



MCG would like to introduce you to David Wojick, our newest senior consultant. David joins Marco Consulting Group from Marquette Associates, where he was a Vice President/Consultant, working with Taft-Hartley plans, public funds, and corporate clients. He was also a member of Marquette's investment manager research committee. David has over 18 years of experience working in investment services, ranging from consulting to institutional bank services to master trust administration.

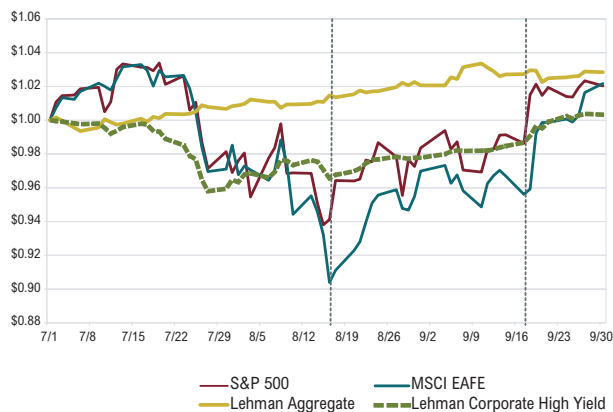
David received his Masters of Business Administration from the Loyola Graduate School of Business (Chicago) and his Bachelor of Business Administration from Western Michigan University.

## MARKET SUMMARY

Markets were quite volatile during the third quarter, with returns for most asset classes falling during the first half of the quarter and then rebounding. Trouble in the housing market spurred most of the decline, while actions by the U.S. Federal Reserve prompted the recovery. The chart below (see Figure 1) shows how stocks and bonds reacted when the Fed cut two different interest rates on August 17 and September 18. These lower interest rates restored confidence and liquidity to the markets.

(The Fed lowered the discount rate, the rate it charges when it loans money to banks, from 6.25% to 5.75% on August 17. On September 18, the Fed cut the federal funds rate, the target rate for overnight loans between banks, from 5.25% to 4.75% and also lowered the discount rate from 5.75% to 5.25%.)

Figure 1: Performance, Q3 2007



## HOUSING MARKET

So, where did the trouble in the housing market start? Mortgages can be divided into two groups—agency and non-agency. Agency mortgages require the borrower to meet certain standards, for example, for loan amount and credit score. These mortgages are originated by brokers, banks or lending companies and then sold to government agencies like Fannie Mae and Ginnie Mae, who then package these into mortgage-backed bonds. Up until 2003, agency mortgages accounted for over 75% of all mortgages issued in each calendar year.

Non-agency mortgages have looser lending standards, and can be categorized as jumbo (over \$417,000), subprime (for borrowers with weak credit scores), and "Alt-A" (in between prime and subprime). In 2004, the non-agency share of all mortgages issued that year rose to 46%, and it rose to 56% in 2006 (source: Bear Stearns Fixed Income Research). Investment banks took many of these non-agency mortgages and repackaged them into collateralized debt obligations (CDOs), complex bonds with varying risk levels.

Many of these non-agency mortgages were adjustable rate mortgages that started with low teaser rates for the first few years. When the teaser rates began to expire, interest rates on these mortgages rose and many homeowners had trouble making their monthly payments. Defaults on these mortgages became losses for those investors who purchased the CDOs. Hedge funds often bought the riskiest slices of CDOs. Hedge funds that were using leverage (borrowed money to amplify returns) then needed to sell high-quality securities in order to post enough collateral to cover their losses. Forced selling during a time of market stress led to further losses and instability for both stock and bond markets. One segment that remained unscathed was U.S. Treasury securities, which benefited from the flight-to-quality.

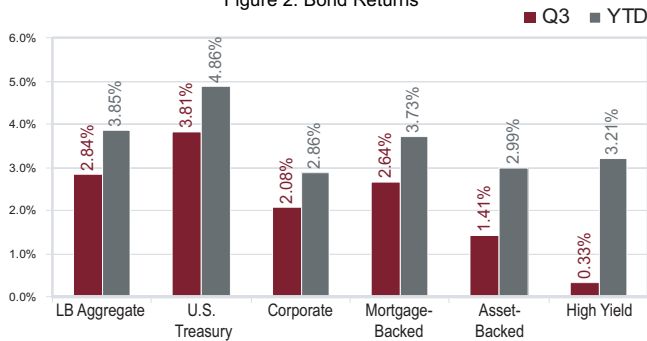
Some CDO securities had the highest credit rating possible, because the rating agencies predicted very low default rates. Before July, banks and other investors regarded these highly rated CDOs as safe, and were content to accept these securities as collateral for short-term lending. As concerns erupted about the quality and prevalence of these outstanding CDOs, the short-term lending markets froze up and some short-term bond funds experienced losses. This is how the housing problem spread from individual homeowners to investment banks to hedge funds to bond funds and back to individual investors.

