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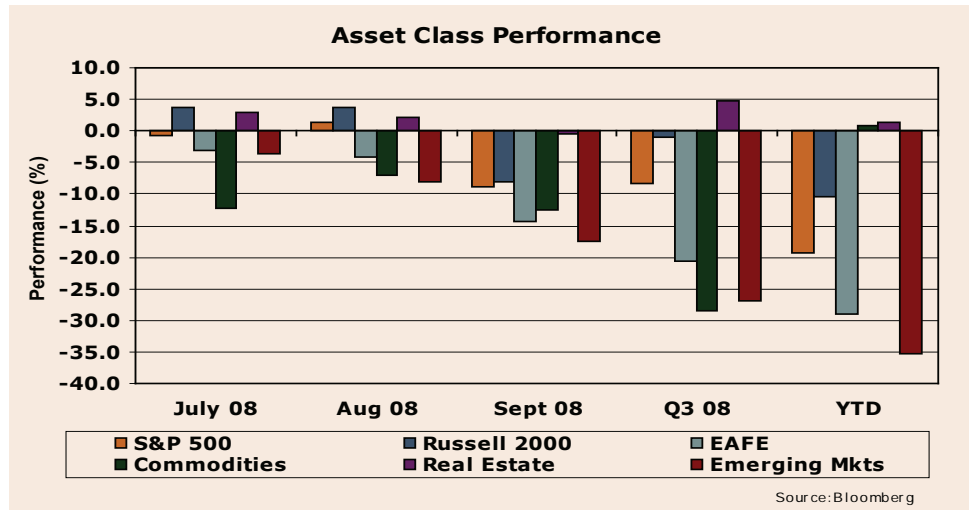
Credit Crisis

The first, harbinger wave struck in early September with the nationalization of Fannie Mae and Freddie Mac. In the following weeks, the full tsunami hit with the bankruptcy of Lehman Brothers, Merrill Lynch selling itself to Bank of America, AIG accepting an \$85 Billion federal credit infusion, Goldman Sachs and Morgan Stanley becoming banks and WAMU and Wachovia collapsing into the hands of stronger institutions. It’s difficult to put a period at the end of that last sentence since many fear that there is more to come in this stunningly vast and rapid transformation of the US financial services landscape.

In the article that follows, Rich Palmer traces the history and denouement of the government sponsored entities, Fannie and Freddie, that illustrates the risk of unintended consequences that can result from inadequate design and oversight. Each one of those subsequent events could (and no doubt will) spawn several books. Our remarks will be relatively brief.

While it’s difficult to be optimistic about near-term outcomes from here, we still believe long-term optimism is appropriate. In our view, an energetic and creative global government policy response will combine with a resilient private sector to galvanize and...eventually... move the economy and capital markets back to a growth-oriented equilibrium. We plan to communicate our thoughts about this road map in more detail soon.

For the present, however, the story for clients’ investment portfolios is grim. With a July and August that overall were relatively flat for equities, the third quarter ended with deep losses in September.



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In contrast to more normal times when diversification can easily demonstrate its investment advantage, recently there has been “nowhere to hide”. Virtually all asset classes suffered significant losses for the quarter. A sad adage of the investment world is that, in times of great stress, all correlations approach one. Still, some of the subtle differences even here have given us opportunities to rebalance portfolios to remain in line with their target long term strategic allocations.

Not a “Bailout”, but a Catalyst

Sadly, most media and many politicians have characterized the \$700 billion rescue legislation (the Emergency Economic Stabilization Act of 2008) as a “bailout” of banks and Wall Street firms for their poor performance. In fact it is, in our view, another necessary catalyst to reignite the confidence essential to the even rudimentary functioning of credit markets. When investors and banks are paralyzed by fear of loss and refuse to lend to even high quality borrowers, even to other banks, the entire edifice of trust in repayment can rapidly collapse. That in turn severely constrains all forms of essential economic activity and the contagion can quickly spread around the world. Bringing the US Treasury, and other global governments and central banks, as the convincing purchasers of last resort, to the market can break that paralysis. And, importantly, the US rescue is not a give-away but the purchase of distressed assets, some of which will actually perform at some level at some time. If the Treasury doesn't pay too much, the US taxpayer could end up suffering only modest losses or could even turn a profit.

Much of the opposition to this catalyst hinged on the moral grounds of not rescuing bad economic behavior. Appropriate as a sentiment, in practicality, it's not clear where the punishment should fall. There is plenty of blame to go around: interest rates held too low too long; overly aggressive lending; exotic mortgage securitization strategies; “mark to market” accounting rules being applied even when markets ceased to function on normal terms; fraud by borrowers and mortgage brokers; inadequate regulation; and an excessive confidence in real estate value appreciation. At some level, many are guilty and the moral hazard of too easy a rescue from bad decisions or bad behavior could be very widespread. The fingers of blame point in many directions. Blame is not the answer to this problem; rather, learning from mistakes and establishing improved structures and processes should be the outcome.

Recession or Not?

Whether we're already in or about to enter a recession has moved beyond any notion of technical definitions to one of psychology.

