Quarterly Report

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July 23, 2008 Quarter 2, 2008

What's New?

Our website has been revised. Please visit www.ufpartners.com to view our new site.

Company News

I'm happy to acknowledge our 11th year in business here at Union Financial Partners. Of course I couldn't do it without my wonderful staff, Amber Rico and Anthony Gesek.

Amber Rico, the voice on the phone and my Brokerage Operations Specialist, has been with me for over 4 ½ years. She's an expert in her job now and I lean on her for carrying out much of the day to day work here and to meet the customer service needs of our clients.

Anthony Gesek, our Associate Portfolio Manager, has been with me for a year and a half now. Anthony graduated from UC Santa Cruz with a BA in Mathematics. He runs the portfolio performance system, supports the financial planning process, and performs investment research. Anthony is studying for his Series 7 Investment Exam.

Thanks to both of them for their hard work!

I know that I couldn't achieve these results without them.

Economic News

Regulation/Deregulation

There is no doubt that, formal recession or not, Americans are feeling financially pinched and are worried about the future. The economy is experiencing the ingredients of the so-called "perfect financial storm" that planners spend much time protecting clients against—poor investment returns, slow growth, high(er) inflation.

Last quarter I wrote about the deregulation of the Credit Derivatives market and its contribution to the magnitude of the credit crisis. Phil Gramm (R-TX), who spearheaded both major pieces of deregulation legislation, stepped down last week as co-chair of the McCain campaign. He got in trouble for saying that the country had become a "nation of whiners" who constantly complain about the state of the economy. He also had suggested that the country was facing a "mental recession" and not "real economic problems." Huh? As McCain's economic advisor, this man will likely be found in a cabinet position if McCain is elected. Personally, I think that the financial markets do need to be regulated and that the Fed needs to exercise more power, not less.

I was surprised by headlines that read "Fed moves to end deceptive lending practices" as if this is a newly-bestowed power. Deceptive lending has always been illegal. Only now after the crisis has happened do they decide to enforce the laws.

Similarly, the Fed already has broad regulatory authority to police both the banking and investment

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industries. This is nothing new. Despite this authority, the Fed allowed all of the deregulation to take place, citing "concerns" but imposing no regulation or restrictions. Protecting public banking deposits did not appear to be a priority.

Carmen Reinhart, a University of Maryland economist who has studied centuries of financial crises, concluded in a study that blowups happen almost inevitably after financial markets are liberalized or some innovation allows capital to flow more freely. On this basis, I have to wonder whether or not recent "innovations" in the oil commodities markets are precursors to a bust in that market.

The crisis of the past year has resulted in increased regulation which is, in my opinion, a good thing. I believe that there is no reason to be overly concerned about the so-called "bailout" measures that have been taken so far. These measures are appropriate actions for a country's Central Bank to take.

The Bear Stearns bailout did not involve the Fed handing money to Bear Stearns or JP Morgan. Bear Stearns turned over a portfolio of their best securities worth approximately $30b to the Fed and JP Morgan in exchange for cash. The worst of the "bad" quality securities were "written off." The $30b was contributed to an LLC $28.85b by the Fed and $1.15b by JP Morgan. The Morgan portion represents a guarantee against a portion of any potential loss. Since these securities were transferred at a "crisis" price, it is entirely possible that there will eventually be a profit on the deal as the Fed sells the assets over the next ten years.

Those who lost money on the deal were a) two Bear Stearns hedge funds, and b) Bear Stearns stock-holders. Is that not appropriate?

As for Fannie Mae and Freddie Mac I think it is important to remember that they were originally established as governmental agencies in 1938. Their "privatization" as public

People are particularly concerned about the impact of the Fed's recent actions on inflation. The CPI has risen from about 3% a year ago to 5% this past year, ending June 30, 2008.

Investment Update

Despite the worst market in 40 years, our portfolios are holding up very well. Our portfolios are designed for broad-based diversification and it's times like these that really show how important this is.

In 2007 the bull market of 2003 – 2007 fell apart and the credit/ housing crisis hit our portfolios. Our small-cap and value bias portfolios were especially hard hit as large beat small and growth beat value throughout the year. For 2007 we generally underperformed "the market."

In 2008 we see the reverse with a higher degree of resilience than the "market" in general. The S&P 500 is down 12.82% ytd ending June 30. In general, our stalwart "Total Return" Portfolio, consisting of 60% Stocks and 40% Bonds had an average of -4.8% ytd return.

In the past year we have subjected our portfolio compositions to two sets of extensive historical back-testing. We found that the portfolios are indeed positioned for optimal risk/return results and resiliency and rank higher than the other options tested or reviewed.

One of those other options was to look at the portion of the portfolio allocated to international equities. Many models recommend higher international allocations than the UFP Portfolios. These models base the international allocation on the country in which the company is domiciled

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The price of gas is a major issue – will we reduce our dependence in time?

Economic News (Continued from Page 2)

an implied government backing which the Fed did nothing to dispel. Therefore, it is not at all shocking to me that the Fed would extend credit (a loan not a handout of funds) to both of these companies in order to maintain liquidity in the mortgage market. As with Bear Stearns, share-holders of both companies have experienced a fall in the share price—the risk shareholders take.

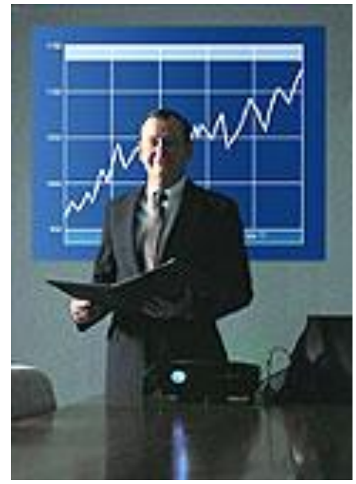
Both companies have reported some degree of solvency and may not even tap the credit window which has been extended to them. Since the Fed earns interest on all loans and ultimate default is highly unlikely, I see no problem here.

