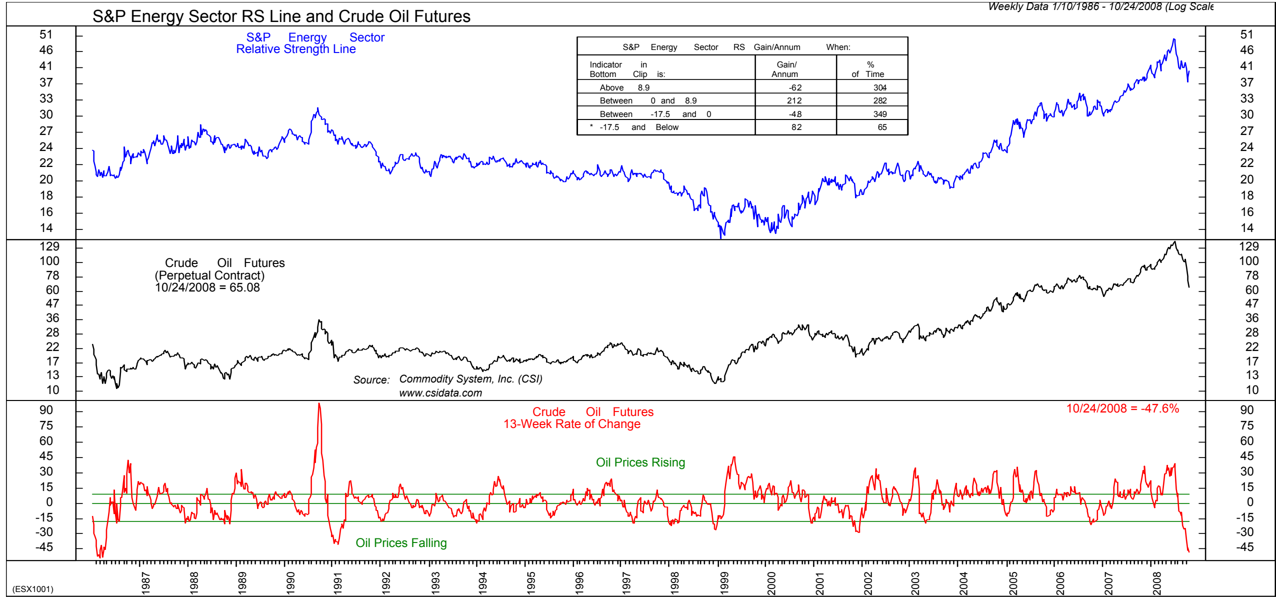
Source: Ned Davis Research

Table XXII



Source: Ned Davis Research

Figure XXIII



Source: Ned Davis Research

PORTFOLIO CHARACTERISTCS

Table XXIV

ALTMAN INVESTMENT MANAGEMENT

AIM PORTFOLIO CHARACTERISTICS

As of September 30th, 2008

	Value Equity	S&P 500
# of Holdings	40 stocks	500 stocks
Portfolio Beta	1.04	1.00
Wtd. Avg. Price to Book	1.7x	2.2x
Wtd. Avg. Price-Earnings (Current)	11.5x	13.0x
Wtd. Avg. Price-Earnings (FY1)	9.9x	12.1x
Wtd. Avg. Price/Sales Latest 4 Qtrs	1.01x	1. 10x
Wtd. Avg. Dividend Yield	3.1%	2.5%
Price to Cash Flow	7.4x	9.4x
Equally Wtd. Market Cap.	$65.7 Billion	$86.8 Billion
Ten Largest Holdings (% total)	34%	--
Approx. Portfolio Turnover	30%-40% per annum	--
Maximum Cash Position	10%	--

Sources: S&P 500 characteristics are utilizing a combination of Baseline data and FactSet Research Systems, Inc. as of September 30th, 2008 for weighted average book value, price/earnings, price/cash flow, and price/sales figures. AIM, LLC utilized both first call estimates from Baseline and IBES estimates from Bloomberg statistics for the current and forecasted S&P 500 earnings in 2008 and 2009.

1

FIRM UPDATE

Altman Investment Management, announced its seventh year managing investments for our valued clients this year, dedicated to servicing our investment partners in good and more difficult times, by achieving both consistent and superior investment performance relative to our benchmarks and peer group across both equity and fixed income classes. Our singular focus on investment performance and exceptional client service, with seasoned investment professionals, continues to solidify our long-term partnerships. We have been managing client portfolios for over 30 years with a continued emphasis on our value discipline approach, achieving superior relative performance results for our flagship value equity product since we incorporated in June 2001. Our annual compounded performance results (1) calculated in accordance with the Global Investment Performance Standards (GIPS®).2 and are available on several investment consultant data basis including PSN and eVestment Alliance. We recently introduced several new products that address our clients expanding needs dedicated to continuing our tradition of achieving the superior results that our clients should expect and deserve. During periods of uncertainty, we especially appreciate our clients, business partners and friends for their continued confidence in our process and expertise. We look forward to celebrating our ten year anniversary with the same degree of energy and passion as on the first day of incorporation.

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(1) The peer universes data is supported by PSN software and is provided by the Informa Investment Solutions, Inc.
(2) These standards were created by the Association of Investment Management and Research (AIMR-PPS) the predecessor to CFA Institute.

The opinions expressed in this commentary are those of Altman Investment Management, LLC as of the date appearing on this material only and are subject to change. The material is based upon information we consider reliable but we do not represent that it is accurate or complete and should be relied upon as such. This material does not take into account the particular investment objectives, financial situation or needs of the individual client and should not be viewed as an endorsement of any particular investment. Certain investments give rise to substantial risk and are not suitable for all investors.