By that measure, we can all agree that the “R” word applies. Without even one quarter of observed negative GDP growth so far, investors and consumers are very pessimistic. At the risk of seeming insensitive to the actual areas of pain, we believe that some important economic fundamentals are in decent shape. Inflation is low, energy prices have returned to more tolerable levels, the jobless rate is still in a historically low range, and, leaving the financial sector aside, corporate earnings are at historically high levels. Of course, investors are rightly concerned with the *future* direction of growth, corporate profits, and employment. From that perspective, Warren Buffet's investment in Goldman Sachs and Wells Fargo's efforts to pay much more for Wachovia than CitiGroup offered suggests that careful, patient, and very successful investors see long-term opportunity even (especially?) among the devastated financials.

Some of our clients, who are still accumulating assets or have excess cash positions, may also see the current environment as a rare buying opportunity, an excellent time to deploy available cash or, in the right circumstances, even to add margin. As we discuss in Mike Angell's and Ray Edwards' article below, it's also an opportunity to take advantage of temporarily lower asset values and low interest rates to optimize family wealth transfer goals.

However, the safest course of investment action will be to persevere in the portfolio strategy already in place. Markets are far too volatile at present to make any confident defensive moves. More importantly, a defensive strategy would forego the upside opportunity that market recoveries, someday, will surely provide and that may be necessary for our clients to accomplish their goals.

We really do understand how difficult it is to be brave in the face of fear on all sides. Our personal portfolios are suffering, side by side, with yours.

Meanwhile, we are taking some tactical action, as appropriate, in managing our clients' current strategies. We're capturing tax losses and rebalancing portfolios to target allocations.

More strategically, as we described in our Annual Report at the end of September, we are carefully reviewing our long range view of the risks, returns, and correlations of global asset classes to see if any modifications to clients' portfolio strategies are appropriate. We expect that any changes, on balance, will be fairly modest and that for quite a few clients, there may be no change at all.

Consequently, as unsatisfying as we know it must be for many clients, we urge continued patience with the unsettling present and optimism for a far better future.

*Tim Kochis, CEO
Editor*

The GSEs: Good Intentions, Bad Results

"What we know about the global financial crisis is that we don't know very much."

Paul A. Samuelson, 1970 Nobel Economics Prize Winner

Nationalizing the Single Family Mortgage Market

Almost lost now in the shadow of more recent news, the US government effectively nationalized the Federal National Mortgage Association (Fannie Mae, **FNM**) and the Federal Home Loan Mortgage Corporation (Freddie Mac, **FRE**) on September 7, 2008 by placing both into conservatorship¹. Combined, they had either bought outright, securitized and sold to others, or guaranteed single and multi-family mortgages summing to over \$5 trillion, representing over 40% of the \$12 trillion of all such mortgages outstanding. This is immense: the entire United States public debt is "only" \$9.5 trillion currently.

In nationalizing these government sponsored enterprises (**GSE**), Treasury Secretary Paulson essentially admitted that the combination of inadequate regulatory supervision, risk-taking encouraged by the stockholder ownership form, and innovative financing unaccompanied by effective risk

¹ Under the Housing and Economic Recovery Act of 2008, the Federal Housing Finance Agency purchased \$1 Billion in senior preferred stock convertible to in 79.9% of common stock and committed up to \$100 Billion more in capital to each.

A Word, or Two, About Communication During Unprecedented Volatility...

From July 1 through yesterday, October 7, the Dow Jones Industrial Average rose or fell more than 1% in 40 out of 67 market sessions, including 23 market declines, 13 of which were greater than 2%. As you might imagine, on each of those days, we engage in internal and external meetings, conference calls, and emails trying to assess the situation. We measure client exposure and search for actionable insight consistent with our fundamental long-term philosophy. Should we change asset allocations? Should we rebalance and harvest tax losses? Can we even successfully implement those techniques within guidelines when volatility is so high? Will our clients expect to hear from us today? Is another client communiqué appropriate or do we risk redundancy, cliché, seeming Pollyannaish?

In the days and weeks ahead we will continue to monitor markets and events closely; challenge our own long held policies and principles; and communicate with you whenever our best judgment suggests we should. Thus far, painful as this all is, we see nothing that leads us to fundamentally alter course. However, we have already begun a deeper assessment of the economic, market and political conditions that led to this crisis and plan to issue a whitepaper describing the conditions necessary and the likely timetable for the economic recovery that we know will come. This assessment coincides with our already scheduled project to reset the capital market expectations that drive our asset allocation recommendations. We look forward to sharing the results of our work with you soon.

As we strive for the right balance between too much communication or not enough, we strongly encourage your feedback and questions. Never hesitate to contact your client service team or Aspiriant leadership. Please know that exceeding your expectations is paramount in our minds especially during these challenging times.

management would lead to the shrinkage and possible eventual extinction of the GSEs.

The Treasury plan will limit the size of each GSE mortgage portfolio to \$850 billion as of year-end 2009. After 2009,

the mortgage portfolios for each GSE will shrink by 10% per year until the mortgage asset total falls to \$250 billion. As a consequence, in the future, the GSEs are very unlikely to be able to supply substantial liquidity to the US mortgage markets or act as the marginal buyer.

How did we come to this unfortunate end result after such a long, mostly stable history for the GSE form of organization?

