STEWARDSHIP PARTNERS
MARKET COMMENTARY

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Third Quarter 2008 Market Commentary

"I am still confident in this: I will see the goodness of the Lord in the land of the living." Psalm 27:13

Due to the exceptional conditions and opportunities in the financial markets during September and October, we made the decision that it would be in our clients' best interests to focus all our efforts on positioning their portfolios to best achieve long-term capital appreciation. While the market's decline has been disheartening, it has provided an unusual opportunity to acquire shares at prices that appear to greatly underestimate the long-term earnings power of the underlying companies not to mention the current strength of many company's balance sheets. Accordingly, we have temporarily put aside the time-consuming task of writing and compiling our normal twelve-page Quarterly Commentary. Instead, we have replaced it with this shortened version. We may yet produce the longer version (depending on market conditions) for the third quarter. Moreover, we expect the typical full version of our Commentary to be produced at year-end.

While it now seems like ancient history, our portfolios generally outperformed their indices during the third quarter. Our Global, Global Rising Dividends, Global Balanced, International and US Balanced BRI portfolios all performed better than their indices. Our US and Concentrated BRI portfolios trailed their indices while our SMID Cap BRI portfolio trailed its index slightly. Results for the year-to-date period were quite similar to the quarter relative to the indices. Unfortunately, while these results were largely attractive in relative terms, the values of all portfolios fell significantly in absolute terms. Additionally, while Tactical versions of our portfolios benefited early in the year from our use of inverse index ETFs, we did not utilize these before the September/October crash. As a result, the third quarter returns on the Tactical versions of our portfolios were essentially identical to the Standard versions, but better for the year-to-date period. We are disappointed we did not do a better job of protecting our clients from the decline but are confident that we "will see the goodness of the Lord in the land of the living" in due course.

The short-term economic outlook can only be described as bleak. The credit crunch is accurately compared to an economic heart attack. While it is evident that the global economy survived, it is equally apparent that there will be some heavy economic costs associated with this near-death experience. Many sectors of the economy that depend on credit to function normally saw business activity fall sharply for a two to four week period spanning late September and early October. Due primarily to the US Federal Reserve's swift response, which has been truly breathtaking in scope, the global economy now appears to be on the road to recovery. But it is still early in the recovery process. Progress will likely be slow at first and setbacks could easily occur. There will be no shortage of scary headlines as economic data from October and November are reported during November and December.

Nevertheless, the economy should improve as the credit crunch is clearly easing. Already, we have seen key interest rate indicators start to "heal" and the massive amount of liquidity injected into the global financial system is clearly having its intended beneficial impact. US consumers have been rapidly downshifting their spending, eschewing debt and seeking to increase their savings rate as their net worth has been undermined by both the real estate and financial market crashes. Many are concerned about their continued employment even while unemployment readings still remain more attractive than we would have thought. It appears likely, however, that unemployment trends will weaken sharply before long and that the US and global economy will experience a sharp decline in the fourth quarter. As financial institutions and consumers alike seek to repair their damaged balance sheets, there almost certainly will be a significant decline in economic activity. The worst of this decline is likely to be seen in the current quarter but continued weakness could easily be present through the first half of 2009 at a minimum. Given the overwhelming stimulus injected into the economy and the many dislocations caused by the credit crunch, we will need to vigilantly follow trends as they develop as the range of economic possibilities is quite wide.

The principal cause of the current recession is the credit crunch, which itself was the consequence of the massive accumulation of debt throughout the world in the last two decades. The weight of unwinding this huge debt should be a drag on the economy for some time. While many are concerned about the inflationary consequences of the massive monetary stimulus currently being undertaken, the sizable deflationary impact of the bursting of the global debt bubble cannot be underestimated. Additionally, while monetary stimulus normally has inflationary consequences, the sharp decline in what is known as the velocity of money will impede any short-term inflationary implications. As a result, deflation remains our principal economic concern at this time. We expect global economic policy makers to continue to do all they can to stimulate growth. The US Federal Reserve has already reduced interest rates to 1% and we expect the European Central Bank to move quickly in that direction as well. Moreover, we fully expect global efforts to provide fiscal stimulus as well. These efforts will be aided by the decline in commodity prices, notably the oil price. The decline in gasoline prices alone will add over $200 billion to the US consumer's pocketbook alone. The consequences of deflation from a bursting debt bubble and banking crisis are severe, as demonstrated by Japan's experience over the last two decades, and every effort will be made to avoid a similar outcome.

During the course of the panic over the last two months there have been many unusual turns of events. Foremost among these has been the strength of the US dollar. Since the US has been the epicenter of the crisis, one would have expected confidence in the dollar to fall. Instead, it has strengthened markedly. While this is partially the result of fearful global investors rushing headlong into the perceived safety of US Treasury securities, it also apparently was influenced by the meltdown in the hedge fund industry. Many hedge funds had been "short" the dollar and, as their fund's collapsed, they needed to cover these short positions thereby adding buying pressure to the dollar. Indeed, almost all major moves in stocks, bonds, commodities and currencies seemed to have some tie to the rapid deleveraging of $2 trillion hedge fund industry. We have sought to take advantage of the forced liquidations the hedge funds have experienced by focusing our portfolios on the high quality stocks they had to sell at distress prices. We believe this has positioned Stewardship Partners' portfolios favorably for both short and long-term outperformance.

