



SECTOR LOGIC™

INVESTMENT INSIGHTS

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AUGUST 21, 2008

Over the last twelve months, the stock market has had to digest a global financial crisis, falling home prices, soaring oil prices, and an economic slowdown. These challenges may be with us for some time. However, current stock prices have already discounted these impediments. More importantly, the economic and financial conditions are likely to improve substantially in the coming year. Over the next twelve to eighteen months, oil prices are likely to fall, home prices are likely to stabilize and the economy is likely to recover.

The Opening Bell

As we look forward to the next twelve months, given the current investment environment and stock valuations, we believe stocks are the asset class of choice. Since stock prices are anticipatory, we believe the financial markets will improve before the economy does. In fact, based on our analysis, there is a high probability that a new bull market will begin before year-end.

Sector Performance

In the second quarter of 2008, energy and commodities sectors were hot, and financials and housing related sectors were not. Our industry sector models did an impressive job identifying strong performing industries and avoiding poor performing ones.

Our disciplined ranking process identifies industries with higher potential for superior returns. We analyze, evaluate, and rank approximately 100 industries on a weekly basis in order of potential for out-performance. To illustrate our industry ranking method, using our March 31, 2008 rankings, we computed the subsequent three-month returns for the top 10 and bottom 10 rated industries. We demonstrate this in Tables 1 and 2. Our top 10 rated industries had an average return of 16.91%. In contrast, our bottom 10 rated industries had an average return of -14.21%.

Historically, stocks and commodities frequently move in opposite directions. Given the recent parabolic rise in oil and commodity prices, we believed it was important to manage our risk exposure. Therefore, in our managed accounts, we diversified a portion of our portfolios into broader stock market indices in order to reduce energy and commodity industry concentration risk.

For reducing risk we seek to avoid industry sectors that have a higher probability of poor performance. As Table 2 shows, in the second quarter of 2008, we correctly identified some of the highest risk industries.

Table 1: Top 10 Rated Industries on 03/31/2008

Sector Logic Industry Ranking	Industry	Trade Date	Subsequent Returns (Price Change Only) 03/31/2008 to 06/30/2008
1	Petroleum Pro	03/31/2008	19.93%
2	Railroad	03/31/2008	14.37%
3	Coal	03/31/2008	85.12%
4	Chemical - Basic	03/31/2008	2.26%
5	Natural Gas (Diversified)	03/31/2008	17.65%
6	Oil Field Services / Equipment	03/31/2008	27.89%
7	Environmental	03/31/2008	13.15%
8	Pharmacy Services	03/31/2008	- 7.18%
9	Tobacco	03/31/2008	- 5.29%
10	Medical Supplies	03/31/2008	1.15%
Top 10	Average Price Change 03/31/2008 to 06/30/2008		16.91%

Table 2: Bottom 10 Rated Industries on 03/31/2008

Sector Logic Industry Ranking	Industry	Trade Date	Subsequent Returns (Price Change Only) 03/31/2008 to 06/30/2008
91	Furniture / Home Furnishing	03/31/2008	9.96%
92	Auto & Truck	03/31/2008	- 26.84%
93	Apparel	03/31/2008	- 4.60%
94	Retail Store	03/31/2008	- 8.91%
95	Financial Services Diversified	03/31/2008	- 12.92%
96	Bank	03/31/2008	- 27.72%
97	Bank - Regional	03/31/2008	- 32.05%
98	Bank - Canadian	03/31/2008	- 2.28%
99	Newspaper	03/31/2008	- 7.45%
100	Thrift	03/31/2008	- 29.24%
Bottom 10	Average Price Change 03/31/2008 to 06/30/2008		- 14.21%



Oil Prices and Stock Returns

Because oil plays such an important role in our economy, changes in oil prices have an impact on stock returns. On July 11, 2008, West Texas Intermediate Crude Oil closed at \$145.66 a barrel, over double the price of a year earlier. Since July 11th, oil prices have fallen nearly 17% to close at \$120.93 a barrel. As Chart 1 shows, stock prices, on average, respond more to falling oil prices than they do to rising oil prices. If crude oil prices continue to decline, this could provide the needed stimulus for an economic recovery and a catalyst for a new bull market.

Monetary Policy and Stock Returns

Monetary policy can have a profound impact on stock and bond prices. In the United States, the Federal Reserve has the responsibility for setting monetary policy. In a law passed by Congress and signed by the President, the Federal Reserve was given two primary objectives: promote maximum employment and stable prices over time. To pursue their policy objectives, the Federal Reserve influences the cost and availability of money and credit. The Federal Reserve strives to accomplish their economic objectives through three monetary policy tools: open market operations, the discount rate and reserve requirement.

