



Krosnowski & Scott LLC

Investment & Retirement Planning Specialists

Dear Clients & Friends,

We thought the following message might interest you:

Stock Market Perspective- Winter 2008

Since reaching highs in the 14,000 range during the Summer and Fall of 2007 the DOW Jones Industrial Average (DJIA) has declined toward the 12,000 range as of January 23, 2008. The driving forces for the stock market decline have been investor fears of an economic recession or slowdown caused by the combination of rising crude oil prices and the liquidity crunch which has resulted from the fallout from the sub prime mortgage loan losses which have been decimating the banking industry. Not to mention the additional uncertainty created during a Presidential election year. The stock market which is driven by fear and greed tends to over react when things are doing well and also when things are not going well. It frequently seems that when you have at least three or more negative short term events influencing the financial markets that the markets tend to over react and sell off more than usual. During these times if you have cash it may be a good time to be adding to your investment portfolio and if you do not we believe it is wise to remain fully invested.

Historical Perspective:

A. During my third year in the investment business in 1987, the DJIA opened at 1895 on January 1. On August 25, the DJIA peaked at 2746 (over a 40% run up in the stock market from the beginning of the year). On October 20 of that year over recessionary concerns the DJIA plummeted to a low of 1616 (over a 40% decline from the previous high for the year). By the end of the year, the DJIA closed at 1938. Investors who were invested in the DJIA for the whole year had a positive return (thanks in part to dividends) and for those who invested at the top of the market in August it took them two years to break even. The period from September 1987 to January 1988 was one of the lowest

periods in my career (this side of 2002 which was the most difficult of the three year bear market caused by the burst of the tech bubble). The worst month was January. Investors were shell shocked. Things were so quiet in my office that you could hear a pin drop. At the time when the stock market declined precipitously in September and October it was traumatizing. However, we remained calm, nobody panicked, the stock market soon recovered and everything worked out all right. Looking back at the stock market activity in 1987, in the end it was actually not that bad.

B. During 1988 the storm clouds were brewing in the financial markets. President Clinton was being prosecuted for perjury by Ken Starr. Long Term Capital Management, a hedge fund run by some Nobel prize winning economists on Wall Street had imploded and threatened to cause catastrophic damage to the financial markets throughout the world. Eventually, the big Wall Street brokerage firms (including Merrill Lynch, UBS, Morgan Stanley and Smith Barney) had to come up with over \$500 million to bail out the hedge fund. The federal government was deadlocked in a Congressional budget impasse on Capitol Hill and was forced to shut down for periods of time during the Fall of that year. The DJIA started off the year at 7908. On July 17 the DJIA peaked for the year at 9412. By September 1, investors had had enough of the political and economic uncertainty and the ensuing sell off sent the stock market into a tailspin. The DJIA bottomed out at 7379 (down over 20% from the previous high for the year) on that day. On December 31 the DJIA closed at 9181, a 16% increase for the year excluding dividends.

C. During two months in 2007 the DJIA traded above 14,000. Recently, the DJIA has declined to 12,000 or close to 14%. Will the stock market go lower before it begins to recover? Nobody knows. It could temporarily recede down into the 10,000 to 11,000 range on the DJIA. Recently, Allen Meltzer an economist at Carnegie Mellon University and Jeremy Siegel, a professor at the Wharton Business at the University of Pennsylvania shared their views. In the investment community, about half the economists feel that the U.S. economy is headed into a mild recession (which is defined as two consecutive quarters of a decline in economic growth) and the other half feel that we are headed toward an economic slowdown (with the economy growing at 1 to 2% during the first half of the year and 2 to 3% during the second half. In either case, the next few quarters are going to be difficult. Both gentlemen referenced above feel there will be an economic slowdown and that the Federal government should not get carried away with stimulus packages that may not be necessary. As you will see in the comments in the summary section below, a recession is not the end of the world. It is a temporary set back.

Normal Market Activity From Year to Year:

The economy and the stock market go through cycles which involve periods of expansion and contraction. From 2003-2007 investors enjoyed steady returns. Normally in one out of five years in the financial markets there is an off year. During a year when there is a stock market lull or a bump in the road returns tend to vary in the -5% to +5% range. "As we climb the stairs toward financial prosperity there will be times when we have to take one step backward before we can take the next two or three steps forward."