## BOND RETURNS

Third quarter returns for various bond indexes were mixed (see Figure 2). U.S. Treasury bonds rallied as investors flocked to those safe investments, and this also contributed to strong returns for the LB Aggregate index. Investment-grade corporate bonds and agency mortgage-backed bonds dropped mid-quarter amid general market volatility but recovered some of that lost ground in the second half of the quarter. The asset-backed segment includes non-agency mortgage bonds and those performed quite poorly, as did high-yield bonds.

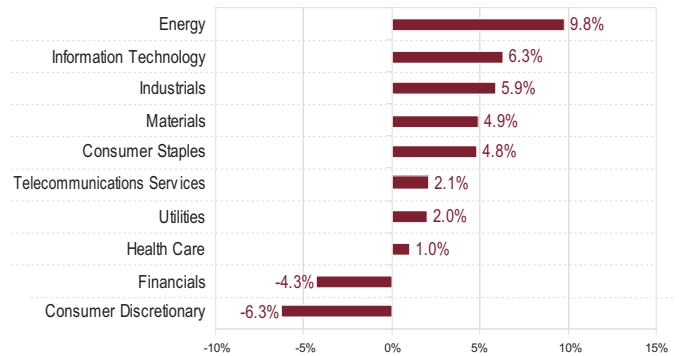


Figure 2: Bond Returns



U.S. Treasury performance is the Lehman Brothers Treasury TR Index; Corporate performance is the Lehman Brothers U.S. Credit TR Index; Mortgage-Backed performance is the Lehman Brothers Mortgage Backed Securities TR Index; Asset-Backed is the Lehman Brothers Asset-Backed Securities TR Index; High Yield is the Lehman Brothers High Yield U.S. Corporate TR Index.

Figure 4: S&P 500 Index Sector Returns, Q3 2007



## U.S. STOCK RETURNS

The major domestic stock indexes ended the quarter with respectable returns (see Figure 3), despite the increased volatility. Returns picked up considerably after the Federal Reserve lowered interest rates and calmed the markets. Growth stocks continue to outperform value stocks, a trend that has persisted since August 2006. Large stocks have also outperformed small-caps, in part because larger firms are more likely to participate in overseas growth.

Financial stocks suffered from subprime exposure, and consumer discretionary stocks faltered amid concerns that the U.S. economy is weakening. All other sectors performed strongly, especially those with exposure to global markets and rising commodity prices (see Figure 4).

## INTERNATIONAL STOCK RETURNS

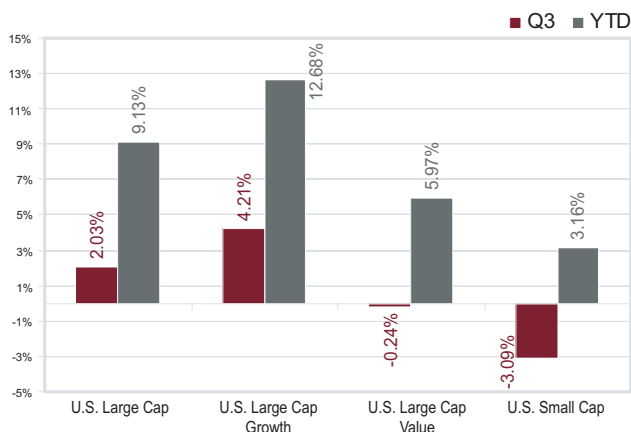
International stock markets reacted to U.S. events, falling in the first half of the quarter as the subprime woes spread and rising in the

second half of the quarter as order was restored to the markets (see Figure 5). Emerging market stocks continue their bullish run, as investors focus on the potential growth in these markets instead of the additional risks.

Lower interest rates cause the U.S. dollar to weaken, as foreigners sell U.S. Treasury bonds and U.S. dollars to find better yields elsewhere. The weaker dollar contributes to higher foreign-stock returns for U.S. dollar-based investors (i.e., unhedged accounts). When the dollar is weak, investors can exchange foreign currencies (in which they purchased foreign stocks) for a larger number of U.S. dollars.