Although the federal funds rate is an overnight rate, it has a significant influence on other key interest rates. Interest rates affect economic activity, the relative valuation of stocks and fixed income securities, and margin costs. Therefore, small changes in interest rates can result in large changes in stock prices. Table 3 illustrates the relationship between changes in the federal funds rate and subsequent stock market returns. In an attempt to stimulate our nation's economy, the Federal Reserve has aggressively lowered interest rates. Following similar periods of rapid declines in the federal funds rate, stocks have performed well.

Seasonal Pattern during Presidential Election Years

Fear, hope and help are the best ways to understand the stock market's seasonal pattern during presidential election years. First, as a presidential election year begins, the political primaries provide voters an abundance of choice and provide investors an abundance of uncertainty. During the first four months of election years, investors' fear and uncertainty about the outcome of the U.S. presidential election often weighs down on the stock market. As a result, the S&P 500 has returned approximately 2 percent in the first four months of a presidential election year. As the primary season ends and political convention season begins, fear often turns to hope. To court the swing vote and position themselves for

CHART 1: Oil Prices & Stock Returns

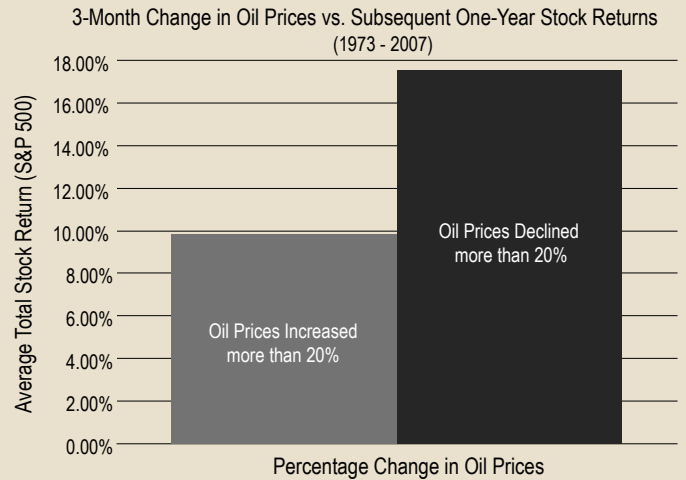
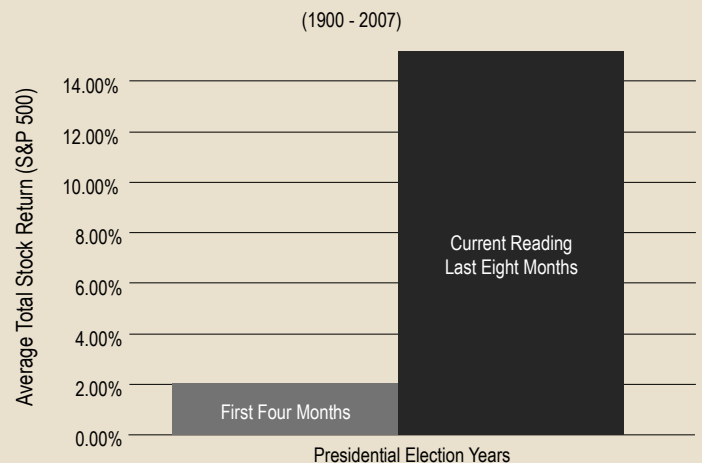


TABLE 3: Changes in the Federal Funds Rate and Stock Returns (1946 to 2007)

Monetary Environment Based on Changes in Federal Funds Rate	Subsequent 52-Week Total Stock Returns (S&P 500)	Reading
Very Accommodative	18.27%	
Accommodative	16.21%	Current Reading
Neutral	12.26%	
Restrictive	10.78%	
Very Restrictive	- 0.93%	

Source: American Strategic Capital, Inc.

CHART 2: Seasonal Pattern During Presidential Election Years





the general election, the nominees move to the political center. During this period, the nominees' economic and business policy positions become more certain. Around the beginning of May, stocks begin to trend higher.

Finally, one should not underestimate the potential helpfulness of politicians in an election year. To improve the likelihood of retaining power for themselves or their political party, presidential administrations manage the economy. In the two years leading up to a presidential election, presidential administrations frequently increase government spending, reduce taxes and exert political influence on the Federal Reserve to lower interest rates. Given the fiscal stimulus package and Federal Reserve interest rate cuts, this year is no exception. As Chart 2 demonstrates, stocks generally produce outstanding returns, over 15%, in the last eight months of presidential election years.