Sponsoring Home Ownership through Fannie and Freddie: Social Engineering Does Not Always Produce Intended Results

Fannie Mae had been originally chartered in 1938, but became a stockholder-owned GSE through Congressional action 30 years later. The intent was to provide funding for longer-maturity mortgages not requiring bullet payments and to allow for lower down payment percentages. In 1970, Congress created Freddie Mac to provide more competition to Fannie Mae in the *secondary mortgage* market, which involves the structuring and sale of securities collateralized by the mortgage loans or whole loan purchases. Both GSEs had been created by Congress initially to increase funds available to finance home purchases and later to make housing more affordable and accessible for low and moderate-income cohorts. Later, each executive administration could through regulations and interpretations of Congressional laws prioritize its own set of housing objectives through the GSEs. As an example, in 1993 the Clinton administration issued new regulations under the Community Redevelopment Act that provided for more access to mortgage credit for inner city and rural communities. Many of these mortgages, which may not have been funded under previously established underwriting guidelines, involved borrowers with lower credit scores, smaller percentage down-payments, and lower debt service coverage ratios.

Although the Federal government did not legally have the obligation to guarantee the outstanding debt of the GSEs, investors had always assumed an implied federal guarantee to the GSE obligations. This allowed the GSEs to issue debt at lower interest rates than otherwise, to be exempt from state and local income taxes, and to use higher leverage ratios (i.e., invested assets to capital) than commercial banks. Over time, the GSEs were allowed to increase their leverage ratios to as much as 70:1, (\$70 in mortgage assets could be supported with as little as \$1 in capital). By the end of June of this

year, Fannie Mae's leverage ratio was 20:1, while Freddie Mac's leverage ratio was 70:1. With such high leverage, asset impairment is magnified in a downturn, causing rapid capital depletion. It was this lack of adequate capital and the apparent difficulty of raising more capital that forced the Treasury's hand.

Higher Home Ownership Rates, Creative Financing and High Leverage Lead to a Cycle Downturn

The home ownership rate², which had moved in a rather narrow range from 64% to 66% from the late 1960's to the early 1990's, had increased to 69% by 2005. Average national home prices had increased by an annualized 11.3% from 2000 through 2006³ while average income enjoyed only a modest increase. Normally, economic theory would predict that the higher the price of a good, the lower the demand. But real estate proved otherwise as more borrowers, through creative and expansive financing techniques, qualified for home purchases from the mid-1990's through 2006.

The Federal Reserve Bank of Atlanta in Sept. 2007⁴ estimated that more extensive financing alternatives, such as adjustable and hybrid rate mortgages, contributed from 55% to 70% of the increase in the home ownership rate. During the latter period of this mortgage expansion phase, from 2004 to 2007, Moody's estimated that financial institutions and independent mortgage brokers made approximately 15 million mortgage loans that were poorly underwritten and made the dire prediction that up to 10 million of these loans will eventually default.

Meanwhile, the share of *subprime* mortgages to total originations rapidly increased from 5% in 1994 to 20% in 2006, representing approximately \$600 billion, while the average rate difference between subprime and prime mortgages declined from an average of 2.8% in 2001 to only 1.3% in 2007. This rate differential occurred even while subprime borrower and mortgage loan risk profiles deteriorated.

Chasing Market Share and Accepting Higher Risk

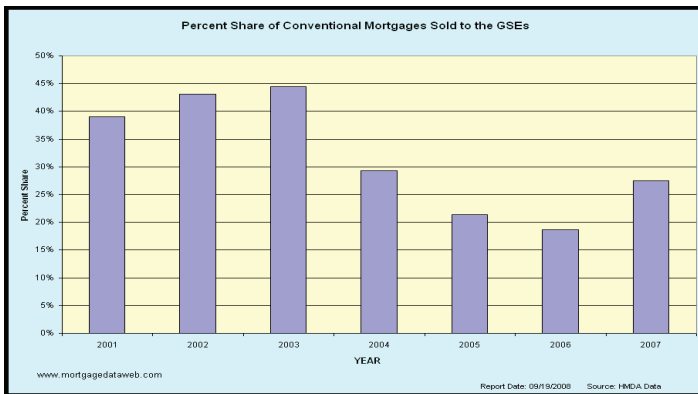
During this phase of a substantial expansion in mortgage

² The home ownership rate is defined by the Census Bureau as owner-occupied homes divided by total occupied households.

³ S&P/Case-Shiller National Home Price Index.

⁴ "Accounting for Changes in the Homeownership Rate", Matthew Cahmber, Carlos Garriga and Don Schlagenhauf, Sept., 2007.

originations, the GSEs actually lost market share to private label originators. The percentage of originated conventional⁵ loans that were purchased by the GSEs declined from the 40% range in the years 2001 to 2003 to under 20% for 2006.



In seeking to reverse their falling market share of originations, the GSEs began to underwrite mortgages that have been characterized variously as “Alternative A”, “Expanded Approval” or “A Minus” mortgages. These mortgages were ultimately similar in credit quality to the older definitions of “sub-prime” mortgages. The GSEs also began to accept some “low-documentation” mortgages that had lower loan-to-value ratios than private label issuance and involved lower loan amounts.

In seeking to maintain mortgage securitization market share, the GSEs began to concentrate more on their relationships with larger mortgage originators, assisting in the development of the large “aggregator” model where underwriting partners, such as Countrywide Credit and Washington Mutual, provided ever larger percentages of the originated mortgages. As these large aggregators turned more to low documentation, alternative A, and interest-only adjustable rate mortgages (ARMs), the purchase wherewithal of the GSEs lent support to the growth of these alternative mortgage markets. The GSEs in turn appreciated the scale of mortgage operations and servicing capabilities of the large aggregators.

