

Review for the 2nd Quarter 2008 and Future Outlook

It feels like a wildfire

The second quarter began with high hopes that the worst of the credit crunch was over, earnings growth would pick up and stocks would rise. However, like the wildfires that California is currently experiencing, our financial markets felt like they were going through something similar. While it initially seemed like the markets were stabilizing, there was more smoke that would turn into fire.

Answering your questions – We are here for you

We understand that many of you have concerns and questions about the state of our economy, our financial markets and how it affects your portfolio. This letter will shift from its usual format to offer some answers to frequently asked questions - or questions we think you might want to ask.

While we cannot put out the fires that are sweeping through the markets, we think it's important for you, our client to know that we understand your concerns and what is causing the volatility.

Frequently asked questions:

What happened last quarter? We are in the midst of a severe crisis of confidence. In mid May, the optimistic hopes were shattered when the situation deteriorated on several fronts. It became apparent that the effects of the credit crisis were getting worse, oil and food prices were skyrocketing, real estate continued to soften and it looked like consumers might curtail spending. In summary, good news was in short supply.

Why did my account decline in value? Virtually every segment of the market declined, some more heavily than others. The Dow Jones Industrial Average was down 7.4% for the 2nd quarter and is down 15.4% from a year ago.

If one of your objectives includes some level of 'growth', then you will have some exposure to stocks. Our job is to help you reach your goals by making sure you are diversified which helps to minimize risks.

If you are heavily weighted in cash or municipal bonds, then the declines should be small if any at all.

How is diversification applied to my account? We have a number of ways we can diversify your assets but we do not apply the same techniques for all of our clients. Generally speaking, a portfolio with 5 stocks is less diversified than a portfolio with 25 stocks. The portfolio with 25 stocks is better able to spread the risk. A more common way

we diversify is by using mutual funds and exchange traded funds (ETF's) to construct a portfolio. We also diversify your holdings by industry, market capitalization, country of origin and investment style. Finally, we construct a portfolio of stocks and bonds (sometimes using mutual funds and ETF's), that we feel will best help you reach your goals and satisfy your tolerance for risk.

I see that some bonds declined in value. I thought they were safe? Generally speaking, bonds are much safer and more conservative than stocks. But their value can fluctuate for a number of reasons such as interest rate movements or a ratings downgrade.

A recent concern that contributed to bond price declines was the viability of the companies that insure some bonds. This is another example feeding the flames in the crisis of confidence. Another reason bonds declined in value is because some hedge funds and banks needed to raise capital - and to do so they sold their bond holdings which also caused price declines

Why is the U.S. Government getting more involved? The Government has taken some extraordinary steps – and we support this approach. We believe if the U.S. government is willing and able to intervene, thus preventing a catastrophe from occurring, it will instill confidence and help the recovery.

The U.S. government helped facilitate the buyout of Bear Stearns to JP Morgan, it is lending money to investment banks and most recently it has proposed to help both Fannie Mae and Freddie Mac, which are the two largest U.S. mortgage finance companies.

How safe are the banks? Will any more banks default? No one knows how many banks will close, but it's safe to say that there will be more. On the whole, the banking system is sound and depositors are insured. The situation today is nowhere near as bad as the S&L crises of the late 1980's. However, bank stocks are still seeing an unprecedented level of selling. The S&P Financial Sector was down 18.5% for the quarter and some regional bank stocks were hit especially hard - falling as much as 50% in some cases.

If you have stocks in your portfolio, chances are you have some exposure to financials. Once again, it's important to note that having a diversified portfolio is the best way to navigate through the uncertainty – and that is what we strive to do.

Can there be another 'Great Depression'? We don't think so. In the 1930's there were many safeguards put in place, the most common is the FDIC – Federal Deposit Insurance Corporation which insures accounts up to \$100,000 at member banks.

In addition, the U.S. Federal Reserve and the U.S. Treasury are in constant contact with foreign governments to coordinate a world wide strategy.

Should I make changes to my investments or modify my goals? We take great care in constructing an investment plan to meet your goals and objectives. Additionally, we monitor your account, we review the quality of the investments selected and we make changes when needed. If there is a change in *your* situation – or if you’ve exceeded your comfort level with the recent volatility, then please let us know.

What is your outlook and philosophy? At Carl P Sherr & Co., LLC, we believe that this situation will pass and we have faith in the economy. Our experience leads us to conclude that the best opportunities for profit are presented when sentiment is the most negative. Conversely speaking, one should be extra careful when investor sentiment is overly optimistic which can create what’s known as a ‘bubble’.

Speaking of bubbles, we believe there is a bubble in the price of petroleum. It’s tough to identify a bubble until after it bursts (real estate of 2008 and technology of 2000), but one of the best predictors of a bubble is when most people think that it can move only one direction – higher! If we are correct - and assuming that hostilities do not flare up in the Middle East, then we think the price of oil will eventually decline, which will help foster a stock market recovery.

If you have a long term perspective we believe you should stay invested. Maintaining a long term perspective means spending time in the market, not timing it.

We appreciate and recognize the trust you have put in us and your confidence continues to be our highest priority. Please contact us with any questions – or to schedule a review.