



3rd Quarter Market Commentary

The S&P 500 posted a 2.03% gain for the period as most equity indices finished the quarter in positive territory. These end results masked a volatile quarter which severely tested investor's conviction and patience. While technology and energy stocks performed well throughout the quarter, the sub-prime clouds that were beginning to form at the end of the second quarter, quickly developed into a major storm. Equity markets sold off and many parts of the credit market seized up. Risk of a major financial meltdown became real. These events led the Federal Reserve to take action by initially lowering the discount rate by 50 basis points and shortly thereafter, moving more aggressively by reducing the federal funds rate by 50 basis points as well.

Within the bond market, U.S. Treasuries benefited from heightened concerns over a weakening economy and a revaluation of risk throughout the credit markets. The Lehman Aggregate index was up 2.85% for the quarter. The flight to quality widened spreads, particularly in the corporate and high yield markets. The Federal Reserve's action steepened the yield curve as fixed income investors question the Fed's commitment to fighting inflation.

The merger landscape has dramatically changed as financial buyers no longer enjoy what appeared to be unlimited cheap capital. While we can expect to see a slow down in deal activity, we can still expect to see strategic acquisitions continuing as companies benefiting from strong global growth and the US dollar's weakness, are posting strong earnings growth. It is fair to expect foreign companies including banks to be looking at US opportunities, capitalizing on the weak dollar. One can expect continued volatility throughout the balance of the year as the markets' digest the shocks and excesses it has witnessed. For now, the market is comforted knowing the Fed is prepared to step in, should further market dislocations occur.

In summary, the 3rd quarter once again proved how difficult it is to time the market. Those investors that chose or were "forced" out of the market in the face of the quarter's challenges, are now kicking themselves as the markets have recovered to make new highs. It is said that "you make 80% of your money in 20% of the time". If you're out of the market during one of those 20% times, you have not only forgone that return, but the future of its compounding forever.

A handwritten signature in cursive script that reads "Frank M. Sternick".

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