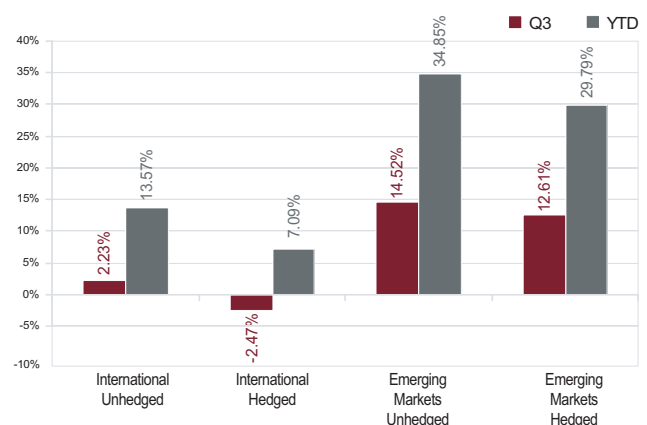
A weak U.S. dollar has a few benefits. It makes U.S. assets cheaper for foreign investors and this contributes to increased export activity. This in turn helps stabilize the trade deficit, which is an economic measure of total imports versus total exports. On the other hand, a weaker dollar makes U.S. Treasury bonds less attractive to foreign investors and imports

Figure 3: U.S. Stock Returns



U.S. Large-Cap performance is the S&P 500 TR Index; U.S. Large-Cap Growth performance is the Russell 1000 Growth TR Index; U.S. Large-Cap Value performance is the Russell 1000 Value TR Index; U.S. Small-Cap performance is the Russell 2000 TR Index.

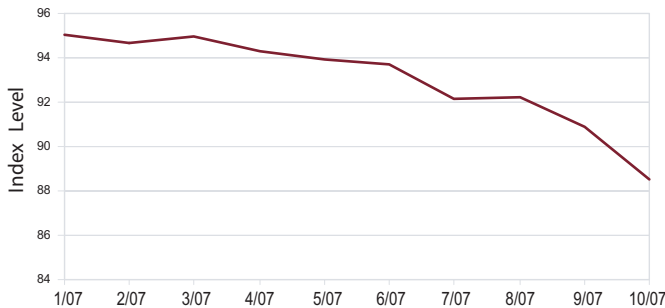
Figure 5: International Stock Returns



International Unhedged performance is the MSCI EAFE GR USD Index; International Hedged is the MSCI EAFE GR LCL Index; Emerging Markets Unhedged is the MSCI EM GR USD Index; Emerging Markets Hedged is the MSCI EM GR LCL Index.



Figure 6: Price-Adjusted Broad Index of Currencies vs. USD



Source: Federal Reserve

more expensive. Above chart (see Figure 6) shows how the U.S. dollar has declined against a broad index of foreign currencies.

## OUTLOOK

It is still not clear how widespread the damage will be from the housing crisis. Existing home sales are slowing (see Figure 7) and median prices are dropping. While the quantity of sales of existing single-family homes is lower across all regions, the drop in median prices is much more modest in the Northeast and Midwest (both -0.7%) compared to the South (-5.7%) and the West (-9.0%). (Source: NAR)

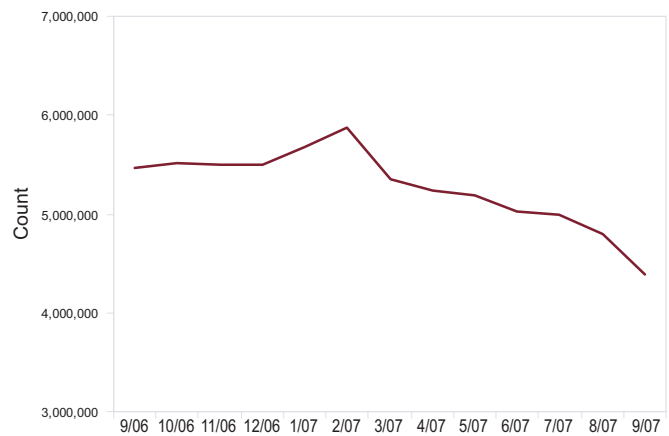
Prime borrowers are still able to obtain reasonable financing. Rates on 30-year fixed-rate mortgages now average 6.3%, compared to 6.5% a year ago. (Source: NAR). But, subprime or Alt-A borrowers or those looking for jumbo loans will have trouble obtaining reasonable terms, as very few lenders are willing to issue non-agency mortgages right now. As more existing adjustable rate mortgages reset their rates, more borrowers will default, especially if the value of their home has dropped below the original mortgage amount. Many bonds tied to the mortgage market have been repriced, but it is not clear whether the repricing accurately reflects the default rates that will occur in the future.



In addition to housing concerns, oil is at a record high, surpassing \$80 a barrel at quarter-end and \$90 a barrel in recent weeks. High energy prices, low home prices, and more expensive imports may limit the consumer's ability to continue spending in the future, and some market participants are worried about the possibility of a recession.

