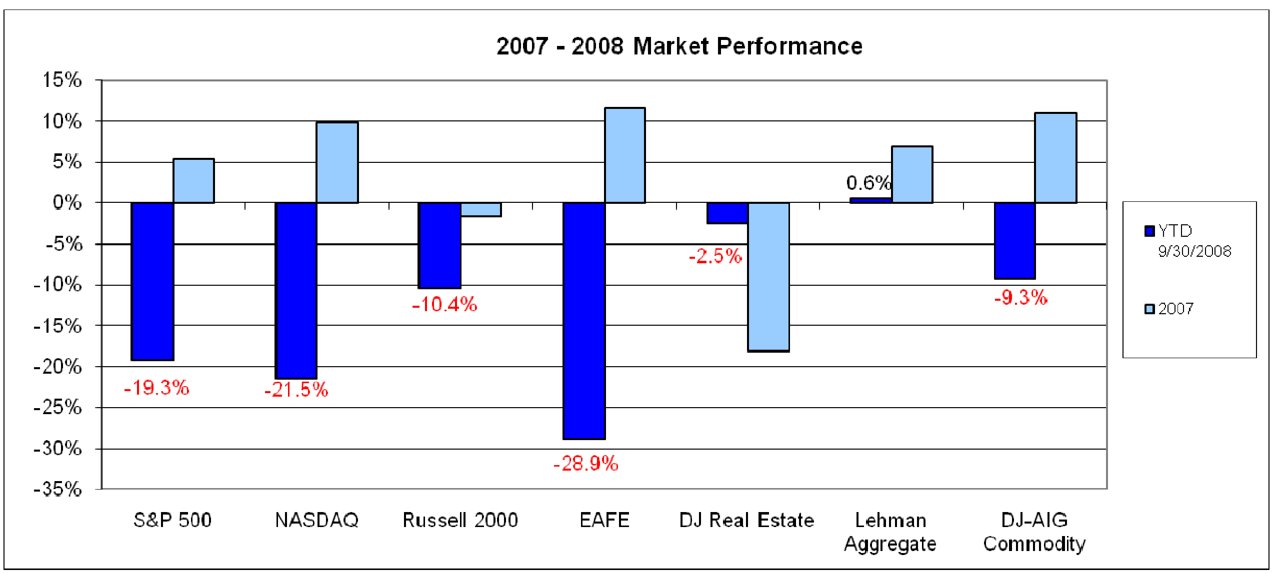
WESTPORT RESOURCES

Markets and Economic Summary & Outlook

Year-to-date through September 30, 2008

Global equity markets grew increasingly distressed during the third quarter, and the declines have accelerated with previously unimaginable speed the first two weeks of October. The explosion of another asset bubble, this time home prices, has triggered a series of events causing the failure of several prominent "investment grade" financial institutions, and frozen the world's credit markets. Tighter credit conditions and the unwinding of massive debt piled on over the last six years is being compounded by toxic combinations of new financial products designed to boost fee income, but in the end, their sole purpose being to deceive pliable regulators and investors. Lack of confidence in the financial system has triggered panic selling and a massive response from multiple governments, which eventually will lead to recovery, but the extent of future damage is still very unclear.

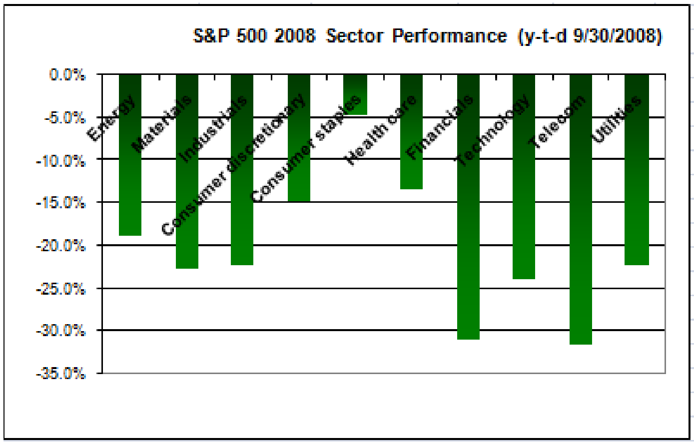
The S&P 500, comprised of U.S. large and mid-cap stocks, fell **8.4%** (total return including dividends) during the third quarter of 2008 (-19.3% year-to-date through Sept. 30), while the NASDAQ Composite dropped **9.2%** (-21.5% year-to-date). The S&P 500 is down **30.5%** through Monday, October 13, 2008. Non-U.S. equities, measured by the MSCI EAFE index, fell **20.5%** during the third quarter, a foreshadowing of what was to come. Asian and European markets are now down **35% to 60%** for the year. Commercial real estate as measured by REITs (real estate investment trusts) was only down an inexplicable **2.5%** through September 30th, but reality has caught up to the sector, and it's down another **20%** over the past two weeks.