Recent regulatory action at the Fed has resulted in another outcome among the nation's largest banks: Covered Bonds. These bonds are popular in Europe and are intended to make mortgage financing more available in the US.

Covered Bonds are backed by mortgages but are considered safer than credit derivatives that sparked the current crisis. That's because the bonds stay on the bank's balance sheet and are backed directly by a cover pool of high quality mortgages. Investors are protected because the bank ensures that bond holders get their interest – even if there are defaults.

Finally, I think that the mortgage assistance that is coming from government and industry to help those people facing foreclosure will have a positive effect on the economy.

The regulatory pendulum swings into high gear in response to crisis and then backs off. Wouldn't it be better to have a sensible level of regulation all the time?



Roth 401ks

In 2001 the EGTRRA Act provided for a new innovative retirement tool to begin as of January, 2007 – the Roth 401k.

As you may know, a Roth IRA is not a tax deductible retirement contribution so it won't save you money on your taxes right now. But! You **don't pay taxes** on the Roth later when you withdraw funds. The Roth IRA contribution limit is $4,000 in 2007 ($5,000 for age 50+). Of course, you can only contribute to a Roth IRA if your income (Adjusted Gross Income on your tax return) is less than $114,000 single and $166,000 married.

Now people who cannot contribute to a Roth IRA because of these income limitations can contribute a portion of their 401k funds into a Roth 401k. There are no income limitations to qualify.

The regular 401k limits apply - $15,500 or $20,500 for those aged 50+. Any portion of this total can be allocated between regular 401k contributions and Roth 401k contributions.

The Roth 401k contributions will be made on an after-tax basis, with the 401k portion being pre-tax. The Roth 401k contribution can be used to qualify for an employer profit sharing or matching contribution. The employer contribution, however is always pre-tax. The Roth 401k can be rolled over to a Roth IRA if you leave your job. Separate accounting is required to track the Roth and Regular 401k contributions.

If this seems like a good idea for you, check with your Human Resources Department at work. If your company isn't offering Roth 401k's in their plan, maybe they should talk to us. We manage money for company 401k plans and work with Third Party Administrators to make sure the plans offer every advantage.

ROTH 401k??

Do you wish you could save money in a ROTH but can't because you make too much money? Now you can make ROTH contributions to your company 401k---up to $15,500 (or $20,500) with <u>NO</u> AGI limitations.

Tip: Ask the Human Resources Department at your Company about a Roth 401k!

Investment Update (Continued from Page 2)

Warren Buffet likes to stress the fact that even if you know what is happening in the economy, it will not help you predict what is going to happen in the stock market.

regardless of the countries in which the company operates and from which it derives its revenue. However, in an age of increasing globalization, this method may no longer capture the true regional exposure of a portfolio. I have long held fast to the theory that revenue source provides a better proxy then domicile to evaluate the foreign exposure in a portfolio.

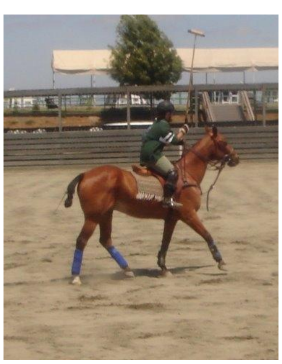
If you think about the potential impact on the investment world of a fall in the relative value of the US dollar it leads many individuals and professionals to conclude that foreign companies will fare better than domestic ones. But the US companies operating abroad will also benefit from advantageous exchange rates in foreign markets. Domestic US companies also report benefits in revenue as rising transportation costs and foreign goods bring many operations back home. Companies that sell US goods overseas also benefit. Therefore, we have concluded that the international allocations in our portfolios will stay at their current levels.

It is important to review the range of expected returns that can be expected for a given risk-level portfolio and ask if the current experience is within bounds of the original expectations. In the case of the "Total Return Portfolio" we originally presented a historical range of the past 30 years (1975 – 2004) since we started using this analysis in 2005. During this period, the portfolio ranged from a high of 29.08% in 1975 to a low of -3.2% in 1990. There were three negative years during the period.

I recently evaluated further the worst case scenario for these portfolios. I extended the period to include 1973 and 1974 – the worst market years since the Great Crash of '29. The result for the "Total Return Portfolio" was a range of +29.08% in 1975, preceded by the worst loss of -12.80% in 1974. I expect that during the year returns could have been -15% or more. The average annual return for this portfolio, even with these two (1973 and 1974 negative years included) was 10.23%. The best years consistently followed the worst years.

It is important to continue to re-evaluate and be reminded of this historical perspective when the news headlines are screaming "collapse." Most of all, an average annual return of 10% or more is sufficient for staying on track with the financial models we have developed for you in your financial plans.

Again??



Two years ago I fell off a horse and broke my arm. It was the first time I ever broke a bone in my entire life. Last month I fell off the horse again and broke my ankle. I worked from home a couple of weeks before hobbling back into the office on crutches.

Is it too much? Most of the bone-broken people I met in the hospital told of falls in the bathroom or garage – even falling on the sidewalk.

"At least you were doing something fun" I heard over and over.

I agree, although I have re-pledged to be more careful. The picture on the left is me playing my first ever practice polo chukker (a period in a polo game). I had the time of my life.

I will be away on vacation August 13th through 23rd.

I'm going to Honk Kong to watch the Equestrian Olympic Competition. Crutches notwithstanding, I'm looking forward to my vacation.

If you need anything while I'm away, of course you can call my capable staff, Amber and Anthony. I will be in touch with them daily.

---Ann Terranova, CFP®