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Interim Third Quarter, 2008 Portfolio Report
Comments on the Current Environment

We will be preparing quarterly portfolio reports shortly and, as you are undoubtedly aware, the third quarter saw weak investment performance. Although that would be bad enough, the first two weeks of the fourth quarter have shown significant volatility in the equity markets along with further generally downward movement in stock prices.

Over the last few weeks, we have received calls from many clients concerning the financial events unfolding across the globe. We would prefer to speak directly to each and every one of you, however, time simply would not allow, even though we welcome and try to answer as many of the calls that we receive.

As many of the conversations have had common questions and themes, we thought some of those should be addressed in writing. These will be brief, perhaps oversimplified, comments on some of the concerns and questions you may have and we certainly cannot profess to have all the answers as many issues are complex. Hopefully, these points will help you put some of the ongoing issues in perspective. As most of you have questions, we have determined to address these issues in question and answer format.

What the devil is going on?

Books will be written on the events of the last several months, but a confluence of events have come together to create significant uncertainty in the markets, a few of which are discussed below:

- A broad global decline in real estate values. This has resulted in large loan write downs over the last several quarters. This is not unusual as regional real estate downturns have been seen before. However, the virtual global decline in real estate value has not been experienced before. Although most banks have significantly written down loan exposure over the last several quarters, no one can accurately predict when the price declines may end. This has adversely impacted banks willingness to lend.
- Easy consumer credit has overextended the US consumer. This coupled with a tightening in credit has precluded the consumer's ability to

refinance this debt. Further, although banks have written down their mortgage balances, this does not translate to the borrower's debt. Significant diminution in equity has created broad consensus that consumer spending will continue to decrease and result in a recessionary environment.

- Toxic assets on the balance sheets of many financial firms. The scope and exposure of many derivative instruments on the books of some financial service firms seems to be almost beyond comprehension. The complex nature of these instruments has made accurate determination of value and potential liability exposure difficult, if not impossible. Market reception for such large scale unknowns is predictable and is a full discounting of what can be conceived of as the worst possible outcome.

You may have some other points of your own to add to the list such as high energy costs or the like, but any one of the above mentioned conditions would arguably place a heavy burden on the economy. Together the impact of these conditions has been seen to be exponential.

Will this lead to the next great depression?

Several months ago, we would have told you the probability of a depression was quite narrow, probably under one percent. Now, most believe that at least a significant recession is a foregone conclusion. There is no shortage of opinion that a depression is also inevitable. However, we still see such a play out of events to this end as a relatively small probability, still less than 5%. We say this because, even though there will be a large amount of the US consumer spending curtailed by lower real estate values, there is an even larger segment which will not be as heavily impacted. Further, beyond the financial sector, most companies are neither overextended nor teetering on the verge of huge write offs. Indeed, the balance sheets of many entities are sound and business strategic plans appear to be already accounting for at least a slowdown. One presidential candidate has taken extreme heat for his comments a couple months ago that the fundamentals of the economy were sound, however, he was not entirely wrong outside of the financial sector. Lastly, it appears that governments and central banks around the world are definitely committed to push as much capital as necessary to keep banking functions operating. Indeed, it appears most governments are simply ready to replace banks as the providers of capital should banks be unwilling. We do not believe it will come to this and thus, over time, one way or another, there should be ample liquidity provided to businesses.

What if I disagree and am convinced we are heading toward depression over the next several years? If you are convinced that we will continue to cycle down and down over the next several years, the investment policy we suggest is not appropriate. Financial instruments issued by corporations and even municipal agencies will not fare well and would likely continue to move down in value significantly. The time frame for equity recovery would extend beyond the seven years we generally suggest that encompasses more probable

economic scenarios. You should liquidate all your holdings in equity and fixed income exposure and move to very short term treasury holdings. Again, we do not suggest that investment policy on what we believe to be a low probability event. The point is that we believe there is no real effective partial hedge against such an economic scenario other than complete liquidation.

