



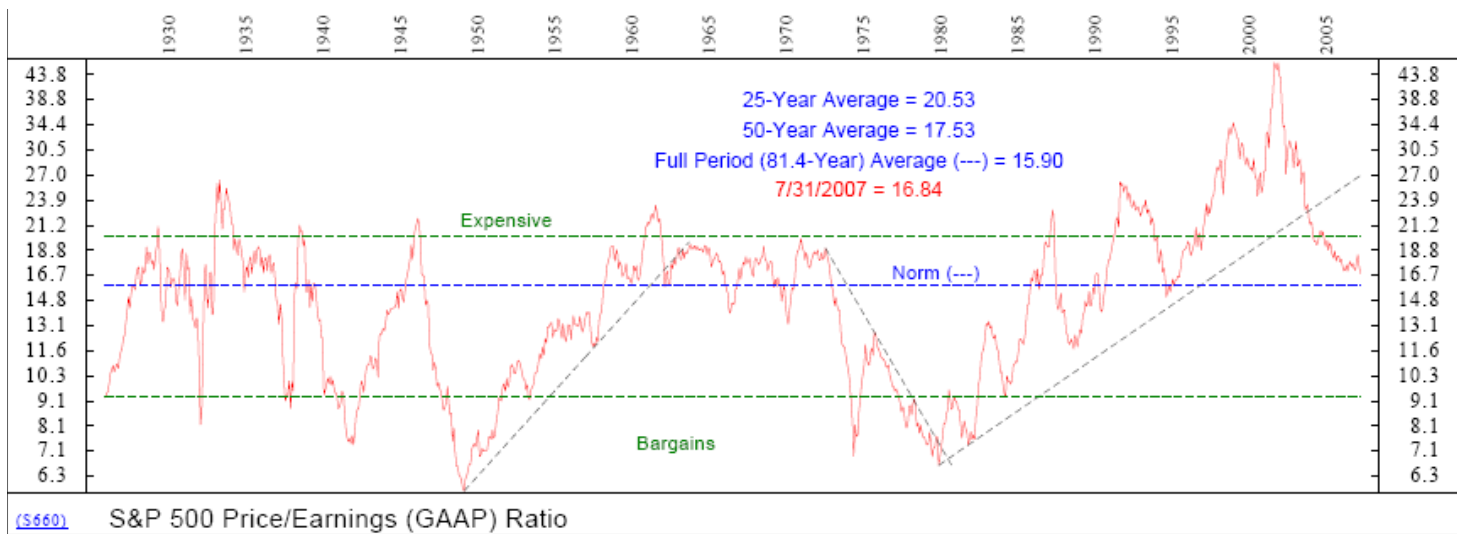
**MEMO FROM THE NORTHERN CAPITAL MANAGEMENT, INC. INVESTMENT COMMITTEE**  
**January 19, 2008**

As would be expected over the last couple of days the volume of calls received from concerned clients has increased. Some of this has been in response to the NCM Special Notice expressing our belief we are in recession and bear market territory. Obviously some inquiries have been due to market events.

While it is human nature to draw comparisons to this downturn and 2000-2002, it is perhaps most important that we distinguish between the two. Each period had its unique circumstances, threats and consequences.

The most striking difference between “now” and “then” is reflected in the price of stocks relative to corporate earnings. This relationship is referred to as the price/earnings ratio (P/E) of stocks.

The P/E ratio is widely used by investors to determine whether a stock is a bargain or balloon ready to pop. It is calculated by dividing a company's share price by its earnings per share. Pretty simple.



As reflected in the chart above, the 25 year average for the ratio has been 20.53, but many in the investment world tend to use the 50 or 81 year average of 17.53 or 15.90. In all three cases, if you rely on Wall Street's 2008 earnings estimates, the market's P/E stands at 14.6. At a minimum an appealing 10 percent off its historic price tag. We will address the validity of this figure in just a moment.

Looking back to early year 2000 which was the all-time high for P/E's, you will observe on the graph above the S&P 500 index (an aggregation of 500 large US companies which make up nearly 70% of the capital in the stock market) checked in at a sensational 44! OK folks, the party is over – last person turn out the lights! Today stock prices are much more reasonable regardless of one's beliefs about corporate earnings in 2008.

The lower P/E will provide us some needed cushion when assessing the potential magnitude of declines. Remember, the S&P cumulatively lost 42% of its value in the 2000-2002 downturn.