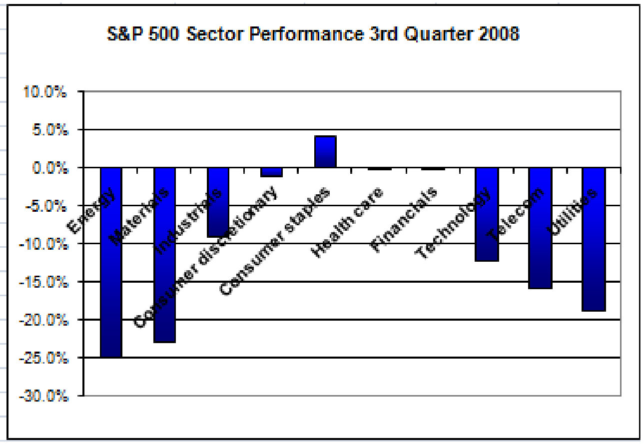


Total returns include capital gains and losses plus dividend and interest payments received and reinvested over the periods described. S&P 500 is an index of U.S. large and mid cap stocks; NASDAQ is the NASDAQ Composite Index; Russell 2000 is an index of U.S. small cap stocks; EAFE is an index of stocks from Europe, Australia, and Far East; DJ Real Estate is an index of traded U.S. REITs (real estate investment trusts); Lehman Aggregate is an index of U.S. Treasury, agency, and investment grade corporate bonds; DJ-AIG Commodity is a total return index of futures contracts on metal, agricultural, and energy commodities.

The bottom fell out for most commodities during the third quarter. The Dow Jones commodity index declined over 35%, and in the past, similar large declines have been dependable indicators of economic recession. Investment grade bonds (Lehman Aggregate) lost **0.48%** during the quarter as corporate bond credit spreads widened in reaction to deteriorating credit conditions.

All U.S. industry sectors were in negative territory through September 30, with financials, telecom, technology, and utilities among the worst performing. Looking at the third quarter in isolation, consumer staples was the only sector that recorded a gain, but this too fell over 20% in early October (down 13% through October 13).





Investors in most non-U.S. equities earned excellent returns over the last five years, however most markets in 2008 have performed much more poorly relative to U.S. equities. The unexpected strengthening of the dollar since the beginning of the year has also been a contributing factor (the U.S. $ has appreciated over 13%).

Best Performing Non-U.S. Equity Markets

Last 5-years annualized returns

MSCI Brazil Index(SM) (10/10/2008)	+24.17%
MSCI Mexico Investable Market Index (10/10/2008)	+14.61%
FTSE/Xinhua China 25 Index (10/10/2008)	+14.14%
MSCI Turkey Investable Market Index (10/10/2008)	+12.30%
MSCI Spain Index (10/10/2008)	+11.04%
MSCI South Africa Index (10/10/2008)	+11.02%
MSCI Israel Capped Investable Market Index (10/10/2008)	+10.03%
MSCI Singapore Index (10/10/2008)	+8.78%
MSCI Canada Index (10/10/2008)	+8.42%
MSCI Chile Investable Market Index (10/10/2008)	+8.14%
MSCI Germany Index (10/10/2008)	+7.93%

Year-to-date 2008 returns

MSCI Israel Capped Investable Market Index (09/30/2008)	-14.48%
MSCI Chile Investable Market Index (09/30/2008)	-16.39%
MSCI Canada Index (09/30/2008)	-18.52%
MSCI Mexico Investable Market Index (09/30/2008)	-18.96%
MSCI Switzerland Index (09/30/2008)	-19.81%
MSCI Japan Small Cap Index (09/30/2008)	-21.42%
MSCI Japan Index(SM) (09/30/2008)	-22.21%
MSCI South Africa Index (09/30/2008)	-25.80%
MSCI Spain Index (09/30/2008)	-28.48%
MSCI Singapore Index (09/30/2008)	-28.60%
MSCI France Index (09/30/2008)	-28.62%

Source: Barclay's Global Investors (through September 30, 2008)

