

2008 Market Outlook and Investment Strategy

It is our hope that everyone is doing well as we enter another new year. As most of you are aware, Dermann & Smith Personal Wealth Management has recently relocated to a new office facility in south Lexington. Our new office, located at 535 Wellington Way, is more centrally located to the majority of our growing client base thus allowing easier access for many of you. Additionally, we have also upgraded our information gathering, financial planning, and reporting capabilities in order to provide you with an even higher level of personalized service. While we may not always be able to accurately predict financial market behavior, take comfort in knowing that Dermann & Smith Personal Wealth Management is continually seeking to add value to our relationships with the wonderful clients that we have the privilege to serve.

Review of 2007

The U.S. financial markets this past year could be clearly differentiated as increasingly volatile and uneven as our economy dealt with some significant influences that created a considerable degree of uncertainty for investors, businesses, and consumers. While the markets performed relatively well during the first half of 2007, the second half was characterized by increased volatility and overall downtrends in most U.S. market sectors from mid-year levels. The combination of a marked slowdown in the U.S. residential housing market and the high profile crisis in the subprime mortgage markets created price, valuation, and liquidity concerns across the entire U.S. economic landscape. These trends eventually had a negative impact on business investment, job growth, and consumer confidence which resulted in downward pressure on the majority of the major U.S. financial markets. Their most notable impacts were felt in real estate, financial institutions, and various debt obligations. Also, in 2007, the Federal Reserve incrementally lowered the Fed funds rate on three occasions (totaling one percent) in an attempt to offset the tightening in the credit markets.

On a more positive note, most major international equity markets exhibited significant strength in 2007 as the global market boom continued. Of particular note was the growth experienced in the emerging international economies in general and the rapid ongoing development of China and other Asian countries in particular. Overall, international market performance easily outpaced that realized in the U.S.

2008 Market Outlook

It appears that 2008 may well be a very challenging year for the U.S. economy and its financial markets. However, a number of international economies, particularly those in emerging Asian markets, are likely to continue to exhibit strength in 2008, although at more moderate levels than in 2007.

A key question for the U.S. economy, as we enter 2008, is whether or not the continuing pressures created by the residential housing correction, higher energy and healthcare costs, and a tightening in credit available for consumers and businesses will stifle growth and result in a recessionary economy. Other questions of concern are the ability of the U.S. to sustain its current high rate of employment, and the ability to increase payroll, and expand industrial manufacturing. Or, from a more optimistic perspective, have we already weathered the major impact of the negative trends encountered in 2007 and thus stand poised to resume more traditional economic growth in an environment of lower interest rates and increased consumer hope for a better life that election years typically hold? Regardless of the eventual answers to these questions, it appears that U. S. economic growth will slow measurably in the first half of 2008 and then perhaps show moderate improvement in the latter half of the year.

In general, international economic growth should remain robust in 2008. While growth rates in Europe and the United Kingdom may be slower than previously anticipated, the emerging economies should continue to grow at above average levels. In 2007, the major stock indices of China, Indonesia, India, and Hong Kong had an average gain of nearly 59%. Therefore, it is easy to see that even if last year's market increases in these economies are nominally reduced in 2008, they will still represent considerable value compared to expectations for the U.S. markets. The only major concerns to a continued expansion of the international marketplace is the extent to which the U.S. subprime credit damage may have spread to European and Asian banks and investors, and the potential effect that \$100 a barrel oil might have on international growth and/or diminishing demand for exports.

2008 Investment Strategy

For at least the first half of 2008, our investment strategy will be decidedly defensive in nature compared to the past few years. This strategy will be implemented through a sensible combination of timely investment rebalancing and broader portfolio diversification. If need be, we will also recommend adjusting the asset allocation mix in client accounts--particularly in instances where significant periodic distributions are currently required.

While every client's investment portfolio is unique in its composition, there are some common general themes of our investment strategy that we will pursue. First, new investment in income-producing securities will be focused on high quality debt instruments until such time that the subprime mortgage crisis and its attendant spillover effects are clearly behind us. Next, we will continue to expand our exposure to and diversification in the international sector as we feel that significant near and long-term opportunities exist in these markets. Also, we have identified positive potential for the global infrastructure sector which includes both domestic and international investments in areas such as utility systems, highways, bridges, hospitals, schools, and communication systems. Finally, we will assume a more defensive investment posture with respect to the balance among U.S. growth and value investments as well as between small, mid, and large market capitalizations.

We believe that this investment strategy will provide both a sense of stability and opportunity for portfolio growth as we address these very challenging and ever-changing conditions.

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