The US election results seem certain to usher in a period of dominant rule by the Democratic Party. The Democrats will likely control the US Senate, Congress and the presidency, perhaps with veto proof majorities in Congress. Accordingly, investors should expect to see higher taxation on personal income, dividends, capital gains, estates and businesses. Additionally, there will be increased regulatory burdens for most businesses and reduced expenditures on defense. While such a backdrop is not encouraging, we should be quick to remember that this does not mean that stock prices will fall. It is true that stocks may not perform as well as they would have under a more business friendly government but equities still should be able to achieve higher returns than most other investment alternatives, just as they have in the past under similar circumstances. Moreover, in the early portion of the next presidency, the economic situation is more likely to dictate policy than any candidate's ideology. Stocks also may bounce on the back of the new government being elected as a new slate of leaders may restore hope of better times, even if in the long run this may not prove to be the result.

Another issue share prices will need to contend with is a certain decline in earnings in 2009. The recession will be sharp, at least initially, due to the near cessation of lending for a brief period, and a likely slow recovery thereafter. The big question for investors is whether the currently low valuations on normalized earnings are sufficiently depressed for investors to look beyond the ongoing profit decline and buy up the bargains. Will investors bid up share prices in such an environment? They have in the past but that is no guarantee it will happen this time. Clearly, the decline in stock prices has been one of the most severe and rapid ever seen, reflecting a concern that the financial markets were facing a complete collapse. Additionally, the forced liquidations by leveraged hedge funds pushed many stocks, particularly those of high quality companies they (and we) owned, to seemingly absurdly low levels. While stocks have already bounced over 15% off the lows seen on October 10, 2008, additional gains could be seen before year-end as valuations recover from their end-of-world fears as well as from the forced liquidations. After such an initial bounce, share prices could remain volatile within an upward trend as both the global economy and corporate earnings struggle to overcome the collateral damage of the credit crunch and global deleveraging. From a longer term perspective, however, share prices are at levels that seem exceptionally attractive. It is possible that the lows of October 10, 2008 will mark a low point that will not be seen ever again.

Knowing Jesus Christ as Your Lord and Savior

While most of those reading this will have already established a personal relationship with Jesus as their Lord and Savior, it is very likely that many have not. If you are someone who has not yet turned your life over to your Creator, we would have failed you miserably if we presented only information relating to your investments yet did not share with you the most important information of all: truths which have eternal significance for your soul and that will have an overwhelmingly positive impact on your life on this earth.

The gospel message is a simple one, far less complicated than the global impact of rising oil prices or the effect of a revaluation of the Chinese currency. For most people, the first part of it is easy to relate to – you are a sinner. If you are anything like the rest of us (and you are) more often than you probably would like to admit, you either do, say or think something that is clearly wrong and which you are ashamed of. "But what's the big deal", you might say. "If everyone has this problem with sin, can't we all just accept the fact and try our best to get along?"

Well, on this earth, that is exactly what we try to do. We forgive one another's faults and press on with life. From an eternal perspective, however, there remains a problem. Our Creator, who loves us with a love that can only be described as extravagant, has prepared an eternal home for us that He very much desires to share with us. Unfortunately, in our sinful state, we are unable to enter into heaven, which is by its very nature perfect. Desperate not to be separated from us for an eternity, our God devised the only possible solution – a divine exchange. He sent His very own son, who was perfect and thus without sin, as a sacrifice to pay the penalty for our sins. In this exchange, Jesus bore, through His death, all of our sins, so that we in turn could receive all the glory that was due to Him. He was made sinful while we were made perfect and, in our now perfect state, we are able to enter into the eternal home our Lord has prepared for us.

What then gives each of us access to participate in this divine exchange? By responding to this incredible demonstration of extravagant love by our God through an amazing act of your own. As you let the realization of just what your Lord has done for you filter through your heart, mind and soul, you will unavoidably desire to humbly come before Him, acknowledging that it was your sin that led to His sacrifice and recognize His Lordship in your life. And with this step of faith, the divine exchange is completed in your life, and along with it, the assurance of eternal life with a Lord whose love for you knows no bounds. If you have not done so already, we encourage you to take this time to contemplate the issue of your eternal destination and to take that step of faith that will make all the difference in your life, both now and eternally. Based on my experience and the experience of literally millions of others throughout history, it is the most satisfying, enriching and worthwhile choice you will ever make. Years of wonderfully inspiring spiritual growth await you and, if the Bible ever seemed confusing to you in the past, you will now find its wisdom leaping off the pages and into your heart.

If we at Stewardship Partners can be of any assistance to you in this all important matter of your eternal destiny, please do not hesitate to contact us. Like Jesus, we also greatly desire to share an eternal heavenly home with you!

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