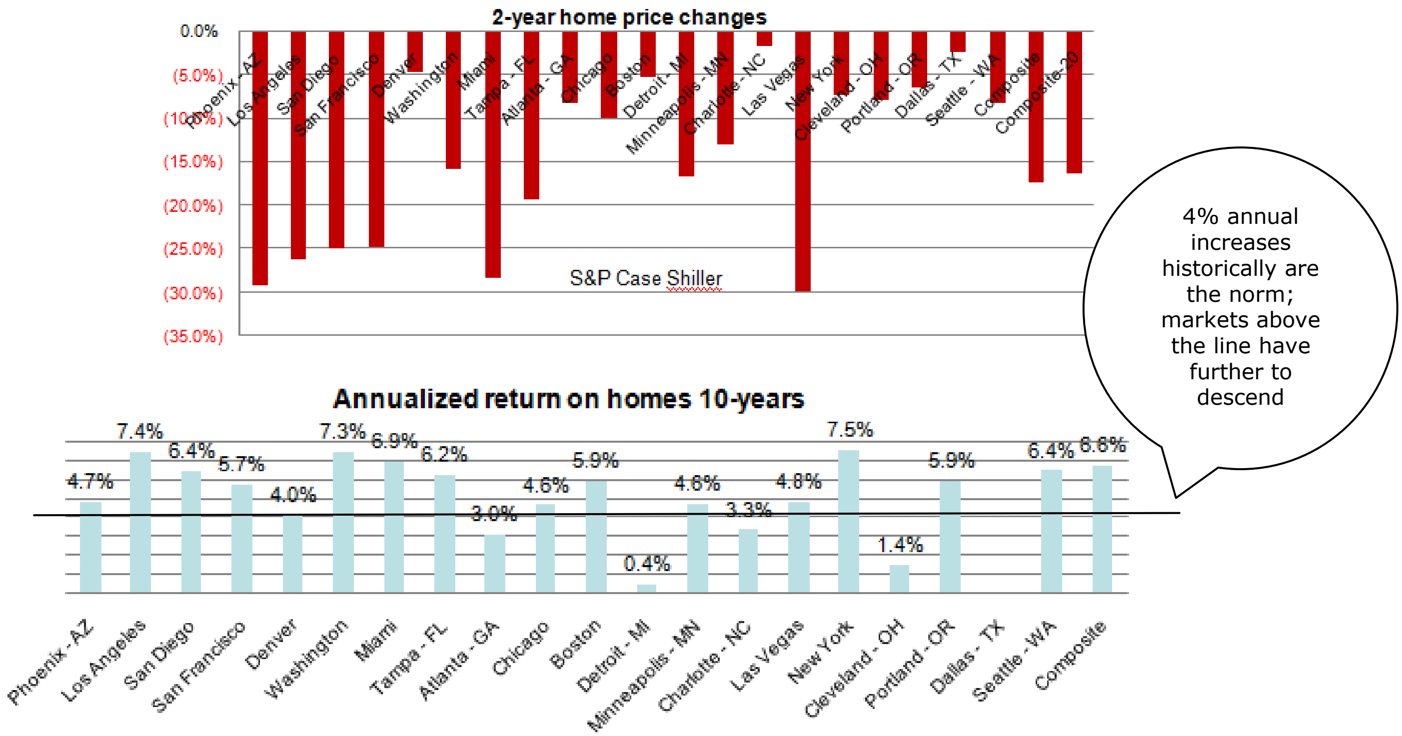
Late 2008 & Early 2009 Outlook

Most economic indicators suggest that the U.S. and Europe are indeed in the midst of a recession. In the U.S., we're seeing unemployment over 6% and rising, and the year-to-year decline in retail sales is probably in the 5% range. Automobile sales are down 30% for all manufacturers including Toyota. A recession in itself wouldn't be too terrible a thing at this point in the business cycle, but layered on is the great unknown of the current credit crisis, and depending how the financial sector responds to the various measures being put into place, this will determine the length and depth of our present downturn.

The next sixty days are likely to remain turbulent with new failures and recapitalizations occurring at an unprecedented level. The interconnections among many financial institutions around the world have contributed to heightened uncertainty and mistrust among lenders and borrowers. Credit downgrades, lack of short-term funding, actual defaults, and unknown ramifications from forced liquidations of assets has spilled over into the world's equity markets. Economic authorities in the U.S., Europe, and Asia together are assembling a plan to purchase troubled assets, provide banks and corporations billions in short-term funding, and even make direct equity investments in banks and other institutions. These actions should restore confidence among lenders and borrowers both in the short and long term debt markets. This is an important first step in avoiding an especially long, deep recession.

