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HELP WANTED, PART ONE

You'd have to be living under a rock to be oblivious to the economic and financial miasma which has wafted through U.S. and world markets this year.

As of the end of September, all U.S. indices were substantially down -- the Dow Jones Industrial Average at 21%, the S&P 500 at 24% and the Russell 2000 at 17%. The rest of the world was not immune to the market's turmoil either. France and Germany saw their markets off 29% and 30%, respectively; Australia was down 26%; Japan 27% and Brazil 28%. In August, China's Shanghai market had dropped 62% from its peak. Put in context, a similar drop in the U.S. market would take the Dow to around 5,500. (It's about 9,950 as I dictate this on October 6th).

Many are calling this the most significant financial crisis since the Great Depression. And yet you will find many middle-class Americans, our beloved "Joe Six Packs" and "Soccer Moms," who believe there is no problem for them, and that its limited to Wall Street's fat cats.

I happened to sit next to a couple on a Southwest flight on Sunday returning to Philadelphia from Raleigh Durham. They live outside Media. She works in the public school system and he works for a car dealer. They were intelligent, pleasant and educated. They also thought that Middle America had no crisis whatsoever. His business could borrow money and her paycheck was not threatened. They were angry at the \$700 billion dollar Washington "bailout." That same sentiment, echoed in thousands of emails from constituents around the country, caused the House of Representatives to initially reject the rescue plan on September 29th before they finally passed it later in the week on October 3rd.

It's more than mind boggling to say that the changes in the financial landscape have been shocking. All I need to do is

just mention names and consequences: Bear Stearns -- gone; Lehman Brothers -- gone; Washington Mutual -- gone; Fannie Mae and Freddie Mac -- rescued by the tax payers; Merrill Lynch -- no longer independent; Wachovia -- to be acquired by Citigroup or Wells Fargo; AIG -- one step removed from bankruptcy.

The same dynamics have happened in Europe as well. Just in the last week, Sweden, Denmark, Iceland, Germany, Ireland, Greece and Austria have all been compelled to provide government guarantees of their citizens' bank deposits.

The U.K., France, Belgium, Luxembourg, the Netherlands and Germany have either bailed out failed banks (Bradford and Bingley), provided government-backed loans to avert a bank meltdown (Dexia); taken control of mammoth financial services firms (Fortis); or initiated loan packages in the AIG mode to Germany's second largest lender (HYPO Real Estate).

Forty-one percent (41%) of the U.S.'s toxic \$740 billion net subprime mortgage exposure is estimated to be held by European banks, according to the IMF. At Monday, October 6th's close, the world markets had all felt this credit crisis tsunami. This is how far they fell in that one single day:

| | |
|--------------|----------------------|
| U.S.-S&P 500 | (3.8%) |
| Indonesia | (10%) |
| Russia | (19%) trading halted |
| Germany | (7%) |
| France | (9%) |

Government bailouts have, been fast and furious. They have come from socialist countries like Sweden and France as well as from free-market advocates such as the U.S. When the world is in economic crisis, political theory takes a second seat.

Alex J. Pollock of the American Enterprise Institute was quoted recently in the *Wall Street Journal* as follows:

"If you would like an empirical law of government behavior, it is that in a panic or threatened financial collapse, governments intervene -- every government, every party, every country, every time."

American history supports this position.

In the panic of 1792 our federal government added a full 25% to our-then existing national debt by taking on the

obligations from states such as Massachusetts and South Carolina which were incurred as part of the Revolutionary War.

Alexander Hamilton, the Treasury Secretary at the time, had an out-of-the-box solution. To wit, he caused the federal government to buy troubled bonds from private banks, boosting the market value of those bonds. If this sounds vaguely familiar, it should. The same strategy is in place today with our bailout. Substitute Henry Paulson for Hamilton; substitute collateralized mortgage obligations and other bad loans for the 1790 bonds. Hopefully, we will have the same success.

In the panic of 1907 there was a run on one bank that had made loans to seek to corner the market on the stock of a particular copper company. Like dominos cascading, public confidence in that bank, Knickerbocker Trust Company, along with a multitude of others, evaporated over night.

J.P. Morgan, the undisputed king of New York financial markets gathered New York's bankers at his home and worked through the night until he had persuaded them to create a joint pool of capital to pay depositors at banks that faced depositor runs. Soon confidence returned to the markets. Warren Buffett just committed \$3 billion dollars to GE last week. And the recent act by Congress raising insurance on money market funds to \$250k in non-retirement accounts and to \$750k in retirement accounts, will hopefully stem the concerns of Joe Six Pack that his cash in our nation's banks is no longer safe.

Franklin Roosevelt created a federal agency during the Depression to buy defaulted mortgages from banks. The government then refinanced those mortgages for homeowners at lower rates, thus stemming the meltdown in Depression era foreclosures. About one in ten Americans with nonfarm, owner-occupied dwellings received aid from the Homeowners' Loan Corp. I expect Congress to copy this tool soon with regard to their Fannie and Freddie rescue.

Finally, the savings and loan crisis in the late 1980's and early 1990's saw approximately half of our country's 3,200 saving and loan's close shop. In response, Congress created the Resolution Trust Corp. to make depositors whole and to clean up the industry. Unlike today's bailout, it took eight long months of debate before that federal entity was created. Skeptics claimed the government was reaching too far into the free market. They predicted that the RTC would be saddled with bad assets for generations. Indeed, by the time the crisis had ended the U.S. taxpayers were on the hook for \$124 billion dollars, according to FDIC research. However, that

was government pocket change compared to the when crisis which would have erupted otherwise without that federal help.