What of the government interventions and will they work? The government has provided bailout funds directly to institutions (AIG) as well as on a broad based fashion (the bailout fund). Further, they have pumped much capital into banking reserves (most recently taking preferred equity stakes), cut interest rates, and have directly participated in the commercial paper market, to name a few of their more significant actions. In our opinion, some of this intervention was clearly necessary, but more to restore institutional and investor confidence rather than for immediate monetary policy impact. We have seen an availability of credit problem not a cost of credit issue. Many developed markets around the world have taken very similar significant actions, indeed on an unprecedented and surprisingly coordinated fashion. At this point, our opinion is that it is somewhat overdone and that the most beneficial action at this point is for governments and central banks to take a rest and let thing play out. For over the last two weeks, a major presidential or treasury announcement is a daily occurrence. The equity markets seem to recover during the course of a trading day until the major announcement is made and then they often crash. The only day the government was off was Columbus Day and the market recovered by the largest gain in its history. The actions are well intentioned and are generally appropriate; however, we believe it is now the time to let them run their course.

If I stay the course, or even liquidate, is my custodian safe? We predominantly use the institutional groups of both Fidelity and Schwab for custody. These have proven to be very sound custodians and, in our opinion, have been and continue to be the best alternative for custody of your assets. These accounts are also insured by the SPIC. The valuation of the securities, of course, is not insured, but the assets within the account are insured against the potential insolvency of the firms. Thus, if these firms did end up in bankruptcy like Lehman Brothers, the assets in client accounts would be separate and insured. These firms have stuck to their primary businesses of transactions, management and custody. They have not been heavily involved in lending or taking large positions in proprietary product. Thus, we still believe they are the preferred custody agents.

What about the core cash in my account, is it safe? Is it insured like a bank deposit? The money market funds are technically subject to price fluctuation even though the principal objective of the funds is to maintain a stable \$1 per share net asset value. There was a recent case of a money market fund "breaking the dollar" and suffering some loss and there have been a few cases in prior years. However, all money funds managed by both Fidelity and Schwab are much larger and in our opinion, much better managed than such examples.

The managements of these funds are keenly aware of the risks inherent in the money markets and have adjusted their strategies accordingly. Yields on these funds have increased significantly as many investors have flocked to treasury instruments. There are non-core cash money market alternatives that are solely invested in treasury securities; however, we believe that holding such funds against the regular money funds, both taxable and exempt, is not necessary. The balance of money funds within these plans as of September 19th is insured by the FDIC as all Fidelity and Schwab money funds have elected to participate in the new treasury program which is in place for at least one year.

What about the fixed income exposure within my portfolio? While this portion of your portfolio is intended to be safe, we have seen some defaults and pricing on individual issues and fund's net asset values has fallen well below average. Where individual issues are involved, defaults to this point have been few and the impact on overall fixed income exposures and portfolios limited. We believe that defaults seen to this point have been due to extreme circumstances and that the very rapid deterioration of some financial firm's conditions was unforeseeable. We do not anticipate further significant defaults and further would anticipate that as yield spreads between treasury and corporate issues narrow, there will be price recovery seen in these instruments. We do not believe that it is currently necessary nor an opportune time to liquidate taxable or exempt issues.

Are there any changes to suggested investment policy based on current events? We suggest maintaining cash and fixed income exposure substantially representative of your projected requirements against the portfolio over the next several years. The balance of funds should then be oriented toward longer term growth through investment in broadly diversified equities. Current events severely test this policy which we still firmly believe to be appropriate. Many have proposed a pull back in growth when things "settle down". The problem with such an approach is that the markets will anticipate beforehand any such settlement and recovery from these levels is likely to come in concentrated and inexplicable time frames. The volatility of the markets will make timing such recoveries very difficult if not impossible. If and when markets do recover somewhat, things will not really be "settled down". The possibilities of sharp equity market price declines continue today and will persist through economic recessions and recoveries. That is the nature of equity investment. In our opinion, only time and diversification can mitigate the risk.

Again, we welcome your comments and questions. As always, we appreciate your continued confidence.