Winning Formula For Long Term Success:

Since 1926, the DJIA has averaged around 10.5% annual return. We target an 8% return goal for our clients, who for the most part have significantly less risk than the DJIA for the following reasons:

1. Most of their portfolios are balanced. A portion of their assets are invested in money markets and bonds. This dampens volatility during times of stock market decline.
2. We employ in our opinion one of the finest money management firms in the world. Although past performance is no guarantee of future results, they have historically performed well during difficult stock market conditions. We believe the reason they have been more successful than many of their competitors in good times and bad is because they employ a conservative, value oriented investment approach which focuses on healthy dividend paying companies throughout the world.
3. Assets are invested globally (even though in recent years the correlation of U.S. and non-U.S. stock markets have become more correlated than in the past). This concept enables investors to spread out their risk across many stock markets throughout the world.
4. The stock portion of our client portfolios are focused on dividend growing companies. In our opinion, this dull, boring, tortoise approach has been very successful. From 1975 to 2005, financial studies confirm that not only did dividend growing companies outperform the broad stock market averages, they did so with less risk or volatility. This concept is referred to as “investment efficiency.”
5. Dollar Cost Averaging- “Potential opportunity during times of adversity?” We welcome temporary stock market declines because it enables quarterly dividends to be reinvested at a lower price. Over time, when the stock market recovers, investors who reinvested their dividends will have more shares at a higher price. This results in a greater balance down the road.

Dollar Cost Averaging is a system of investing in which the investor buys a fixed dollar amount of securities at regular intervals. The investor thus buys more shares when the price is low and fewer shares when the price rises, and the average cost per share is lower than the average price per share. This strategy does not protect against loss in declining markets and involves continuous investment, regardless of fluctuating price levels and there is no guarantee that dividends will continue at current levels.

6. Experience- A typical managed portfolio for our clients has approximately seven to eight portfolio counselors who separately manage a portion of each portfolio. These individuals average over 23 of years of investment industry experience. Many of these portfolio counselors have been through five or six economic cycles. Close to ten of them have over thirty years of experience.
7. Expense Management- During slower market conditions it is important to try to keep your total annual investment fees to less than 1.0%. We believe that many of

the big Wall Street firms have difficulty providing this type of fee structure to their clients because they have high overhead expenses.

Summary- We advise clients to prepare for the worst and hope for the best. Right now is a good time to try to “**tune out the noise**” from the media which tends to over dramatize and blow short term events out of proportion. Take a deep breath and focus on other priorities in your life such as your family, your health and things that you like to do. Historically, these temporary corrections in the stock market provide “excellent buying opportunities.” In fact, there have been ten recessions since 1949 (the S&P 500 low points occurred in the months of June 1949, September 1953, October 1957, October 1960, May 1970, October 1974, March 1980, August 1982, October 1990 and September 2001). Based on the 10 recessions, the S&P 500 tended to anticipate the slowdown by declining into the start of the recession, and continued to decline over the next five to six months, and then recover in anticipation of the end of the recession. In all ten cases, the market’s recession low turned out to be a bear market bottom. Following those lows, the performance of the market has been very attractive with the S&P 500 averaging 32% return over the next 12 months (according to Ned Davis Research). We may have been in decline already from as far back as August 2007. Since we believe market timing is impossible, our advice is to hold steady until the storm passes over, hopefully in the next six months or so. We can then re-evaluate your asset allocation and comfort level after things settle down. Please try to remain positive. The FED lowered the discount rate .75% today in an attempt to stimulate the economy. We feel if you continue to stay the course that you are going to come out way ahead over the next five, ten, twenty year periods and beyond.

If you feel uncomfortable about the current stock market conditions and you need some reassurance, please do not hesitate to contact us.

Hang in there!

Sincerely,

Andrew Krosnowski

Melissa Scott-Paine

*Source for DJIA statistics= bigcharts.com

Andrew J. Krosnowski
Senior Financial Consultant
Krosnowski & Scott, LLC
123 Rowell Court
Falls Church, VA 22046

888-901-8310 (phone)
703-506-9556 (fax)
akrosnowski@1stallied.com

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