Valuation: Stocks vs. T-Bills

In the long-run, changes in stock values are driven by business success as measured by current and future company earnings, corporate profitability, cash flows and dividends. Since there are a variety of methods to analyze and evaluate a company's current and future prospects, there are numerous ways to value stocks.

To make the stock versus T-bill comparison more consistent, we utilize the trailing five-year average earnings for this comparison. On August 21, 2008, the trailing five-year average S&P 500 earnings was \$68.09, the S&P 500 closing price was 1,277.72 and the coupon equivalent T-bill yield was 1.72%. As Table 4 shows, using this method, the risk premium was 3.61% on August 21, 2008.

Stocks are currently more attractive than T-bills. As Chart 3 illustrates, when the smoothed earnings yield exceeded T-bill yield by 3.00%, investors who opted for stocks instead of money market securities (T-bills) were 16.7% richer a year later. In other words, given a 3.61% risk premium, historically, if T-bills generated a 2% return, then stocks, on average, produced an 18.7% return.

Valuation: Stocks vs. Bonds

From a valuation perspective, stocks are currently more attractive than bonds. For this comparison, to smooth out the earnings and economic cyclicalities, we calculate the earnings yield using trailing peak earnings. Trailing peak earnings are the highest earnings ever achieved in four consecutive quarters. As Chart 4 demonstrates, when trailing peak earnings yield exceeded the bond yield the by more than 1.75%, investors who held stocks instead of bonds were 18.01% better off a year later.

TABLE 4: Stock versus T-Bills (August 21, 2008)

Smoothed Earning Yield	Minus	T-bill Yield	=	Risk Premium
S&P500 Trailing Five-Year Average Annual Earnings	■	T-bill Yield	=	Risk Premium
Current S&P500 Stock Price				
\$68.09	■	1.72%	=	Risk Premium
1277.72				
5.33%	■	1.72%	=	3.61%

CHART 3: Stocks vs. T-Bills

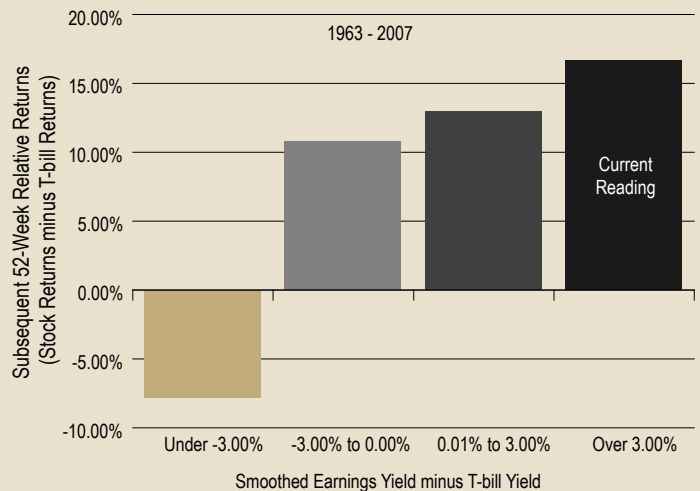
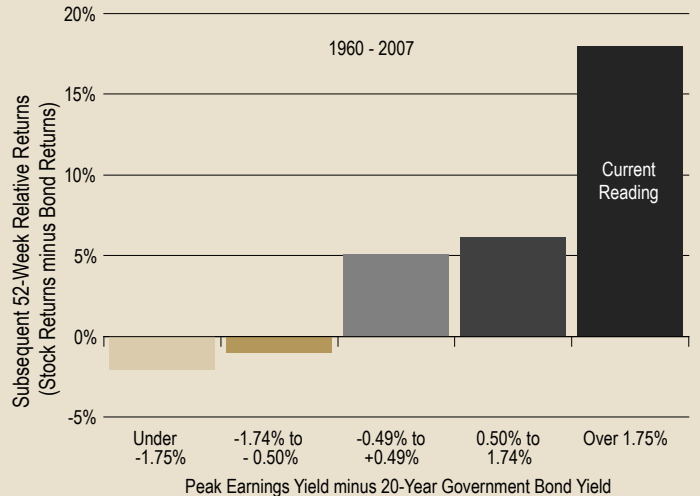


CHART 4: Stocks vs. Bonds





Bear Markets Create Enormous Investment Opportunities

On July 9, 2008, we officially entered into a bear market. Bear markets are generally defined as a market price decline greater than 20 percent from its most recent price peak. With the Standard and Poor's 500, the Dow Jones Industrial Average and the NASDAQ Composite all down more than 20 percent from their recent highs, these stock market indices fulfilled the traditional bear market definition.