Starting in 2004, the GSE portfolios of subprime and Alternative-A loans and securities began to grow rapidly with the GSEs becoming the largest purchasers of such mortgages

⁵ A conventional mortgage loan is a mortgage in which the terms and conditions meet criteria established by Fannie Mae and Freddie Mac. Conventional mortgages can have either fixed or adjustable rates.

between 2004 and 2007. Eventually, the total GSE exposures to Alternative A and ARM mortgages from direct holdings and mortgage guarantees came to represent about 40% of the value of these mortgages. Ultimately, this concentration of loan origination risk and the loosening of underwriting standards caused sufficient loan loss write-offs and loss reserve accumulations to render the GSEs insufficiently capitalized.

Future Roles for the GSEs: Costs of Providing Mortgage Market Liquidity

“For years governments have been promising more than they can deliver, and delivering more than they can afford.”

Paul Martin, Canadian politician

The net costs to the Treasury from the credit crisis, with the mortgage market at the epicenter, may ultimately total in hundreds of billions of dollars. Through committing initially up to \$100 billion in capital to each of the GSEs, the Treasury is on the hook for any ultimate mortgage losses in excess of shareholders’ equity, which could indeed prove to be negative on a mark-to-market basis for each GSE. The net cost of the recently enacted Emergency Economic Stabilization Act, if any, would be in addition to this.

With little capacity left to purchase mortgages due to the \$850 billion mortgage exposure limitation, the GSEs are not well positioned to fulfill their traditional roles of supplying liquidity to the mortgage marketplace. As financial institutions have suffered approximately \$600 billion in asset write-downs as of the date of this article, they are largely reluctant to commit capital to the mortgage markets and, therefore, do not provide a substitute for the GSEs in terms of funding mortgages.

It appears that the next Congress is likely to decide on the organizational form, operational scale and strategic mission for the GSEs or their successors. Enabling socially-oriented objectives, but with a lax regulatory structure and ineffective constraints on the business practices of the GSEs ultimately proved very expensive to US taxpayers.

Policy is always designed, of course, to improve overall societal welfare: implementation can occasionally cause a disconnect from intent. The next version of these structures will, we hope, have learned from these errors.

Rich Palmer

Recap of Aspiriant Client Conference: September 18, 2008...and Other Remarks

In San Francisco, on September 18, Greg Valliere, political and economic commentator of the Stanford Washington Research Group, spoke to clients and friends of the firm on a variety of key topics. The recording of the event is available at www.aspiriant.com/valliere.html.

Among Valliere's main predictions and observations;

- Congress: the Democrats will win seats in the House and the Senate...but not enough (60) to cut off debate (filibuster) in the Senate.
- The White House: The vote will be close, with the electoral vote hanging, again, on one or two states. We will go to bed on election night not knowing who the next President will be.
- Taxes: Income taxes, both ordinary and capital gain will go up; the only question is when and how much. The estate tax uncertainty will be resolved, with no repeal, but with permanent exemptions of \$3.5 to \$5M per person.
- Geopolitical Threats: Among many, the hottest spot of all is Iran; and the greatest near term risk is that Israel will run out of patience with Iran's continuing nuclear development.

Several of us heard similar remarks from David Gergen, commentator and former White House staffer under five Presidents, at the annual convention of the Financial Planning Association in Boston on October 5th. In his view, however, an unstable Pakistan should be our greatest external worry. And, Madeleine Albright, former Secretary of State, speaking at a major Schwab –sponsored conference in Atlanta, on September 26, offered the hope that whichever candidate is elected President will seize this juncture to restore America's moral leadership among the nations of the world.

All three would agree that the domestic economic and global diplomatic environment will present the next President with some of the greatest challenges in many decades. Gergen added the hope...and expectation...that the American people will move away from currently polarized positions to once again unite in a common purpose to attend to these challenges. We, of course, certainly hope so, as well.

The Rich Get Richer by "Giving It Away"

Today's unnerving volatility in global stock and bond markets, combined with low prevailing interest rates and the prospect of higher income taxes ironically creates an unusually good opportunity to effectively transfer wealth to family members and benefit charity in the bargain. Some of the most effective family wealth planning tools involve the companion act of giving to charity. One such vehicle is the Charitable Lead Trust ("CLT"), a lesser-known relative of the "charitable remainder trust" often used by the rich, famous, and well-advised. In fact, Jacqueline Kennedy Onassis is sometimes credited with making the CLT fashionable when, upon her death in 1994, it was revealed that a large portion of her estate was designated to fund "The C & J Foundation", a CLT named for her two children.

Mechanically, a CLT is an irrevocable trust that makes annual distributions to charitable beneficiaries for the life of a related individual or some fixed period of time, and distributes its residue on termination to non-charitable beneficiaries, such as children, grandchildren, or even the creator of the trust (the "grantor"). Because of the interim charitable annuity, the grantor is only subject to gift tax on the present value of the remainder interest and the remainder interest, including any future appreciation, passes to the non-charitable beneficiaries free of any gift tax.

