Executive Economic Outlook & Summary

Fall/Winter 2007-2008

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As I write this letter, Multop Financial's economic outlook for the Fall/Winter 2007-2008 remains cautiously optimistic. The markets experienced roller-coaster like volatility from July to September. The Dow Jones Industrial Average Index leaped to14000 points in July 19th, took a precipitous fall below 12850 on August 16th, then grinded out a climb above the 14000 mark again on October 1st. The main culprits behind the market's almost erratic movement are the sizable drop in home sales, falling prices for homes, elevating oil prices and a dramatic tightening in the credit markets. Due to little regulation on lending practices, many lenders have watched their balance sheets erode as the number of defaults on home mortgages continues to rise to record numbers.

The Federal Reserve has had its hands full in managing the market's predicament. To counteract the effects of a credit crunch, the Federal Reserve has utilized some of its more unusual methods to maintain monetary policy. On August 17th Federal Reserve Chairman Ben Bernanke lowered the discount rate by 50 basis points (0.5%). The discount window functions as a last resort for banks to borrow reserves to ease liquidity problems. The Federal Reserve has also injected extra reserves into the system. On September 6th it added $31.25 billion in additional reserves. On September 18th, in a final move to curtail uncertainty and a potential drop in the economy, the Federal Open Market Committee lowered the federal funds rate 50 basis points, and the discount rate an additional 50 basis points.

The markets reacted positively to Fed's move, with the Dow Jones Index roaring above the 14000 mark. However, many economists are still predicting a slowdown in the economy for upcoming 2008. These are a few indicators that would add validity to that sentiment:

- Gross Domestic Product (GDP) grew 3.8% (revised) for the second quarter amid an increase in exports and business investment. However, durable goods orders for August fell by 4.9% from last month. This suggests that business investment for computers and machinery has fallen, thus negating the main driver for the GDP growth in the 2nd quarter.
- Recently the U.S. Dollar has fallen to record lows against the Euro. The Japanese Yen has also strengthened considerably against the dollar and for the first time in nearly 31 years the Canadian Dollar rose to parity against the U.S. Dollar. A weaker currency makes U.S. goods cheaper for overseas buyers, which propels exports. Conversely, a weak currency makes importing goods more expensive. As a result, prices for domestic goods and services rise, and inflation begins to enter the picture.
- The Department of Labor announced that the nation's employers increased the number of jobs by 89,000 in August, a figure slightly lower than what economists predicted. Real

wages increased by 0.5% (revised) for August. That marks one of the largest month-over-month gains this year. An increase in wages will help maintain consumer spending (which accounts for 70% of GDP), but higher wages can also fuel inflation.

- Prices on commodities have swelled. Oil has broken the $80 per barrel mark effortlessly. Oil prices are invariably tied to gasoline prices, which ultimately are passed on to consumers.
- Gold has recently rallied to a 27 year high of $755.70/oz. Typically investors will flock to precious metals during times of uncertainty.
- Building permits, which is a guide to future construction, dropped 5.9% to a 1.307 million pace. That's the lowest reading we've had since 1995, which further points to a continuing slowdown in the housing market.

Despite the uncertainty and volatility in the markets, Multop Financial still has faith in the U.S. economy. Consumer spending continues to remain strong with an increase of 0.6% for August, an improvement from the 0.4% rise in July. A key inflation reading, the Personal Consumption Expenditures (PCE) Index has shown modest improvements. The August report showed a 1.8% rise, after a 1.9% rise in July. The Federal Reserve is believed to prefer a reading somewhere between the 1-2% increase year-over-year. Should the PCE index continue to ease further, the Fed will have more justification for additional rate cuts. Locally, western Washington has avoided many of the housing problems that plague the rest of the nation. Barbara McMahon of John L. Scott Real Estate reports that a recent analysis by the Mortgage Bankers Association sets the state's foreclosure rate on all loans at 2.6%, one of only six states with rates fewer than 3.0%.

Generally speaking, we still recommend that our clients maintain a retirement portfolio that has approximately 50% exposure to the market. Of that exposure, we currently favor allocating some of that portfolio into short term and international bond funds. We also feel that an increased exposure to the utility and energy sector will also help offset any potential downswings in the market.

What does this mean for you, the investor? In our opinion, the mixed indicators do not give a clear direction for the future market movement. We are currently still in a bull market, but with a lot of short term volatility which gives us a mildly bearish slant. If you have met with us within the last 4-6 months, we have aligned your portfolio for this market. If you have not had a formal investment consultation since our last Economic Outlook letter, we suggest you come in for a review. Some allocation changes might be appropriate, depending on your tolerance for volatility.