



SECURITY NATIONAL TRUST COMPANY

Market Update

December 17, 2008

To our clients and friends:

In the past three months, global financial markets have experienced extreme volatility, the economy worsened, an eleven month old recession was confirmed and numerous events splattered headlines from bank and auto industry bailouts to massive ponzi schemes. The purpose of our letter is to share our observations on the financial markets and how these events impact the decisions we make when managing our clients' assets. We understand that the volume and rapidity of recent developments may seem overwhelming. Our Portfolio Managers are focused daily on market activity, news and developments that could impact the accounts we manage, and are prepared to take decisive action when needed. As always, please feel free to contact us with your questions or concerns.

Economic Conditions

In our last quarterly letter, we noted that during late summer the focus of the Federal Reserve had shifted to a more accommodative monetary posture. Well, following this week's FOMC announcement, the Fed has become about as accommodative as possible, at least in terms of monetary policy. Yesterday's announcement to lower the Fed Funds Target rate to near zero, while eliminating the availability of this policy tool, is an indication of the Fed's aggressive stance on economic recovery. In addition to the rate cut this week, the Fed indicated that it intends to use "all available tools to promote the resumption of sustainable growth and to preserve price stability". It is important to keep in mind that rate setting has traditionally been the Fed's primary policy tool, but in recent months the use of its balance sheet has played the key role in the Fed's crisis fighting policy. As evidence of this, the December, 14 H.4.1 release from the Fed indicated total assets stood at \$2.2 trillion, \$1.4 trillion higher than a year ago.

Let's not allow these figures to give us a false impression that the Fed is the sole provider of economic stimulus. After a few rounds of political brinksmanship in Washington, the Troubled Asset Relief Program (TARP) was passed which authorized the Treasury to spend \$750 billion to establish a market for, well, troubled assets CMO's, CDO's and CDS's and such. After subsequent consideration, the Department decided the best use for these funds was to supply capital directly to financial institutions. As of their November 30 report, about \$335 billion had been committed. Following the bank investments, it didn't take long for the line to form, hat in hand, with U.S auto maker's front and center. Again, we were all treated to a few more rounds of pontification and handwringing in our nation's capital over the big three's future. The end result is still unknown, but it seems unlikely that the current administration will allow its legacy to include the failure of Detroit. They will survive, at least until the new administration takes office. Speaking of which, expectations are for the Obama administration to quickly initiate what has been called the mother and father of stimulus packages (\$600 billion to \$1 trillion in size). We are likely to see this stimulus package aimed at infrastructure spending, aid for states and extension of unemployment benefits. Finally, lest we seem ethnocentric, we need to mention that the idea of stimulus (and recession) is no longer a purely American concept. Governments and Central Banks around the globe have joined in with rate cuts, spending packages, deposit guarantees, and the list goes on.

In the U.S., economic releases have been bleak. Our economic slowdown has been sharp and broadly based. The payroll report for November was dismal with jobs falling by 533,000 in the month. Year to date payrolls have contracted by 1.9 million jobs. Manufacturing has contracted further as indicated by the regional Fed and Institution for Supply management surveys. Housing has yet to find its bottom with sales and starts continuing to fall. The retail sector has experienced gloomy sales numbers as inventories grow pointing to the need for heavy discounts and pressuring bottom lines. The silver lining in terms of economic releases has been inflation numbers, which have fallen sharply at the headline level. This has provided some flexibility in fiscal and monetary stimulus policy action. The market's broad concern over inflation seems to have abated; however, we are cautious given the tremendous

amount of liquidity being pumped into the financial system. Our concern is the possibility of flooding when credit begins to thaw.

In November, the National Bureau of Economic Research (NBER) confirmed that the U.S. economy entered a recession in January of 2008. In a way, the NBER just confirmed something that was widely expected, but what was most meaningful may have been the amount of water already under the bridge. A few observations about the NBER announcements might provide some comfort. First, in the 147 year history of recorded cyclical economic activity there have been 32 cycles with recessions averaging 17 months. This includes the Panic of 1873 (65 months) and the Great Depression (43 months). In the post-war period there have been 10 cycles where recessions have averaged 10 months. Additionally, since NBER began announcing turning points in 1979 the average duration of recessions post announcement has been 2 months.

Market Developments

Equity markets have experienced a rough ride over the last three months as the bear market roared into October. During the first two weeks of October, based on closing levels, the S&P500 fell by as much 22.5%, or 260 points to 899. Since then, markets have ricocheted wildly with the S&P500 marking its recent high of 1007 and low of 752 on November 4 and, 21 respectively. The sell off in stocks was widespread, and all sectors suffered.

Treasuries have rallied throughout the equity market decline as a result of flight to quality, reduced inflation concerns, a weakening economy, and talk at the Fed of purchasing long-term bonds in the market. Since mid-September, yields on treasuries have fallen across the curve, in some cases to record low levels. Yields on Treasury securities two years and longer have fallen over 1.50% in the past three months. This rally was not reflected in spread products, however, as the credit markets remained frozen. Spreads on corporate and municipal debt remain at historically wide levels.

Portfolio Management & Asset Allocation

In volatile markets it is important to remember the principles upon which the portfolio management process is built. The essence of this process is the establishment of investment objectives and having the discipline to follow them. Objectives give consideration to concepts such as: liquidity needs, the investment horizon and the ability and desire to take risk. This process is the cornerstone of the investment management process. Having the discipline to follow the plan is key to long-term success.

From time-to-time it is necessary to make changes to objectives. These adjustments should be related to changes in an investor's situation, not movements in the financial markets. Unfortunately, bear markets sometimes bring investors to the conclusion that their objectives are too aggressive, like wise, bull markets might create second guessing about whether or not you're being aggressive enough. As much as we would like to believe that markets are efficient and investors are rational, on a short-term basis they're probably not. Emotions like fear, panic and greed do impact markets and cause short-term returns well above and below normal long-run averages. We encourage our clients to share these emotions with us, but not let them get in the way of sound long-term investment decisions.

In terms of specific asset allocation decisions, we continue to underweight equity exposure levels in our portfolios. Within the equity component of our portfolios, we are maintaining international equities at a modest underweight as we believe foreign markets have lagged US markets in their response to the current situation. In our US equity portfolios we continue to hold modest overweight positions in small and midcap names with a bias towards growth companies. In our managed domestic large cap portfolios we continue to underweight financials, particularly banks. Additionally, we are underweight on consumer discretionary stocks and have moved to neutral on energy. We are overweight in consumer staples as a defensive measure given the economic uncertainty. In our fixed income portfolios we continue to emphasize a high-quality, short-term portfolio.