However, there are some positive factors which may avert a recession. First, the Federal Reserve has been especially responsive to market turmoil, most recently cutting the federal funds rate from 4.75% to 4.50% and lowering the discount rate from 5.25% to 5.00% on October 31. Second, global growth and demand for goods continues to be strong, with some U.S. firms participating in that growth. U.S. firms also have access to fairly low interest rates for financing. Lastly, the most recent gross domestic product (GDP) report was very positive, showing a 3.9% increase in GDP during the third quarter, fueled by strong consumer spending and export growth. The report also indicated that inflation remains under control, as consumer expenditures rose only 1.6%.

Figure 7: Existing Single-Family Home Sales



Seasonally-adjusted, source NAR

## SAVE THE DATE

2008 Marco Consulting Group Client Conference  
Friday, February 1 to Tuesday, February 5  
Sheraton Maui, Maui, Hawaii

For information, call Mary Gremmler at  
312.612.8448 or email her at  
gremmler@marcoconsulting.com



## Marco Consulting Group 2008 Client Conference



February 1–5, 2008

The Marco Consulting Group invites you to the 2008 Client Conference at the Sheraton Maui in Maui, Hawaii from Friday, February 1, 2008 to Tuesday, February 5, 2008.

The theme of this year's Client Conference is "*Exploring Contemporary Investment Strategies*". The following professionals of The Marco Consulting Group will serve as presenters for this program: Jack Marco, Tom Mitchell Sr., Dick Graf, Ian Jones, Michael Joyce, Amy Forebaugh, Greg Kinczewski, Jodie Gunzberg, Miguel Zarate, Jason Zenk, Erin Keating, John Marco, Frank Nigro Jr., and Michael Lyons.

# Marco Consulting Group 2008 Client Conference

## AGENDA

### Friday, February 1, 2008

1 pm .....	Refresher on the Basics Ask the Consultant Demystifying the Buzz Words
3 pm-6 pm .....	Conference Registration

### Saturday, February 2, 2008

7 am-8 am .....	Continental Breakfast
8 am .....	Session I

#### Digging Deeper into Hedge Fund Strategies

Amy Forebaugh, Jodie Gunzberg, and Jason Zenk

#### Discussion Topics:

- Complexities of Hedge Fund management.
- Real life examples of strategies that worked, and some that didn't work
- Performance differences/risks of strategy options.

### Sunday, February 3, 2008

9 am-10 am .....	Continental Breakfast
10 am .....	Session II

#### Year in Review - Investments and Proxy

#### Guest Speaker

Dick Graf, Michael Lyons, and Greg Kinczewski

#### Discussion Topics:

- Review of 2007
- Human emotion of investing
- Proxy Report

### Monday, February 4, 2008

7 am-8 am .....	Continental Breakfast
8 am .....	Session III

#### Global/International Equity and Fixed Income Investing

Miguel Zarate, John Marco, Frank Nigro, Jr., and Erin Keating

#### Discussion Topics:

- Developed vs. Emerging Markets
- Market history, economies, returns, currencies, exchanges, and corporate governance
- Global tactical asset allocation
- Case Studies

### Tuesday, February 5, 2008

7 am - 8 am .....	Continental Breakfast
8 am .....	Session IV

#### Additional Contemporary Investments

Ian Jones, Tom Mitchell Sr., Michael Joyce, and Jack Marco

#### Discussion Topics:

- Private Equity, Infrastructure, and Real Estate
- New strategies in the Alternatives world
- Fiduciary Services update and case study

## FEES

<b>Conference Fee:</b>	\$1,150 (includes continental breakfast daily, Super Bowl Party, and Monday Dinner for attendee)
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#### Hotel Rooms

#### Single/Double

#### Occupancy

Run of House:	\$255/night + taxes
Run of Ocean:	\$280/night + taxes

#### Add'l. Person(s)

(18 yrs. and older):	\$70/person/night
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Subject to availability, you may reserve rooms at these group rates for the four days before Thursday, January 31, 2008 and for the four days after Tuesday, February 5, 2008.

Room reservations must be guaranteed with a deposit of one night's room revenue plus taxes.

In compliance with LM30 and LM10 reporting, the following events must be paid for by attendees for family/guests:

<b>Saturday Golf:</b>	\$135/person (for attendees and family/ guests) (club rental is extra)
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<b>Super Bowl Party:</b>	\$40/adult; \$20/children 6-12* (for family/guests only)
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<b>Monday Dinner:</b>	\$70/adult; \$35/children 6-12* (for family/guests only)
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These events can be paid for directly to the Sheraton Maui at our Registration/ Reception on Friday, February 1, 2008.

To register, please notify your Plan's Administrator who will be making arrangements for your group. Don't forget to give your Administrator your arrival and departure dates, the events you will be attending and the number of adults and children attending each event.

\* Children 12 and over are counted as adults. Children under 5 are free