Depending on how the grantor structures the trust, the CLT provides either an immediate income tax deduction to the grantor (subject to applicable income tax restrictions on that deduction) equal to the value of the charitable annuity, where the original donor is to receive the assets back after the charitable term. Or, in the case where the ultimate remainder beneficiaries are other family members, the trust receives an income tax deduction for the annuity payments to charity when made and the gift taxable value of the gift is reduced by the present value of the interim charitable payments. The CLT is not a tax-exempt entity and either the grantor recognizes any income tax attributable to the trust, such as when the grantor received the income tax deduction, or the trust recognizes income tax to the extent its earnings exceed its annual distribution to charity. To minimize such income tax, a CLT is often funded with property that has little current appreciation or is funded at death after the contributed assets received a step-up in basis to fair market value.

A CLT comes in two basic varieties, annuity trusts and unitrusts. An annuity trust pays a fixed dollar amount to charity each year during the period of the CLT. A unitrust pays a fixed percentage of the trust assets determined annually to charity each year during the period of the CLT.

The decision to use an annuity trust or a unitrust hinges upon how the grantor chooses to allocate the investment risk among the charitable and non-charitable beneficiaries and whether the grantor expects returns above the low IRS mandated rate (currently 3.8% for October 2008). Because an annuity trust will distribute the same dollar amount to charity each year, all of the benefits of appreciation and risk of loss in trust asset value will benefit the non-charitable remainder beneficiaries. In contrast, because the charitable distributions paid by a unitrust will vary, up or down, based on the fluctuating annual values of the trust assets, both the investment risk and reward is shared by both the charitable and non-charitable heirs. As a result, to the extent the grantor believes the assets will appreciate at a greater rate than the IRS mandated rate and wishes to maximize the wealth transfer benefit, the annuity trust will provide a greater benefit to the remainder beneficiaries. An additional benefit of the annuity trust is that grantor can effectively reduce or eliminate the taxable gift upon creation by selecting a charitable annuity stream whose *present value* equals the *current* value of the asset. The one drawback to the annuity trust is that it is more difficult to name grandchildren as remainder beneficiaries due to complicated generation-skipping transfer tax rules.

As discussed, the grantor can structure the CLT to provide the grantor with an immediate income tax charitable contribution deduction equal to the present value of the charitable distributions. This type of CLT can be particularly useful when the grantor's taxable income (and/or marginal tax bracket) in a given year is higher than it will be in future years, say, because of a large asset sale or the exercise of a stock option and the grantor is committed to making significant future charitable contributions. By establishing the CLT in this manner, the grantor is able to take an income tax deduction in the year of creation despite the fact that the majority of the charitable distributions will not be made for several years. Plus, the value of the remainder will not be reduced by future income tax payments since those taxes are imposed on the grantor, which may be important for taxpayers facing the prospect of *higher* future tax rates.

A CLT also provides a great opportunity to the grantor who already has a strong charitable intent and is making significant annual charitable contributions. In this scenario, the grantor

can structure a CLT to reduce gift or estate tax that would otherwise be imposed on transfers to children and other heirs and at the same time fund the family's future charitable bequests through a donor advised fund that serves as the family's permanent endowment.

The CLT provides the most benefit when funded with business, real estate, or other investment assets that have the potential to generate earnings and appreciation at a rate greater than the IRS mandated rate. At today's low interest rates and reduced market values, that "excess" appreciation is likely easier to achieve. If you have assets that exceed your own needs and are looking for ways to pass more on to your heirs, now may be an especially opportune time to consider adding a CLT to your existing charitable giving and wealth transfer plan.

*Ray Edwards
and Mike Angell*

Commodities...Part of the Problem or Part of the Solution

We have commented in past issues of *Insight* on commodities as an asset class that we continue to introduce into client portfolios and the implementation vehicles that we use for our clients' investments in them...as recently as [last quarter](#). However, recent market events have provided a dramatic reminder of the unique relationship between commodities, the rest of the economy, and the behavior of financial markets.

Over the course of a few days in mid-September, commodity prices rebounded sharply on fears of a financial market meltdown. The market action, particularly in gold (which experienced the largest one day price increase in history) reminds us of the complicated relationship between commodities and the economy. Commodities are both inputs to fundamental economic processes and some can have a separate role as a store of value.

Over the last two months, concerns about a weakening global economy have pushed down the price of oil and other commodities used as *inputs*. The price of oil fell nearly 40% from its high of more than \$147 on July 11th to \$90 on September 16th, recovered to the low \$100's and dipped again below that mark as the third quarter drew to a close. While one can debate whether these declines were the

Asset Safety

With so much current uncertainty, you may be wondering how safe your investment assets are. As a preliminary selection process, we only use custodians that we are confident have very little risk of insolvency. But even in that extremely unlikely event, there is virtually no exposure for client assets.

Securities held in client accounts at custodians are held by the Depository Trust Company (DTC) which is a member of the US Federal Reserve System. It is a limited-purpose trust company under New York State banking law and a registered clearing agency with the Securities and Exchange Commission. Custodied client securities are kept separately from a custodian's own assets and are not subject to the claims of the custodian's creditors.

