

The logo for Madison Wealth Management features the word "Madison" in a blue serif font, with a grey curved shape behind it that tapers to the right. Below "Madison" is a grey rectangular box containing the words "WEALTH MANAGEMENT" in white, all-caps, sans-serif font.

WEALTH MANAGEMENT

Letter to Clients: Our Thoughts on Current Market Events

September 15, 2008

Just a note to check in and share some thoughts with you regarding the significant events currently unfolding in our financial markets.

As you're undoubtedly aware, despite the intense efforts over the weekend of Wall Street executives and senior Washington policy makers, the fourth largest U.S. investment bank Lehman Brothers declared bankruptcy late Sunday night. The run-up to this announcement was accompanied by news that Merrill Lynch had agreed to be acquired (saved?) by Bank of America and that the large international insurer, AIG, was desperately seeking cash to strengthen its badly depleted reserves.

Certainly, these events, following closely on the heels of the government led bailouts of Bear Stearns, Freddie Mac and Fannie Mae are cause for concern. And they represent a major re-alignment of our investment banking system and a shock to our collective financial system. But they do not represent a collapse.

While the risks are real, so is the concerted, high level response. This situation has drawn the full attention of senior Washington policy makers who have the authority and financial wherewithal to make and implement decisions. Their decision to allow Lehman to fail rather than provide a financial guarantee signals their conviction that the world's financial and economic systems are strong enough to withstand the event and its associated consequences.

And while there's no denying the problem, our economic system is based on identifying winners and losers. The loss for some of these companies represents real opportunity for others. While only time will tell how Bank of America's acquisition of Merrill Lynch turns out, acquirers purchasing valuable franchises at distressed prices is how many a fortune has been made.

Another potential lesson of the Merrill acquisition is the pain felt by the speculators who were betting against Merrill's survival going into the weekend. These folks, many of whom borrowed money to accentuate their "sure-thing" bet, experienced a major reversal when Merrill's stock rose strongly this morning rather than falling as expected. While we do not cheer anyone losing money, we like seeing risk re-established on both sides of the market. For those who are over-confident on either the up or down side, and borrow significant sums of money to leverage their convictions, it's an important reminder that risk is an inherent element of our financial systems, and needs to be respected and managed.

We recognize that these are unusual times and it is natural for you to be concerned. So what do these events mean to you and your portfolio?

First, your portfolio was designed to support your long-term goals. It is broadly diversified and built to weather storms similar to the one we're experiencing today. While we don't predict the timing of such events, we expect that they will occur and build our portfolios accordingly.

Second, it's likely this liquidity event isn't over yet and more companies may fall victim to this correction. But this is nothing new. The market has encountered, struggled with and ultimately prevailed over other shocks as outlined in the table on the next page.

Event Investing

Performance of the Dow Jones Industrial Average after 13 Major Postwar Events

	Market Low after Event	Total Return After Event (%)	
		1 year Later	2 years Later
Berlin Blockade	6/13/49	46.1	70.1
Korean War	7/13/50	34.8	53.5
Cuban Missile Crisis	6/26/62	37.3	67.8
Kennedy Assassination	11/22/63	30.2	44.8
Gulf of Tonkin	6/8/64	16.1	20.6
1969 Stock Market Break	5/26/70	49.6	69.3
1973-74 Stock Market Break	12/6/74	47.8	82.4
Iran Hostage/Oil Crisis	4/21/80	37.5	22.2
1987 Stock Market Crash	10/19/87	28.9	69.6
1990 Persian Gulf War	10/11/90	29.2	39.6
Russian Bond Default	8/31/98	46.1	53.6
Hi-Tech-Dot Com Crash	10/9/02	36.1	44.4
2007-08 Liquidity Event	?	?	?
Average Return		36.6%	53.2%

Source: David Dreman, [Contrarian Investment Strategies, 1998](#)

The Dow Jones Industrial Average (DJIA) is generally accepted as a measure of US stock market performance. Returns assume reinvestment of all distributions, and, unlike fund returns, do not reflect fees or expenses. It is not possible to invest directly in the DJIA. Performance is historical and does not guarantee future results.

Maintaining a long-term investment strategy is far easier said than done. While the table above shows that the financial markets have always recovered after difficult periods, it is never easy to experience such a period first hand. Since no one will ring a bell when the markets have reached a bottom, one must stay invested during the difficult times so as to participate in the eventual recovery.

Third, we are doing the job you hired us to perform. Our focus is on how you can reach for and realize your financial goals. So we are actively monitoring the situation while taking advantage of the volatility to rebalance portfolios to their target weights and harvest tax losses where it makes sense to do so. We have confidence in how your portfolio is positioned. Should you have any questions regarding your ability to meet your financial goals, please give us a call. We would enjoy reviewing your situation with you.

All the best,

Jim

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