Schaper, Benz & Wise
INVESTMENT COUNSEL
Trusted Advisor for Generations

18 Jewelers Park Dr., Suite 200 | P.O. Box 628
Neenah, WI 54957-0628 | 920.727.1137

Economic and Market Summary

October 2008

Quite a few market pundits, television commentators, and even government officials would have you believe we are near the abyss amidst a total breakdown of the financial system. References to the Great Depression have been bantered about, somewhat recklessly, in our opinion. Certainly, the financial markets are experiencing significant stress with the collapse and near collapse of various large financial institutions. The contraction of credit has been felt on Wall Street as well as Main Street. However, notable contributors to the Great Depression were policy mistakes by the government. Between 1930 and 1933, the Federal Reserve failed to replenish the banking system even though the money supply was shrinking due to thousands of bankruptcies and bank failures. Tariffs were raised by up to 50% on a wide range of goods, and this sudden rise in protectionism resulted in the collapse of world trade. The largest peacetime tax increase in the history of the United States was passed in a misguided effort to balance the budget. These mistakes can be avoided. The Federal Reserve has pumped an unprecedented amount of liquidity into the market. The government is working toward creating a comprehensive, viable solution that can effectively recapitalize the financial system while simultaneously protecting the taxpayer from the burden of additional government debt. Normalcy will return to the credit markets. Credit is the lifeblood of our economy, so it is imperative that confidence in the banking system be restored.

On a number of fronts, economic growth is slowing. Businesses have cut back their spending. The consumer is battling numerous headwinds. Nominal and real wage growth has been anemic in the last few quarters. The unemployment rate is going up. Debt ratios for the household sector are high and rising; the debt to disposable income ratio for average households has increased from 100% in 2000 to almost 140% today. One bright spot for the consumer is declining energy prices, while the economy as a whole is benefiting from lower commodity inputs. Exports were a strong contributor to GDP growth earlier this year but their impact may lessen as the economic slowdown spreads worldwide.

Worries about deflation, along with a flight to quality, have resulted in declining Treasury bond yields. Longer term, we are concerned about the inflationary impact of policies intended to fight deflation, namely the printing of dollars and associated dollar weakness. While the Treasury market looks richly priced, we are seeing value in short to intermediate term, high quality corporate bonds in companies we are confident can sustain and grow cash flow.

While we may not capture all of the upside in common stocks because we are reluctant to chase “hot” trends, our investment philosophy has historically been less volatile in times of uncertainty and slower economic growth. We predominantly invest in companies with consistent growth, sustainable competitive advantages, little debt, strong cash flow, improving profitability, and reputable management teams. Many of the companies we own are gaining market share and will emerge stronger from this downturn. Valuations can change dramatically day to day depending on market sentiment, but the underlying fundamentals of the companies we own remain intact.

Christi Salm, CFA