In the event of a failure of a custodian, a new trustee will be assigned to handle the reconciliation and distribution of securities at the DTC. The Securities Investor Protection Corporation (SIPC) provides up to \$500,000 of protection for each account, if the securities are missing due to fraud or the simultaneous failure of a firm that had borrowed securities from the custodian. This borrowing can only happen for individual securities (not mutual funds) held in margined accounts.

The custodians we use also carry additional insurance protection for accounts in the event that SIPC limit is exhausted.

result of speculators getting nervous or pure supply-demand factors, it's clear that a weakening global economy has had an impact, particularly a slowing in the emerging market countries that drove much of the concern over increased demand earlier this year. On the other hand, concern about the falling value of "financial" assets (and the negative impact that would have on economic activity) has driven up the demand for at least some "hard" assets in recent weeks, because their value is thought by some as more certain.

Our Reaction and Outlook

Commodity prices and returns continued to decline sharply in August and early-September, led by a sharp fall in the price of oil. However, prices began to ramp up again in mid-September, again led by oil, but followed closely by gold

and others. Where it was opportune for tax purposes, we rebalanced away from commodities several times during the spring and summer as prices rose, but recently added to many client's commodities positions as prices fell. This volatility is the reason for our narrow rebalancing bands (+/- 15% of the target allocation) around commodities.....they move quickly, so to capture re-allocation benefits, you must keep a relatively tight leash on them.

Despite the recent declines, we believe that the secular commodity bull cycle is far from over as the severe supply constraints that have led to high and rising prices in recent years remain intact. The recent investments in supply infrastructure will take many years to become productive, and may not even offset the decline in production of existing assets. Still, while we think it's a good fundamental bet, one cannot be *sure* that commodities prices generally will rise.

That uncertainty about the future price of commodities does not dissuade us from pursuing modest positions for our clients. It is important to remember our primary rationale for including commodities in client portfolios. In exchange for committing our capital in the futures markets and facilitating commodity producer's hedging their output and commodity users their demand, we expect to earn a premium. This would be true even if commodity prices stay exactly the same. The movement of prices may enhance or offset our reward for bearing that hedge risk, but in the long-run, we believe that that providing capital for hedging activity itself will be profitable.

Much of the wealth-building capacity of our client portfolios depends on the activities of companies around the world which use commodities as inputs. It makes good sense to hedge the price of those inputs – somewhat counter-intuitively, not hedging would be speculation. This is the main reason we include them in client portfolios. On a pure risk/return basis, given our capital market expectations, we wouldn't invest in commodities at all. Our expectation is that spot-price changes will be one of the lowest returning opportunities over time, with the highest risk (volatility). However, commodities provide a hedge to equity investments that make up the majority of most client portfolios. An illustration of the relationship between commodities and equities, in terms of the business cycle (the S curve), is shown below. Commodities are not always "good" bets, but they are often in counterpoise to other portfolio assets.

Table 1 Phases of the Economic Cycle

	Recession Ending	Economic expansion		New recession begins
	Low output Slow growth	Low output Fast growth	High output Fast growth	High output Slow growth
High Performing Assets	Bonds Cash	Equities Bonds	Commodities Equities	Bonds Commodities
Low Performing Assets	Equities Commodities	Commodities Cash	Bonds Cash	Cash Equities

Thus, in the first column, as economic activity is reaching its nadir, both equities and commodities tend to underperform. In the next phase, the stock market anticipates the quickening of economic activity and stocks outperform, though the actual demands for commodities is not yet sufficient to improve returns. As the economic expansion continues but before it crests, demand for commodities and the outputs generated from them drive higher prices for commodities and equities. Finally, as the stock market anticipates a downturn prior to its actual occurrence, equity performance falls off in advance of the cyclical decline in demand for commodities. In this simple model, commodities are out of phase with equities about half the time through an economic cycle.

*Jason Thomas, PhD, Chief Investment Officer
and Andy Hamilton*

Planning for Year-End 2008

As another year-end approaches, we remind you of certain year-end transactions that we stand ready to help you execute:

Income Taxes

Year-end State Tax Payments – If we are not ourselves preparing your taxes, we will be in touch with your tax preparer in December about any issues that should be taken into consideration when preparing tax projections and determining your optimal tax payment schedule. In addition, we will forward tax information for the investment portfolios that we manage for the full year 2008 to your tax preparer in February 2009. Please remember

to forward any 1099s, K-1s, and other tax records you receive to us or directly to your tax preparer. If you changed your tax preparer since last year and/or have not already provided us with your new tax preparer’s contact information, please do so as quickly as you can.

Charitable Contributions – Appreciated long-term capital gain assets, such as stock or mutual fund shares you’ve owned for more than a year, are ideal assets to contribute to charity because you can deduct these assets at fair market value without paying tax on the appreciation. If you have charitable intentions but have not yet identified the charity you wish to benefit, you can donate securities to a charitable gift fund, like the ones available at Charles Schwab & Co., Inc., Vanguard, or Fidelity Investments. By doing this before December 31, you can secure your available charitable deduction for this year and direct the gift (of amounts as small as \$100) at a later, more convenient time.