To provide a historical perspective, we analyzed the 22 bull markets and 22 bear markets covering the period 1919 to 2007. During bear markets, stock prices, as measured by the S&P 500, de-

clined an average of 33%. This is shown in Table 5. Since World War II, bear market declines have averaged 29%. Thus, once the 20% benchmark has been achieved, much of the decline is already over. In terms of duration, the average bear market lasted 342 days or nearly one year. The current bear market began on October 9, 2007 and is now more than nine months old. Thus, in terms of time span, this bear market is quite mature and is likely to end soon.

The greatest investment opportunities occur when economic and financial conditions appear the bleakest. Throughout bear markets and especially at the last stages of bear markets, many investors succumb to their psychological weaknesses. With no regard for the attractive stock valuations, these unfortunate individuals dump their stock holdings at or near the market bottom.

TABLE 5: U.S. BEAR MARKETS 1919-2007

Bull or Bear Market	Market Cycle Number	Begin	End	S&P 500 Total Return	Annualized S&P 500 Total Return*	Number of Calendar Days	Number of Trading Sessions
BEAR	1	11/10/1919	06/27/1921	-31.78%	-20.93%	595	487
BEAR	2	09/07/1929	11/13/1929	-44.14%	-44.14%	67	52
BEAR	3	04/10/1930	12/16/1930	-42.00%	-42.00%	250	203
BEAR	4	02/24/1931	06/02/1931	-31.76%	-31.76%	98	82
BEAR	5	06/27/1931	10/05/1931	-42.27%	-42.27%	100	82
BEAR	6	11/09/1931	06/01/1932	-59.70%	-59.70%	205	168
BEAR	7	09/07/1932	02/27/1933	-38.24%	-38.24%	173	140
BEAR	8	07/18/1933	10/21/1933	-29.06%	-29.06%	95	74
BEAR	9	02/05/1934	03/14/1935	-28.05%	-25.85%	402	331
BEAR	10	03/06/1937	03/31/1938	-51.62%	-49.34%	390	320
BEAR	11	11/09/1938	04/08/1939	-24.82%	-24.82%	150	122
BEAR	12	10/25/1939	06/10/1940	-29.01%	-29.01%	229	187
BEAR	13	11/09/1940	04/28/1942	-27.34%	-19.59%	535	439
BEAR	14	05/29/1946	06/13/1949	-16.24%	-5.66%	1111	857
BEAR	15	08/02/1956	10/22/1957	-17.88%	-14.90%	446	307
BEAR	16	12/12/1961	06/26/1962	-26.79%	-26.79%	196	135
BEAR	17	02/09/1966	10/07/1966	-20.44%	-20.44%	240	167
BEAR	18	11/29/1968	05/26/1970	-32.72%	-23.40%	543	369
BEAR	19	01/11/1973	10/03/1974	-44.80%	-29.14%	630	436
BEAR	20	11/28/1980	08/12/1982	-20.21%	-12.41%	622	430
BEAR	21	08/25/1987	12/04/1987	-32.77%	-32.77%	101	71
BEAR	22	03/24/2000	10/09/2002	-47.41%	-22.33%	929	587
AVERAGE BEAR MARKET (1919-2007)				-32.94%	-34.37%	342	260
AVERAGE BEAR MARKET (1946-2007)				-28.81%	-21.37%	535	373

Using 25% filter rule for determining bull markets & 20% filter rule for determining bear markets.

A Bull Market is one that is up 25% from a recent low. This is computed using price change only.

A Bear Market is one that is down 20% from a recent high. This is computed using price change only.

S&P 500 total return data includes price change and reinvested dividends.

S&P 500 Total Returns covers the entire Bear Market period. For example, Bear Market Cycle 22 period covers March 24, 2000 to October 9, 2002 and shows a total return of -47.41% or an annualized return of -22.33%.

*If calendar days are less than 365, then total return is not annualized.

Source: American Strategic Capital, Inc.



Their indiscriminate selling creates progressively more attractive investment opportunities for the more astute investors.

What follows every bear market is a bull market. As Table 6 illustrates, since 1919, the average bull market has returned 175% and lasted two and a half years. Since World War II, bull markets have generated average returns of 253%.

