Grey Investments
Family Fiduciary Services, Inc.

900 Cummings Center ♦ Suite 205-U ♦ Beverly, MA 01915
Telephone: (978) 922-0050 ♦ Fax: (978) 232-1112

Interim Communication, September 13, 2008 **Third Quarter, 2008**

A number of you have called this week regarding the continued turmoil in equity/bond markets. Further, many of you are trying to understand the affect a Lehman Brothers rescue over the weekend will have on your personal investments. The following are some brief highlights of current headlines:

1. The New York Fed is meeting over the weekend to find a buyer for Lehman Brothers. U. S. Treasury Secretary Paulson has signaled that he does not intend to involve the U. S. Treasury in a government led bailout of Lehman, a reversal from the U. S. bailout of Bear Stearns in the spring. A resolution should be announced Sunday prior to the open of the Japanese markets.
2. Washington Mutual, the largest thrift in the U. S., is viewed as the next candidate for a large failure in the next several months.
3. AIG, one of the world's largest insurers and an aggressive insurer of swaps/derivatives that guaranteed debt of many pools of failed mortgage securities, is now feared to be in jeopardy. The Saturday Wall Street Journal reported that panic selling of some issues of AIG junior debt pushed prices to under 40 cents from 65 cents on Friday (debt markets seem to have been better at predicting many failures than equity markets).
4. Merrill Lynch, previously viewed as a survivor due to its aggressive sale of distressed assets, has seen its stock decline significantly last week.
5. Concerns are rising that the remaining healthy institutions (BankAmerica, JP Morgan in the U. S., Barclays and HSBC, non-U. S.) are rapidly approaching their capacity to take over failing institutions as large as Lehman.
6. Markets in general are becoming concerned that the foregoing will trigger greater concerns about commercial real estate assets and their related debt. Concerns are also growing that corporate debt markets may also witness increased defaults as LBO (leveraged buy-out) debt for deals done in the past several years begin to default.

Short term, we would expect that a deal to sell Lehman will be announced Sunday. Notwithstanding Treasury Secretary Paulson's jawboning, it may be necessary for the U. S. to participate in a rescue or (hopefully), Lehman will be split into pieces and sold to various hedge funds and foreign/U. S. institutions, with no U. S. guarantees. How the markets will treat all this on Monday is unclear (a large move up or down is likely). What we do know, is we are most likely only halfway in a long process of identifying risk embedded in financials balance sheets. Many of you that are concerned should be; we are clearly in a financial crisis second only to the bank closures during the 1930's. That said, most economies including the U. S. appear to be absorbing this news relatively well, with the expectation that a recession may be shallow, rather than deep.

What does all this mean for your investments?

1. Equities: given the level of uncertainty, lowering your exposure to equity markets by perhaps 5-7.5% may be in order for accounts with a time horizon under 10 years or for clients with a particularly bearish view.
2. Bonds: municipal bonds are incredibly attractive relative to U. S. government and corporate debt, and clients in high tax brackets should consider increasing AMT free holdings. After tax returns on long dated municipal bonds for high income clients are approaching equity like returns.
3. Commodities: even though commodity markets have declined sharply over the last month, consideration should be given to slight increases to this asset class.
4. Cash: our discipline calls to remain fully invested, but an allocation of 5-10% may be in order for clients with a horizon under five years.
5. For clients that hold assets outside of our management, any “junk” bond funds should be sold at this point in the credit cycle. In an environment where surprises are common, any equity holding that exceeds 5% of your net worth (excluding companies you run or family businesses) should be reviewed for liquidation.
6. Please review your bank accounts and make sure you are fully covered by FDIC insurance.

Feel free to call next week and we will discuss your portfolio should you wish. Remember, we complete Investment Policy Statements to guide us when economic stresses occur; equity markets still remain the place to be for assets that can be held for long time periods.

David L. Grey
President & Chief Investment Officer