Quarterly Report

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What's New?

Weekly Conference Call Series Recordings are posted on our website.

Still Relevant!!

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Contents

What Can We Do?

Coaches, psychologists, religious leaders, gurus of every stripe have told us that in stressful times it is important to separate what *is* from what *is not* under our control.

The stock market is not something we can control. Neither can the government, big business, day traders, multilateral conspirators nor psychics. Even if there were no housing crisis, subprime mortgage meltdown and no off-balance sheet complex derivatives, the market would still behave like….the market.

Whether it's the Real Estate Bubble (2008), Dot Com Bubble (2000), Tulip Bubble (1637) or any other bubble, what turns a Business Cycle into a Crisis? Leverage.

There are circumstances that have turned a difficult situation into a crisis. Some are completely within our power to control on a national level, even an international level, as well as on a personal level.

Leverage

If there were one thing that would have kept a very bad situation from monumental crisis proportions, it is leverage. The brokerage firms that wove the international web of complex derivatives not only took unprecedented mathematical risks and grossly

Continued on Page 2

Investments

Investment losses in 2008: Historic.

The S&P 500 for 2008 fell 37%. It was the third worst year for the stock market in a one hundred and ten year period. Not only that, no asset classes performed well during the year as the bond market and real estate were also affected.

Commodities experienced such wild swings that no one seriously thought it a safe haven. People rushed to buy CD's only to find the interest rates so puny that even their "safety" position disappointed.

After a very challenging 2008, it is important to remember that one of the basic principles of investing is that there is a trade-off between risk and return that has been true over time – more risk generally means more return. A strategy that includes maintaining investment positions through market and economic downturns is a viable course of action.

Stocks

During the 4th Quarter of 2008 the S&P 500 fell 29.6%. This decline was accompanied by a sharp increase in volatility with record one day falls as well as record one day gains. Uncertainty about the basic health of the global financial system, tight credit conditions, rising unemployment and falling profits buffeted the market on a daily basis. From a high on October 12, 2007 to the low on November 20, 2008, the S&P 500 had declined an astounding 51.8%.

International markets, especially in the area of emerging markets, fared even worse. After achieving status as the highest performing three years running, international equities fell the hardest. Individual investors who chased these returns and

Continued on Page 2

What Can We Do?

Continued from Page 1

miscalculated the potential range of real estate prices, they leveraged those risks on a grand scale. Bear Stearns was leveraged 30 – 1. The other firms were similarly leveraged and they used banking deposits to leverage further.

People who purchased homes with no money down were too highly leveraged. The 30 to 1 leverage at Bear Stearns is like having a $15 Million mortgage on a $500,000 house! Problem…Crisis.

One of the reasons that the stock market Crash of 1929 turned into a national crisis was the degree of leverage people used to finance their stock market investments. Back then, ordinary people were purchasing stocks on margin – ten cents to the dollar. That means that a $10,000 stock market portfolio could be purchased for $1,000. People thought that the leverage made sense because prices would never go down (sound familiar?)

When the market fell 10%, the individual's personal investment was entirely wiped out. When the market went down 20% the individual

Continued on Page 3

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Investments

Continued from Page 1

over-weighted their portfolios in international equities were the most affected.

Real Estate

Real Estate prices are tracked by the S&P/Case-Schiller Home-Price Index. A list of home prices from key Metro Areas was published in a Wall Street Journal blog at the end of the year. Some of the year-over-year price changes in Metropolitan Areas that most people thought would "never go down" fell more than 30% (including San Francisco). (See Sidebar on Page 3)

Bonds

The bond market deteriorated severely throughout the year as high ratings became low ratings and all ratings became suspect. No one predicted the liquidation of Lehman Brothers or the collapse and assimilation of Merrill Lynch. These events sent fear through the system, all but completely freezing the credit markets in September and October.

Municipal bonds, the mainstay of conservative, high tax-bracket investors, showed price declines as much as 25% during the 4th Quarter. Apprehension in the Muni market remains as the recession impacts State and local tax receipts and calls their solvency into question.