More importantly, as Table 7 shows, bull markets take off fast and there is a substantial cost to missing the early stages of a bull market. Given the current investment environment and attractive stock valuations, the surprises are likely to be on the upside.

TABLE 7: The High Cost of Being Late

	S&P 500 Average Price Change (1928 - 2007)
First Five Days of a New Bull Market	9.18%
First Month of a New Bull Market	12.61%
First Three Months of a New Bull Market	20.50%

TABLE 6: U.S. BULL MARKETS 1919-2007

Bull or Bear Market	Market Cycle Number	Begin	End	S&P 500 Total Return	Annualized S&P 500 Total Return*	Number of Calendar Days	Number of Trading Sessions
BULL	1	06/27/1921	09/07/1929	650.34%	27.87%	2994	2454
BULL	2	11/13/1929	04/10/1930	48.93%	48.93%	148	118
BULL	3	12/16/1930	02/24/1931	26.66%	26.66%	70	56
BULL	4	06/02/1931	06/27/1931	27.31%	27.31%	25	22
BULL	5	10/05/1931	11/09/1931	31.86%	31.86%	35	28
BULL	6	06/01/1932	09/07/1932	115.11%	115.11%	98	81
BULL	7	02/27/1933	07/18/1933	124.12%	124.12%	141	109
BULL	8	10/21/1933	02/05/1934	39.97%	39.97%	107	87
BULL	9	03/14/1935	03/06/1937	152.91%	59.80%	723	595
BULL	10	03/31/1938	11/09/1938	66.96%	66.96%	223	185
BULL	11	04/08/1939	10/25/1939	33.33%	33.33%	200	167
BULL	12	06/10/1940	11/09/1940	29.62%	29.62%	152	127
BULL	13	04/28/1942	05/29/1946	218.44%	32.78%	1492	1211
BULL	14	06/13/1949	08/02/1956	454.51%	27.12%	2607	1889
BULL	15	10/22/1957	12/12/1961	114.93%	20.30%	1512	1041
BULL	16	06/26/1962	02/09/1966	101.75%	21.36%	1324	913
BULL	17	10/07/1966	11/29/1968	58.91%	24.08%	784	516
BULL	18	05/26/1970	01/11/1973	88.13%	27.15%	961	665
BULL	19	10/03/1974	11/28/1980	204.39%	19.82%	2248	1555
BULL	20	08/12/1982	08/25/1987	304.56%	31.99%	1839	1273
BULL	21	12/04/1987	03/24/2000	840.18%	19.98%	4494	3109
BULL	22	10/09/2002	10/09/2007	116.90%	16.75%	1826	1259
AVERAGE BULL MARKET (1919-2007)				174.99%	31.56%	1056	771
AVERAGE BULL MARKET (1946-2007)				253.81%	22.56%	1955	1358

Using 25% filter rule for determining bull markets & 20% filter rule for determining bear markets.

A Bull Market is one that is up 25% from a recent low. This is computed using price change only.

A Bear Market is one that is down 20% from a recent high. This is computed using price change only.

S&P 500 total return data includes price change and reinvested dividends.

S&P 500 Total Returns covers the entire Bull Market period. For example, Bull Market Cycle 1 period covers June 27, 1921 to September 7, 1929 and shows a total return of 650.34% or an annualized return of 27.87%.

*If calendar days are less than 365, then total return is not annualized.

Source: American Strategic Capital, Inc.



Investors' Greatest Challenges & Our Human Potential

In the first half of 2008, fueled by the subprime mortgage crisis and soaring oil prices, investors' fears turned to panic. Therefore, we thought our readers would benefit from a timely discussion of behavioral finance.

WHAT IS BEHAVIORAL FINANCE?

