



FAI Advisors, Inc.

Monthly Investment Commentary

September 2008

August Gains

August brought investors a welcome vacation from the wearying declines in the stock market seen throughout much of this year. The large-cap Vanguard 500 Index Fund gained a solid 1.5%, and returns were even better for smaller-cap stocks. The iShares Russell Midcap and iShares Russell 2000 gained 1.8% and 3.6%, respectively, for the month. Broadly speaking, equity returns at the sector level reflected the increasing expectation that the world economy is slowing. This hurt energy and materials stocks—previously the only bright

spots for equities—while beaten-down financial and consumer-staples stocks rebounded. The dollar also rebounded strongly, and that hurt foreign equity performance in U.S. dollar terms. Vanguard Total International Stock Index Fund was down 5.1% for the month. Domestic bonds, as measured by Vanguard Total Bond Market Index Fund, gained 0.7% in August.

Our investment approach is long term, not focusing on short-term performance, since the factors that drive shorter-term performance are difficult to predict with confidence. Nevertheless, it has been a very difficult market

Updated Market Data

“A Year in Review”*

	August	YTD		9/05/08	9/05/07	% Chg
Large Cap Benchmarks			Consumer Rates			
Vanguard SP 500	1.50%	-11.40%	1 Year CD Yld	2.17%	4.36%	-50.23%
Russell 1000 Growth ishares	1.10%	9.90%	30 Yr Mortgage	6.39%	6.42%	-0.47%
Russell 1000 Value ishares	1.70%	-12.50%	Prime Rate	5.00%	8.25%	-39.39%
Nasdaq (QQQQ)	1.29%	-9.82%	Commodities			
Dow Jones Indust (DIA)	1.34%	-11.74%	Crude Oil	106.44	75.71	40.59%
Small Cap Benchmarks			Gasoline	3.68	2.75	33.82%
Russell 2000 Growth ishares	2.50%	-4.50%	Gold	802.80	681.40	17.82%
Russell 2000 Value ishares	4.70%	-0.70%				
Other Benchmarks						
Vanguard REIT Index	2.30%	1.90%				
Vanguard Total Intl Stock Idx	-5.10%	-18.60%				
Vanguard Total Bond Idx	0.70%	1.08%				
Merrill Lynch High Yld bond Idx	0.30%	-0.25%				
Citigroup World Govt Bond Idx	-2.00%	3.10%				
DJ-AIGCI (Commodity Futures)	-7.30%	4.00%				

* Source: JP Morgan Weekly market recap

environment since the onset more than a year ago of the housing meltdown and ensuing credit crunch. The overall stock market is down sharply from its highs last October, but the degree of damage has varied widely across the financial markets. This has created a lot of pain, but it is also creating opportunities. These are coming in a number of forms. At the individual stock level many fund managers are finding exceptional opportunities—in some cases as good as they've ever seen. Time will tell.

At the asset class level, we are seeing some areas getting more attractive on a relative basis, and are keeping a close eye on these. One aspect of this environment is that unusually compelling opportunities are being created in the fixed-income arena. This is happening in part because some troubled financial institutions are forced to sell bonds at steep discounts to shore up their balance sheets. The unique nature of this market environment has our research team enthusiastically working long hours to get their hands around how this all might play out, in terms of both risks and longer-term opportunities. Some thoughts we currently have in the asset class area:

REIT's —We currently believe REITs are in a fair-value range and priced to generate returns in the mid to upper single-digit range, which is in line with equities, but more attractive than bonds over our five-year time horizon. We have avoided allocations to US based REIT's since 2006, but this area is looking more attractive.

High-Yield Bonds —In terms of risk, we think of high-yield bonds as comparable to a mix of stocks and bonds. Right now, on a relative basis high-yield looks fairly attractive in terms of potential returns versus a stock-bond mix, but this is looking out over a number of years, and the near-term risks remain significant. So at

this point, we continue to watch the asset class closely, as it is possible that an opportunity could be created quickly if investors turn sharply negative.

The Presidential Cycle

Finally, it is an election year. You may be looking forward to November so that the constant sound bite political ads stop running. But, markets are affected by elections simply because it is another unknown; especially when combined with all the other current issues we are working through economically.

Regardless of the election outcome, there is a basic theory of political cycles that can affect the markets going forward. The elected president and his party use the first year of the term to get the "dirty work" done. This is typically when taxes are raised, anti-business legislation is passed, foreign adventures begin, and new spending programs are introduced. There can be investment fall-outs from these initiatives that can hit the market in years one and two. In the third year, the political class begins to prepare for the next presidential election and start the process for pro-business, pro-investment initiatives, which will appear in year four. This is also when "pork barrel" legislation and "special interest" spending programs move into high gear, greasing the wheels of the re-election process for incumbents. The Federal Reserve usually adopts a more expansive monetary policy – increasing the money supply, lowering interest rates, all geared to produce a vibrant economy by the next election.

The upcoming October version of the newsletter will explore in depth the possible tax and investment planning implications of either President being elected, and how we plan to address these issues.

FAI Advisors, Inc.
Investment Policy Committee (9/12/08)

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