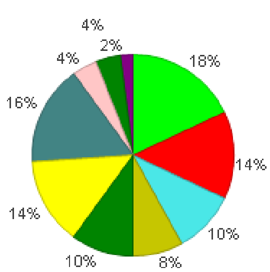
Cash

Cash investments came into question in a number of ways. Money market funds were strained as the global flow of money slowed to nearly a halt. One money market fund that had an unacceptable amount of "high yield" paper faced liquidation. As a result, money market funds faced increased scrutiny and even backstop measures by the Federal Government.

Bank deposits were carefully guarded and FDIC Insurance limits were raised. Interest on 3 month CD's shrunk to less than 1%. You had to go at least three years out or more to get interest over 2%. Those CD's that had higher rates came due and people found it impossible to replace them.

And Still We Should Invest?

And still amid all of this bad news we should invest. We should invest carefully, consistently and calmly.



Diversification is still an effective portfolio technique

The Bailout – Troubled Asset Relief Program (TARP)

It is important not to overreact to the bailout. I know that $700b is a lot of money. However, these measures are not without precedent in history. The Government has not simply "spent" the money. The Capital Purchase Program portion of TARP more closely resembles an "investment" than an "expenditure."
The Government invested in the Banking System under the Capital Purchase Program by purchasing "Preferred Shares with Warrants". The banks receiving TARP funds include both healthy and relatively unstable banks. The reason for this is that the healthy banks will more quickly turn the capital infusion into new loans to stimulate the economy.

The Preferred Shares carry a dividend rate of 5% for the first five years and 9% thereafter, payable quarterly, for a term of ten years. The Preferred Shareholders (that's you and me) must be paid before the company can pay dividends to other shareholders, including holders of common shares. This 5% is a lot higher than the interest being paid on Treasury Bonds right now (nearly 0%). As of January 23, 2009 the US Treasury had received more than $271 milliion in dividend payments.

Redemptions of Preferred Shares are at 100% of the purchase price. Think of Preferred Shares as a bond with an equity kicker.

Continued on Page 4

RMD's Suspended for 2009

People who don't need money from their retirement accounts should not have to take a distribution when values are down

What Can We Do?

Continued from Page 2

investor was not only wiped out, they owed the brokerage firm $1,000 or more, they lost their homes, they lost everything.

On an individual level, too much leverage (home with no money down) created unstable personal financial circumstances that had too many people too far out on a limb. When real estate prices reversed course ("real estate prices will never come down!") these people were at risk. These are the homes that make up the bulk of the foreclosures.

What we need to do as a country on a Regulatory basis is to establish strict guidelines for leverage and *follow them*. These laws need to have enforceable penalties and we need to have the political will to carry out the penalties. It is clear to us now that these companies cannot be trusted to voluntarily limit their speculative activities.

Zero Tolerance for Massive White Collar Crime

Many of the laws that could have kept this problem from becoming a crisis were or are already on the books. How and why did so many people look the other way?

Predatory lending, for example, was already illegal. A failure to disclose and discuss the terms of a loan was already a violation of the law. Inappropriate loans, no doc loans, and yes, even forgeries, were all too commonplace.

Combinations of banks and brokerage firms were prohibited under the Glass-Steagall Act for the very reasons that turned a problem into a *crisis*--banking deposits should not be used as collateral for highly speculative types of investments. However, when Travelers wanted to purchase Citigroup, instead of enforcing the law, it was repealed.

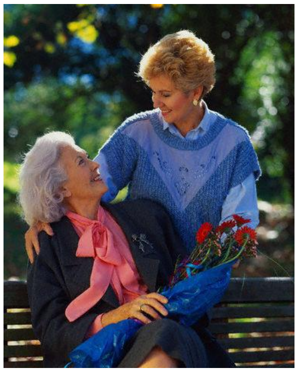
Extravagance

Large scale extravagances, corporate salaries, waste, bonuses, and inefficiencies contributed to the crisis we are facing today. The divergence between the highest paid CEO's and the rest of us had become so extreme it was unsustainable. The natural business cycle is bringing this divergence into a better state of equilibrium.