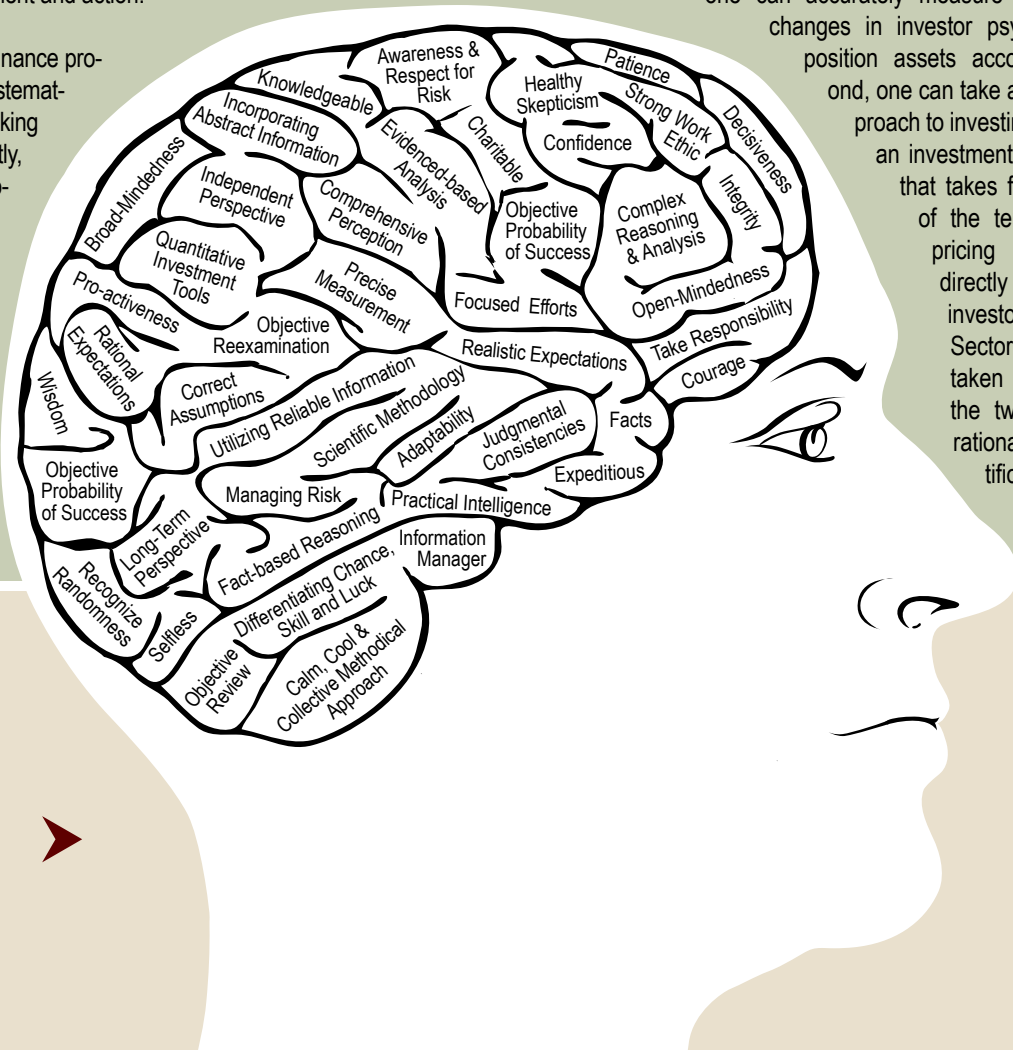
Behavioral finance is the study of finance incorporating psychology, sociology, anthropology, and decision science. One basic assumption in standard financial theory is that investors always behave rationally. However, this contradicts the substantial and growing empirical evidence from research psychology and decision science. Anyone that has ever had a disagreement with a loved one knows that humans do not always behave rationally. Although the majority of people consider themselves as objective, logical and decisive, human emotions can get in the way of sound reasoning, judgment and action.

For investors, behavioral finance provides guidance into the systematic errors in the decision making process. More importantly, behavioral finance provides insights into identifying, overcoming, and becoming a beneficiary of investor psychology. Essentially, behavioral finance applies human psychology and behavior into the what, why and how of capital market movements and opportunities.

BENEFITING FROM INVESTOR PSYCHOLOGY

It has been widely accepted that the financial markets are moved by fear and greed. We believe there are approximately another forty-three contributing factors. All these factors, including fear and greed, are related to investor psychology. We believe that each one of these factors, labeled in "Systematic Errors," existing alone or in combination with other factors create many of the most lucrative investment opportunities.

There are two ways to benefit from investor psychology. First, one can accurately measure and forecast changes in investor psychology and position assets accordingly. Second, one can take a scientific approach to investing and design an investment methodology that takes full advantage of the temporary mispricing of securities directly resulting from investor psychology. Sector Logic has taken the latter of the two; utilizing a rational and scientific approach to investing.



**Our
Human
Potential** ➤



More specifically, Sector Logic utilizes asset allocation and industry sector selection methodologies that are designed to help our clients benefit from investor psychology. By taking a rational and scientific approach to investing, we believe we can improve our investment results by harnessing more of our human potential, shown on page 4.

Our Expertise

As a way to improve our investment process, our Chief Investment Strategist has applied findings from behavioral finance, as he has done for over 21 years.

