

Aureus Asset Management, LLC
Investment Perspectives
October 2008

Performance of nearly every asset category suffered a sharp decline in the third quarter, with the exception of cash and US Treasuries. Diversification, either geographically or by asset class, failed to protect investors. Aureus Asset Management was not immune to these bear market pressures.

World markets have declined severely from their highs in October 2007. As of October 7th, the S&P 500 is down 33% while the EAFE Index of foreign stocks has fallen 40% from the highs of a year ago. When compared with major past bear markets, this decline is somewhat greater than average, suggesting we could be getting close to a bottom. However, in order to establish any long-term reversal in downward momentum, we believe confidence in our financial system and in the future of the global economy must be re-established.

The following is a review of the current situation and discussion of the several steps we feel need to be taken in order to regain global confidence.

THE PRESENT SITUATION

Falling home prices were the initial sign of economic trouble. Then came pressure on the asset values of many types of loans. In mid-September, we saw the bankruptcy of Lehman, the bailout of AIG, and the “breaking of the buck” (failing to redeem shares at their \$1 full value) by the oldest money market fund in the country. These events demonstrated how far that trouble had spread and led to a massive loss in confidence by investors and lenders. Lenders have all but ceased extending credit, even to their most established trading partners. US Treasuries are deemed the only safe place for assets resulting in an unprecedented freeze in the world’s credit markets.

These mortgages and other instruments are to be held by the government until they are either sold to other parties or paid back. After one defeat in Congress and a subsequent revision, the bill passed. While equity markets have continued to trade lower since the bill passed, this action combined with efforts by the world’s central banks to increase liquidity on multiple fronts and lower interest rates may indicate progress in resolving the current credit crisis. This is an important first step to restoring confidence.

RESTORING CONFIDENCE

Without renewed confidence, world markets cannot rebound. Improved balance sheets, resulting from measures being taken by the Treasury and the Federal Reserve, should begin restoring global lending practices. Early signs that the credit markets are beginning to work smoothly will certainly have a positive psychological impact. Markets, of course, have historically bottomed long before the economy turns upward.

Restoring the global flow of credit should eventually lead to increased capital investment, employment, and output. Confidence can be reinforced with a concerted effort to strengthen and simplify regulation of financial institutions. This should be a priority for a new administration, whose plans should be made public as soon as possible after the election. Creating an appropriate regulatory framework and transparency for today's financial system is a critical part of bolstering confidence.

OUTLOOK

While we are beginning to see attractive valuations in several areas, Aureus remains acutely aware of the challenges facing investors today. We are encouraged by the extraordinary actions being taken by governments around the globe. Early signals regarding regulatory changes from a new administration can improve the situation further. As conditions for restored confidence are set and as credit markets begin functioning normally, equity markets may begin to reflect optimism.