Regulation of the financial services industry, which is at issue today, must recognize that when an individual or an institution is making decisions

Continued on Page 4

Case-Schiller Home-Price Index 2008	
Metro Area	**Yr./Yr. % Change**
Atlanta	-10.5%
Boston	-6.0%
Charlotte	-4.4%
Chicago	-10.8%
Cleveland	-6.2%
Dallas	-3.0%
Denver	-5.2%
Detroit	-20.4%
Las Vegas	-31.7%
Los Angeles	-27.9%
Miami	-29.0%
Minneapolis	-16.3%
New York	-7.5%
Phoenix	-32.7%
Portland	-10.1%
San Diego	-26.7%
San Francisco	-31.0%
Seattle	-10.2%
Tampa	-19.8%
Washington	-18.7%



The Bailout – Troubled Asset Relief Program (TARP)

The Preferred Shares include Warrants to purchase common stock in the company equal to 15% of the preferred amount. The exercise price for the Warrants is the market price for the common stock on the date of the Preferred investment.

The ultimate value of the Warrants, and the willingness of the Government to cash them in at a profit remains to be seen. The government is under no obligation to exercise a Warrant that is not "in the money." The government has every right to exercise a Warrant that is "in the money."

While few of the Warrants are currently "in the money" a list of 8 Warrants that have a current value show the Government ahead by $7.5 million. A rise of 10% in the stock prices of these 8 selected banks increases this number to nearly $14 million. There are almost 300 banks in the program.

Certainly, the overall economic impact of these transactions remains to be seen. The cost of carrying debt and a comparison with alternative uses of the funds is a legitimate debate. However, the government stands to make a lot of money on this deal. In the history of bailouts, the government has generally fared quite well, getting paid back on loans extended and selling securities at a profit. For example, the last bailout of Chrysler in 1980 involved a similar transaction and netted the Government a profit of over $660 million.

It is important to view these transactions as an investment and not as an expenditure.

Symbol	Name	Shares	Strike Price	Price 2/11/09	Gain $$
CJBK	Central Jersey Bankcorp	268,621	$6.31	$7.39	$290,110
FCAL	First California Financial Group	599,042	$6.26	$6.59	$197,684
FLFL	First Litchfield Financial	199,203	$7.53	$8.25	$143,426
GJM	GMAC LLC	250,002	$0.01	$10.06	$2,512,521
GSBC	Great Southern Bankcorp	909,091	$9.57	$11.06	$1,354,546
PULB	Pulaski Financial Corp	778,421	$6.27	$6.91	$498,189
STEL	StellarOne Corp	302,623	$14.87	$15.75	$266,308
TRMK	Trustmark Corp	1,647,931	$19.57	$20.93	$2,241,186
Total "In the Money"					**$7,503,971**

Banking

Since last October, I have been working on establishing a reliable set of criteria for determining where to bank. I undertook this work because of the number of questions I was getting from clients on the subject. We looked up banks on ratings services, interviewed bankers, poured through newspapers and generally collected as much information as we could.

I have access to a couple of different ratings services and want to make this information available to you.

If you have questions about a specific bank, you can call or email me and I will look it up for you.

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What Can We Do?

Continued from Page 3

regarding other people's money, they must do so in a fiduciary capacity. Likewise, corporate executives need to treat company money with due regard for all of the stakeholders of the corporation. Stockholders can require corporations to be more efficient so that profits will increase.

Waste reduces corporate profits and shareholder returns. Other stakeholders of corporations include employees, taxpayers, the environment, and the general public.

What is Within Our Control

It is within our control to monitor the leverage on our personal balance sheets. It is also within our power to demand the same of our institutions and our Government.

It is within our control, when we experience a hot, rising investment market – and we will again, to participate in it on a limited basis. It will go down.

We can practice orderly and systematic investment principles and use leverage appropriately.

We can demand that every level of government strictly enforce the laws. Financial regulation is just as necessary as speed laws on the highways. It is a matter of public safety. We don't have to accept the idea that free enterprise means free-wheeling, that somehow asking financial institutions to follow "speed laws" limits innovation and ruins the spirit of free enterprise. Free enterprise doesn't mean free to lie, cheat and steal.

We can practice sound financial principles ourselves. We can live happily within our means so that we can grow financially strong individually and as a nation.