Gifts to Family Members – The current tax law allows each person to make gifts of \$12,000 per recipient, each year, without gift tax. A married couple can give up to \$24,000 per recipient per year. If a recipient is in a very low income tax bracket, it may make sense to give highly appreciated investments rather than cash since the recipient can sell the investment and may only pay 5% capital gain tax. However, a cash gift is still usually the best if you want to maximize the benefits to the recipient. Many clients with young children or grandchildren may be able to give up to \$120,000 (for a married couple) to fund §529 College Savings Plans. These gifts use the same \$12,000 per person, per recipient annual gift tax exclusion but permit a 5-year “bunching” to get to a much greater initial amount. If you haven’t already taken advantage of these opportunities for 2008, there is still some time to do so.

Retirement Plans

Retirement Plans for the Self-employed – If you have self-employment income (from consulting services or corporate or non-profit boards), our planning staff has discussed with you your eligibility to contribute to your own retirement plan. If you haven’t already established a specific retirement plan, we can help you decide which of the several plan choices is appropriate for you. Most of these plans must be established no later than December 31, even if actual funding can occur later.

Roth IRA Conversion – If your adjusted gross income (AGI) is less than \$100,000 (whether for single individuals or married couples filing jointly), you can convert part or all of your traditional IRA to a Roth IRA by December 31. Taxes

must be paid on the conversion but subsequent earnings and distributions are tax-free in a Roth IRA. Your client service team will help you determine whether this opportunity is available to you and, if so, if that strategy is appropriate to pursue. In 2010, this opportunity is currently scheduled to be available, regardless of the amount of your AGI.

Catch-up 401(k) and Deductible IRA Contributions – Individuals over age 50 and those who turn 50 during 2008 are eligible to make “catch-up” contributions to retirement plans. The 401(k) catch-up contribution is \$5,000 and the traditional and Roth IRA catch-up contribution is \$1,000. If you meet the eligibility requirements and haven’t already made the 401(k) catch-up contribution, please contact your 401(k) plan administrator to make the election as soon possible so the extra contribution is made before the year-end. The catch-up contribution to an IRA can be made as late as April 15, 2009 but we recommend doing so early to avoid confusion as to the applicable tax year.

Required Retirement Plan Distributions – Clients who turn 70½ this calendar year are required by law to take a first minimum distribution from their retirement accounts. The first required minimum distribution must be taken no later than April 1 of the year following the calendar year in which one turns 70½, so, “first timers” could wait till April 1, 2009. Still, it is almost always best to get this done by December 31 of the current year so that you are not required to take two distributions in the following year.

In the Emergency Economic Stabilization Act, Congress extended the option for taxpayers over 70½ to make charitable gifts for an amount up to \$100,000 directly from an IRA (neither a SEP nor a SIMPLE IRA qualify) to a public charity (not a donor advised fund, private foundation, or supporting organization). These gifts can count toward the required minimum distribution for the year. There is no tax deduction, but there is no income tax on the amount of the distribution that is given to charity. If you are interested in this option, please let us know and we will be in contact with you to coordinate distributions.

AMT Relief – Another feature of the Emergency Act was to provide a further short-term mitigation of the application of the Alternative Minimum Tax and to provide for a refundable credit for Minimum Tax Credits more than three years old. Some clients may have an opportunity here to capture otherwise unusable AMT credits.

Your client service team is eager to work with you to *plan* for and then *execute* these transactions as early as possible to avoid any year-end rush.

Young Kim,
Director of Investment Operations

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PERFORMANCE RESULTS

			3rd Quarter 2008	12 Months to 9/30/08	3 Years Annualized to 9/30/08
Fixed Income	<i>Intermediate</i>	Benchmark Index: Lehman Brothers Aggregate Bond	-0.5%	3.7%	4.2%
	<i>(Taxable)</i>	Benchmark Fund: iShares Lehman Aggregate Bond	-0.6%	3.6%	3.9%
	*	PIMCO Total Return Institutional	-2.1%	3.8%	4.4%
	<i>Intermediate</i>	Benchmark: Morningstar Muni CA Intermediate Category Avg.	-1.9%	-1.1%	1.5%
	<i>(Tax Free)</i>	Vanguard CA Insured Intermediate Tax-Exempt Adm	-2.3%	-1.1%	1.9%
Real Estate	<i>Global</i>	Benchmark Index: Dow Wilshire Global RESI	-8.5%	-27.6%	2.6%
		Benchmark Fund: 60% SPDR DJ Wilshire Intl RE/40% Vanguard REIT Index ETF	-9.2%	-27.5%	N/A
		DWS RREEF Global Real Estate Sec	-10.2%	-31.8%	N/A
	<i>US</i>	Benchmark Index: Dow Jones Wilshire US REIT Index	4.8%	-12.5%	5.2%
		Benchmark Fund: iShares US Real Estate	3.3%	-15.1%	3.0%
		DWS RREEF US Real Estate	4.4%	-11.7%	6.4%
	<i>Energy Infrastructure</i>	Benchmark Index: Citigroup MLP Index	-16.8%	-20.1%	0.4%
		Kayne Anderson MLP	-14.0%	-21.1%	0.0%
Large Cap: Domestic	<i>Blend</i>	Benchmark Index: S&P 500	-8.4%	-22.0%	0.2%
		Benchmark Fund: iShares S&P 500	-8.3%	-21.9%	0.2%
		Schwab S&P 500 Institutional Select	-8.3%	-21.8%	0.3%
		Schwab 1000 Select	-9.1%	-21.7%	0.3%
	*	Tax Managed Index Separate Account (Aperio/Parametric)	<i>Return based on individual client's portfolio</i>		
	<i>Value Style</i>	Benchmark Index: Russell 1000 Value	-6.1%	-23.6%	0.1%
		Benchmark Fund: iShares Russell 1000 Value	-6.1%	-23.5%	0.0%
		Berkshire Hathaway B	9.6%	11.2%	17.2%
*	DFA Large Cap Value	-8.2%	-22.4%	-1.0%	
*	DFA Tax Managed Marketwide Value	-7.4%	-24.2%	-1.2%	
Large Cap: Developed Overseas	<i>Blend Style</i>	Benchmark Index: MSCI EAFE	-20.5%	-30.1%	1.6%
		Benchmark Fund: Vanguard FTSE All World ex US ETF	-20.3%	-28.9%	N/A
		Vanguard Total International Stock Fund	-20.5%	-30.1%	2.6%
	<i>Value Style</i>	Benchmark Index: MSCI EAFE Value	-19.1%	-32.1%	0.6%
		Benchmark Fund: iShares MSCI EAFE Value	-19.1%	-32.4%	-0.1%
	*	DFA International Value	-17.8%	-31.6%	3.3%
*	DFA Tax Managed International Value	-16.8%	-30.5%	3.7%	