For example, on October 19, 1987, the single worst day in United States stock market history, Dwight Chapin, a reporter with the San Francisco Examiner interviewed Charles Rother, Sector Logic's Chief Investment Strategist.

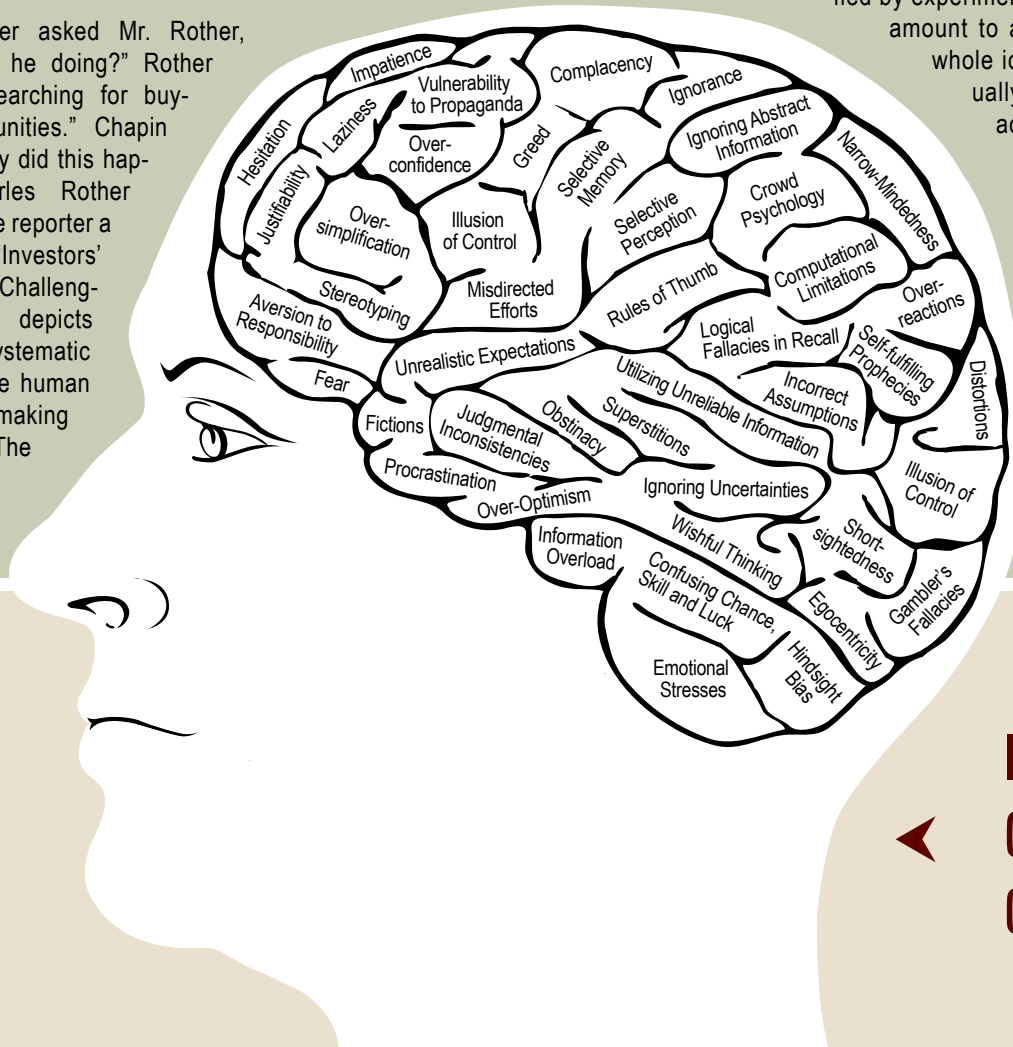
The reporter asked Mr. Rother, "What was he doing?" Rother replied, "Searching for buying opportunities." Chapin asked, "Why did this happen? Charles Rother provided the reporter a copy of his "Investors' Greatest Challenges", which depicts forty-five systematic errors in the human decision making process. (The "Investors' Greatest

Challenges" is illustrated on page 5.) He explained the irrationality of that day's stock market movement. At the time, behavioral finance was in its infancy. In the December 16, 1999 issue of the Economist magazine, the magazine stated "Economists are starting to abandon their assumption that humans behave rationally, and instead are finally coming to grips with the crazy, mixed up creatures we really are."

The stock market crash of October 1987 shattered the confidence of many economists in efficient markets (part of standard finance). The crash seemed to have occurred without any new information or reason. Thus, the door of the ivory tower opened, at first only slightly, to theories that included irrational behavior.