If we are seeking comfort in the current historically low P/E, we must have a certain degree of trust in the 2008 profit projections. At present, this is partially what is causing the market concern. Analysts are projecting full year profit growth of 15%, which is twice as high as historical profit growth. This seems counterintuitive in a deteriorating economic environment. To their credit, they assume most of the earnings growth occurs in the later part of the year. But to suggest that kind of clarity exists at this point is a bit bewildering.

Nonetheless, even if profits failed to rise at all the ratio would still be below normal. We are not arguing one way or the other at this point. However, it is important to keep things in perspective. Most of the profit damage is isolated to consumer goods, real estate and financials. If you were to remove financials alone from the fourth quarter earnings figures, it appears as if profits grew 11% for the period over 2006, which is no slouch!

In addition to much more reasonable stock valuations today versus 2000-2002, it is very important to remember half of the damage associated with that period of time was attributable to 9/11 and the post 9/11 response.



Having pointed out dissimilarities between the two downturns, we can now point out one similarity. The damage done thus far to the markets has been indiscriminant. This is what happened in 2002 when frenzied selling reached a crescendo resulting in market declines of 22%. Below are category returns for the various stock fund objectives. With the exception of Bear Market funds and International Gold, there is no single sector in the black.

Category Name	1 Month	YTD
<b>Domestic Stock Funds</b>		
Bear Market	7.20	10.05
Specialty-Health	0.61	-0.19
Long-Short	-2.68	-3.32
Specialty-Utilities	-4.28	-5.97
Large Value	-7.50	-8.82
Specialty-Real Estate	-6.26	-9.23
Large Blend	-7.58	-9.30
Specialty-Natural Res	-4.78	-9.78
Mid-Cap Value	-8.49	-10.04
Specialty-Financial	-8.97	-10.43
Large Growth	-8.48	-10.62
Small Value	-8.30	-10.74
Mid-Cap Blend	-9.00	-10.84
Small Blend	-8.60	-11.39
Specialty-Communications	-8.94	-12.07
Small Growth	-8.73	-12.13
Mid-Cap Growth	-9.73	-12.35
Specialty-Technology	-11.15	-14.00

International Stock Funds	1 Month	YTD
Specialty-Precious Metals	12.71	2.71
Foreign Large Value	-5.91	-8.66
Diversified Pacific/Asia	-5.44	-9.20
World Stock	-6.80	-9.46
Europe Stock	-6.55	-9.53
Foreign Large Blend	-6.74	-9.98
Diversified Emerging Mkts	-5.00	-9.99
Japan Stock	-8.37	-10.70
Pacific/Asia ex-Japan Stk	-5.01	-10.75
Foreign Large Growth	-7.91	-11.32
Foreign Small/Mid Growth	-8.06	-11.87
Foreign Small/Mid Value	-9.16	-12.11
Latin America Stock	-7.39	-13.00

To be sure this has been a difficult two weeks. Market declines often drive investors to make unwise choices as the human emotion of fear short-circuits logic. Some clients who have called want to become less aggressive. This means we will effectively lock in year-to-date losses, which we are reticent to do.

Rarely does a bear market neglect to provide us opportunities to become more conservative where locked losses are either minor or non-existent. So for those seeking greater safety, we would counsel there will most likely be a better day.

In normal bear markets most of the money is lost at the beginning and not the end. As David Holloway stated a couple of weeks ago in one of our Investment Committee meetings, presently “We are very likely in the eye of the storm.” The type of broad selling in the market this week is reflective of that type of environment.

The Federal Reserve, Administration and Congress are all moving in tandem to “head off” recession. We say – too late. But the good news is the proper steps are being taken, which we believe will be sufficient to prevent significant stock losses this calendar year.

Portfolios have been hit, but clearly less than the overall market for any objective Growth Moderate and below on the Investment Objective risk continuum. The bonds that everybody loves to hate in good markets are serving us well. Further, returns on these bond funds could reach 8-10% this calendar year providing substantial protection for any stock losses. Just remember, bond returns are earned throughout the year so the benefits of ownership become increasingly apparent over time. Stock losses can come in very brief and violent declines.

We are intently monitoring events and the Investment Committee has been formally meeting nearly every week and communicating via e-mail daily. We will keep you posted.

Investment Committee  
Northern Capital Management, Inc.

PS-The single biggest danger to the markets and the economy has nothing to do with earnings, debt, consumer spending or real estate. The biggest threat is a major domestic terrorist event while we are emerging from the slump. That is what happened in 2001.