Echoing part of Henry Paulson's message, a lot also depends on the home price correction now underway for two years. Home prices in the U.S. have fallen 20% nationally since the mid-2006 peak. Our current expectation calls for about another 10% decline to get back to the historical mean for home price appreciation, which is about 4% annually. **We view this as positive.** Further home price declines obviously mean more stress among mortgage lenders (banks and non-agency bondholders), and while clearly subject to change, we see more clarity on depth and length of the correction, with stability potentially returning by mid-2009. We shouldn't lose sight that the housing bubble is not limited solely to the U.S. Similar housing bubbles are present in the U.K., elsewhere in Europe, Australia, the Far East, and even Canada, and the pain in some of these regions apparently has yet to be felt.

Wow, it sounded like a good idea at the time." *We've heard much about credit default swaps (CDS) the past few weeks, but what are they and how did this market phenomenon get so out of control? A CDS is a form of insurance where one entity, a bank or insurance company (the "seller" of protection) for a fee offers to cover another institution's (the "buyer" of protection) loss on a specific pool of assets (e.g., a group of sub-prime mortgages or Lehman Bros bonds). The seller of protection may then find another institution to cover its exposure, and it too becomes a buyer of protection (i.e., hedging out the risk). This cycle may be repeated multiple times for the same underlying assets, which can lead to problems if recordkeeping has been sloppy (it has). CDS are fundamentally just another attempt to generate more fee income rather than to hedge any real exposure, and the lust for greater fees is what really drove the massive growth of this mostly unregulated market. Real life example: The PIMCO Total Return Fund sold CDS protection covering a large amount of Lehman Brothers bonds should Lehman default (it did). The losses on Lehman bonds are estimated at a breathtaking 90 cents on the dollar, which PIMCO (and others) are on the hook for to the extent they didn't unload the risk on someone else, and they might not have because this would reduce their fee income and the total return on the Total Return Fund. Also consider that much of CDS underwriting has come from unregulated hedge funds, many of which don't have the capital to actually cover current and future expected losses, forcing these funds to liquidate assets.*



Portfolio implications for the next 6 to 12 months

There is no question the global economy has significantly slowed in 2008. Unexpected and unfortunate was the severity of the equity market volatility, which clearly has shaken all investors. So what's the best course of action in this environment? The investor with a shorter horizon, for example, a retiree, should understandably be worried about excessive market volatility. It is unwise to not expect testing days in the weeks ahead. On the other hand, while it is perilous to predict a precise market bottom, there appear to be numerous opportunities for the less risk-averse, long-term investor.

Implications for the **more** risk-averse investor (may have a shorter investment horizon):

- It's best to avoid panic and kneejerk reactions in the face of unpredictable day-to-day market gyrations. There have been bubbles before and more bubbles lie ahead, but ultimately the system mends itself and we put experiences behind us. Careful consideration is required before taking action. One's overall asset allocation and individual holdings should be reviewed within the context of current market conditions and risk tolerance. We generally would not advocate a complete exit from equities, particularly given the difficulty in calling a bottom. We could already be near a bottom, in which case, an untimely exit would cause even greater pain.

- Many investors are holding much larger than normal cash positions, and if gun-shy about a return to equities, a higher bond allocation might be an appropriate response. For example, investment-grade corporate bonds are now yielding 4.5% to as much as 8% for less than five year maturities because credit spreads have widened considerably the past several weeks. A credit spread is the difference in interest yield between a U.S. Treasury bond and another non-

Treasury bond. One strategy might be to purchase a series of bonds ranging from short to intermediate maturities (i.e., constructing a "ladder"). Thoughtful credit analysis is required for any bond purchase decision. A similar strategy can be employed for tax-free bonds as well, another group of securities worth considering for today's more risk-averse investor.

Implications for the **less** risk-averse investor (usually has a longer investment horizon):

- The same advice applies for the more risk-averse investor given above to the less risk-averse investor, don't panic and carefully consider the options. Short and intermediate term bonds have a place in any investor's portfolio in these market conditions. This investor might also consider acquiring selected bank and insurance company bonds where spreads have truly widened. A fairly large group of surviving banks and other financials is emerging from the current crisis, and this is where the more interesting opportunities lie at the moment.

- A re-evaluation of one's asset allocation might also involve considering additions of some of the more beaten down equity sectors. It may be time to consider some of the financial, technology, telecom, and even energy stocks that appear to have taken the full impact of the market's wrath the past few weeks. This should be done with eyes wide open, fully acknowledging the impossibility of calling a precise bottom. The reward should appear, but it may require a few more bruises.

- The U.S. near-term will probably provide the better equity opportunities relative to Europe. The emerging markets countries financial systems may be too young and untested or too dysfunctional to deal with the magnitude of stress the world economy is now experiencing. Long-term, however, these economies should no doubt continue to grow at a relatively faster pace, but expect substantial volatility in the coming months.

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