* Preferential Access Through Aspiriant

Returns are stated net of manager's fees, but before Aspiriant fees. All fund returns above are stated including the reinvestment of dividends and capital gains. Figures in bold reflect performance equal to or better than benchmark fund or, in cases where the benchmark fund's performance is not available, performance equal to or better than benchmark index.

PERFORMANCE RESULTS

			3rd Quarter 2008	12 Months to 9/30/08	3 Years Annualized to 9/30/08
Small Cap: Domestic	<i>Blend Style</i>	Benchmark Index: Russell 2000	-1.1%	-14.5%	1.8%
		Benchmark Fund: iShares Russell 2000	-1.1%	-14.4%	1.8%
	*	DFA US Small Cap	-1.7%	-17.6%	0.1%
	*	DFA Tax Managed US Small Cap	-4.7%	-19.5%	-0.4%
	*	DFA US Micro Cap	0.0%	-19.3%	-1.0%
	<i>Value Style</i>	Benchmark Index: Russell 2000 Value	5.0%	-12.3%	2.0%
		Benchmark Fund: iShares Russell 2000 Value	5.0%	-12.2%	1.9%
	*	DFA US Small Cap Value	-1.0%	-19.2%	-0.8%
*	DFA Tax Managed US Targeted Value	-4.8%	-20.3%	-1.4%	
Small Cap: Developed Overseas		Benchmark Index: MSCI EAFE Small Cap	-23.9%	-35.0%	-3.5%
		Benchmark Fund: SPDR S&P International Small Cap ETF	-22.9%	-33.8%	N/A
	*	DFA International Small Company	-22.4%	-32.5%	0.2%
	*	DFA International Small Cap Value	-20.8%	-33.1%	0.4%
Emerging Markets		Benchmark Index: MSCI Emerging Markets	-26.9%	-33.0%	8.7%
		Benchmark Fund: Vanguard Emerging Markets ETF	-25.9%	-32.6%	8.0%
	*	DFA Emerging Markets Core Equity Portfolio (inception date 4/5/05)	-22.1%	-31.4%	8.9%
		Oppenheimer Developing Markets	-18.5%	-25.0%	10.1%
		SSgA Emerging Markets	-29.9%	-36.3%	8.1%
		T Rowe Price Emerging Markets	-30.2%	-36.5%	6.5%
Commodities		Benchmark Index: Goldman Sachs Commodity Index	-28.6%	12.7%	0.3%
		Benchmark Fund: iShares GSCI Commodity-Indexed Trust	-28.2%	14.1%	13.1%
		GSCI Enhanced Commodity Total Return Strategy Index ETN	-28.8%	12.7%	N/A
		iPath GSCI Total Return Index ETN	-29.1%	11.9%	N/A
		Oppenheimer Real Asset Y	-32.8%	6.3%	-0.8%

* Preferential Access Through Aspiriant

Returns are stated net of manager's fees, but before Aspiriant fees. All fund returns above are stated including the reinvestment of dividends and capital gains. Figures in bold reflect performance equal to or better than benchmark fund or, in cases where the benchmark fund's performance is not available, performance equal to or better than benchmark index.

The indices and benchmark funds included herein have been selected to allow for comparison of an individual investor's performance to that of certain wellknown and widely recognized indices and funds. The inclusion of an index or benchmark fund should not be considered a representation by Aspiriant that it is an appropriate benchmark, in all client circumstances, for specific securities, or against overall portfolio performance, nor is it a guarantee of individual investor performance that is greater than the benchmark. The performance and volatility of an individual investor's portfolio may be materially different from those of the indices and benchmark funds. Further, an individual investor's holdings may differ significantly from the securities that comprise the indices and benchmark funds. An investor cannot invest directly in any of the above indices, but could potentially invest in the benchmark funds. In preparing this presentation, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information (including performance statistics) available from public sources. This document is provided solely for informational purposes and is not intended to be an offer or solicitation, or the basis for any contract to purchase or sell any security or other instrument, or for Aspiriant to enter into or arrange any type of transaction as a consequence of any information contained herein.