Today there is a growing school of economists who are drawing on a vast range of behavioral traits identified by experimental psychologists which amount to a frontal assault on the whole idea that people, individually or as a group, mostly act rationally."

By taking a scientific approach to investing, Sector Logic uses asset allocation and industry sector selection methodologies that are designed to help our clients benefit from investor psychology.



Investors' Greatest Challenges



Consumer Sentiment and Stock Returns

One way to assess market psychology is to utilize consumer sentiment surveys. For example, the Conference Board, one of the two most respected consumer sentiment surveys, polls approximately 5,000 households monthly. The survey participants are asked their opinions regarding their attitude toward the current economic environment and future economic prospects. Currently, the Conference Board's Consumer Confidence Index stands at 51.9. In the most recent survey, consumers remained quite pessimistic. According to the Conference Board, "Consumers' appraisal of present-day conditions remained quite bleak in July."

Consumer sentiment is a contrary indicator. As Chart 5 reveals, historically, when Consumer Confidence Index was below 65, pointing to a very pessimistic consumer attitude, on average, stocks generated returns of 23% in the following twelve months.

Historically, when there was this level of bearishness, stocks in the following twelve months produced positive returns 96% of the time. In contrast, when consumers were confident and the Consumer Confidence Index was above 135, stocks declined about 2% in the subsequent twelve months. In fact, when consumers were extraordinarily optimistic, the Standard and Poor's 500 generated positive returns only 45% of the time.

Small Cap stocks provide an even more dramatic example. As Chart 6 illustrates, during periods when consumers were very pessimistic and the Consumer Confidence Index was below 65, small cap stocks produced returns of nearly 37% in the following twelve months. In contrast, when consumers were confident, as measured by the Consumer Confidence Index being above 135, small cap stocks declined 4% in the following twelve months.

Concluding Remarks

Given the current investment environment and attractive stock valuations, we believe stocks are likely to provide outstanding returns in the coming 12 to 18 months.

CHART 5: Consumer Confidence & Stock Returns

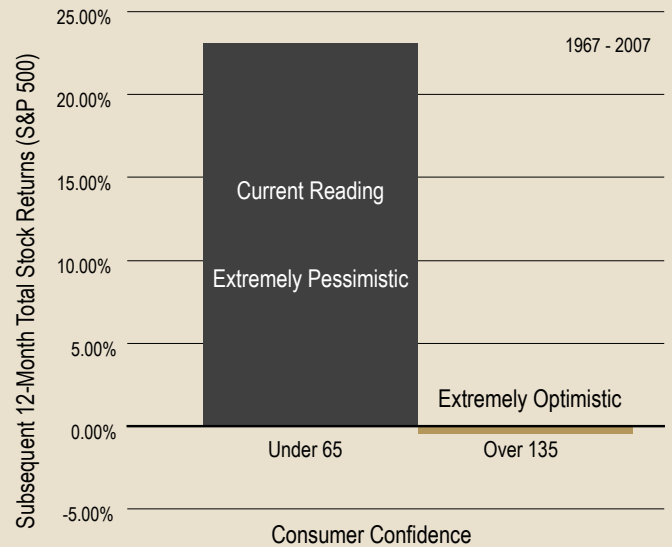
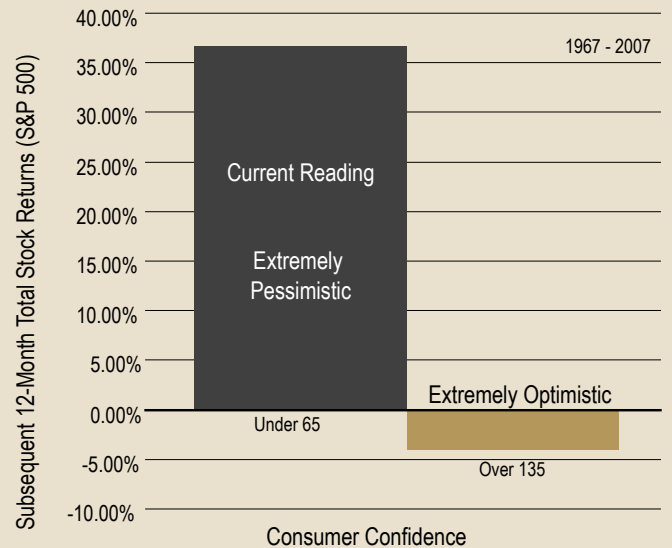


CHART 6: Consumer Confidence & Small Cap Stock Returns



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