And so, in conclusion, I think our country's financial markets, as well as the world's, will weather this storm thanks to the Pollock Dictum, (ie. That government intervenes: -- every government, every country, and every time.)

The musical *Carousel* has a wonderful song, the words and music having been created by Oscar Hammerstein and Richard Rogers called "*You'll Never Walk Alone.*"

Its words read:

 "When you walk through a storm
 hold your head up high
 And don't be afraid of the dark.
At the end of a storm is a golden sky

 And the sweet silver song of a lark.
 Walk on through the wind,
 Walk on through the rain,
 Tho' your dreams be tossed and blown.

 Walk on, walk on with hope in your heart
 And you'll never walk alone,
 You'll never ever walk alone.
 Walk on, with hope in your heart

 And you'll never walk alone,
 You'll never, ever walk alone."

My advice? Walk on through the rain; we'll get through this.

Help Wanted, Part Two

This little investment advisory business I embarked upon in 2000 has taken on a life of its own, growing from a part-time effort to assist a limited number of estate planning clients back then, to a full blown, full-time activity today with more than \$100 million dollars under management.

You all know my assistant, Jennifer Reichner, who has been with me since 1999. Many of you also know our second assistant, Catherine Crepack, whom we added to Westover's staff in April 2007. Eighteen months later I'm pleased to announce that we've added a fourth team member, and a second investment advisor.

This gentleman has worked in the industry for almost ten years. He began his financial career on the trading desk at Jurika & Voyles, a multi-billion dollar investment management firm in Oakland, California. Initially working with the firm's retail or "wrap" client accounts, he was eventually promoted to Equity Trader. In that role he was responsible for implementing the firm's investment decisions, striving to obtain the best execution of equity and option trades for the firm's mutual funds, institutional and high net worth clients.

Moving back East after five years, he secured an MBA in finance from the University of North Carolina at Chapel Hill. (Funny how that school always seems to show up in these newsletters, isn't it?) Importantly, he also earned his Chartered Financial Analyst designation. The CFA designation is globally-recognized and attests to a charterholder's success in a rigorous and comprehensive three year self-study program in the fields of investment management and research analysis.

After securing his MBA and CFA degrees he was hired at Tucker Capital Management in Durham, North Carolina where he assisted the firm's founder in researching and analyzing both public and private companies for potential investment. His four years there were dedicated to public equity research as well as to helping to manage the firm's hedge fund.

In July, I was fortunate enough to persuade this gentleman to join me at Westover Capital. For those of you who don't know who he is, his name may be of interest: Harold M. Sawyer, III. You can call him Chip; his mother and I do.

Bad Guys and Bad Things

Every tragedy needs a villain. Every problem needs a cause. We haven't yet had time to focus on villains or causes, but I am willing to make a couple predictions.

When the time for pointing fingers has come, and it surely will come, my candidate for one of the Bad Guys is the former CEO of Lehman Brothers, Richard Fuld. Testifying before Congress on October 6th, Fuld arrogantly and defiantly defended his \$250 million dollars in salary and bonuses he has received since the year 2000. The leader of this now-bankrupt investment bank failed to accept responsibility for his company's death. It came once Treasury Secretary, Henry Paulson, declined to guarantee the sale of the company, after its stock price tanked amid concerns for the risky mortgage-backed securities Lehman held. Just days before Lehman

collapsed in mid-September a trading partner insisted that Lehman post an extra \$5 billion dollars in collateral to support its trades. This was the straw that broke Lehman's back. Nevertheless 24 hours later Mr. Fuld was telling investors that Lehman was "on the right track to put these last two quarters behind us". Add arrogance and obscene pay up and you get a villain ready made for Washington, DC destruction.

My candidate for the Bad Thing at the core of this issue is an exotic credit derivative instrument; I am speaking of so-called naked credit default swaps. In recent years a multitude of derivative securities have been created, modeled, priced and traded. The trouble is that there has been no transparency, no regulation, no history and no basic and trusted market to these instruments. Consequently, they have taken on a life and a value of their own. An article I read in Paris last week spoke of a small, 350 person department of AIG housed in a nondescript London office. AIG had over 100,000 employees worldwide. This tiny office created and sold the swaps of which I speak for AIG. It provided an incredibly disproportionate percentage of earnings to the company's bottom line several years ago, but also provided the poison pill which killed AIG when those markets went south.

Listen to the Music

We had two winners last time in our quiz, Pete Booker who is President/CEO of Delmarva Broadcasting Company and Greg Inskip, a senior partner at the law firm Potter, Anderson and Corroon. Each of them answered our Eric Clapton quiz. Many of you also had the correct answers to questions which asked for the names of one band of which he has a member, the wife about which he was singing in his song "Layla" (George Harrison's) and the name of a song he made famous. We picked their names out of a hat holding multiple winning guesses.

This time we have a future looking quiz. The winner won't be known until early next year. Unlike previous quizzes, every single reader is able to win our \$100 restaurant gift certificate.

The quiz is this: Where will the Dow Jones Industrial Average be at the end of December 31, 2008? As I dictate this on October 6th in the late morning it sits at 9,940.05. Good luck and let's hope it's not all that bad.

Remember, when you walk through a storm hold you're head up high and don't be afraid of the dark.

October 6th, 2008