



MONTGOMERY INVESTMENT MANAGEMENT, INC.

November 5, 2008

Dear Montgomery Client:

The investment climate has changed.

For a number of years many mortgage bankers and some banks relaxed lending standards on home loans, requiring little or no equity, not requiring income or asset verification of the borrower, and allowing the borrower to determine the pace of repayment of the mortgage. Many of these mortgages were then sold to other financial institutions where they were combined with other mortgages and resold or divided into new products, recombined and resold again. The availability of mortgages with little or no down payment increased the demand for houses and caused a rapid escalation in house prices. This allowed many homeowners to withdraw additional money from their homes. This money was often used to increase consumption.

For a while this created a happy cycle with ever increasing house prices allowing ever increasing consumption and apparent prosperity for all. Some loans were made so aggressively, however, that in spite of the apparent prosperity, the loans were not repaid.

This caused a major problem in the financial system as financial institutions realized that a number of their assets (both mortgage loans and derivatives of mortgage loans) were unlikely to be repaid. In response, the banks tightened their lending standards, causing a decline in the ability of people to purchase houses, which led to a decline in the price of homes. Since the mortgages and their derivatives were made with little thought given to the possibility of house price declines, many more mortgages failed.

Although it was clear that the assets of a number of financial institutions were impaired, the complex nature of many of the mortgage derivatives and other assets held by these institutions made the extent of the damage difficult to assess. In addition, the government sponsored mortgage insurers, private insurers, and the investment banks had been allowed to carry very large leverage ratios. The survival of these institutions was reasonably questioned and a general mistrust of financial institutions ensued with a general unwillingness to lend.

The damage to financial institutions was not limited to the U.S., as a number of foreign financial institutions had purchased U.S. mortgages and derivatives. The unwillingness to lend required a de-leveraging of worldwide financial institutions, non-financial institutions and individuals, leading to a rapid decline in investment and consumption, leading to declines in commodity prices and deflationary forces. Worldwide governments and central banks have taken unprecedented steps to combat these forces.

Our investment thesis for some time has been that freer trade and a more capitalist orientation of foreign governments would lead to increased economic growth worldwide. This thesis has not worked well in the current economic environment and stocks dependent on worldwide growth have underperformed the markets recently. We believe, however, that efforts to re-liquefy our financial system will ultimately prove successful and many stocks at current prices will prove to be excellent long term investments.

Although government action was probably necessary to re-instill confidence in our financial institutions, it will certainly have negative long term effects. Economic growth will certainly be lower than it would otherwise have been because capital allocation decisions will not be made as efficiently. The relative strength of various political constituencies will introduce an unpredictability into our financial system that will lead to larger market volatility and inefficiencies. It is possible that the government's involvements in our financial system will be limited in duration; however, previous experience with Fannie Mae and Freddie Mac indicates this is not likely. It is also clear that the damage done to worldwide economies by the financial panic and the retrenchment of U. S. consumers, caused by the panic and falling home prices will lead to a serious recession, and declines in earnings.

Although the recessionary conditions, increased volatility, and lower growth indicated above would indicate that common stock will be a less attractive investment choice, we believe that these negative factors are more than offset by the current prices of equities. Stock prices are more attractive compared with government bonds than they have been for many years. The general tone of the markets is one of fear and uncertainty and the potential reward for taking risk is higher now than it has been for many years. We therefore recommend that accounts maintain maximum equity exposure consistent with the risk tolerance of the account.

Sincerely,

A handwritten signature in cursive script, appearing to read "Calvin S. Koonce".

Calvin S. Koonce  
President & Managing Director