



CASTLE ADVISORY GROUP, LLC

Quarterly Newsletter



Gary
Pittsford, CFP®
Senior Advisor

Second Quarter Market Review 2008

While the NBER (National Bureau of Economic Research) has not yet officially classified the current environment as a recession, it certainly has felt that way for most of us. The following table shows the performance of some of the major market indices. As you can see, the results have not been pretty for investors.

Index % Returns for Periods Ending June 30, 2008

Name	June	Q2	YTD	1 Yr
DJ Industrial Average	-10.04	-6.85	-13.38	-13.27
MSCI EAFE (International)	-8.31	-3.50	-12.70	-13.04
NASDAQ Composite	-9.06	0.79	-13.22	-11.28
Russell 2000 (Small Companies)	-7.70	0.58	-9.37	-16.19
S&P 500	-8.43	-2.73	-11.91	-13.12
Lehman Bros Aggregate Bond	-0.08	-1.02	1.13	7.12



Darren Nyce
Senior Research Analyst

Each of these indices is down between 19% and 24% since their peak in October. As we have said previously, while down turns in the market like we are currently experiencing can be agonizing, they are neither rare nor unexpected. In case you missed our recent investment brief on "Weathering the Storm," you can find it in the "Resource Center" of our website www.castle3.com. In it, we give some historical context to our current reality as well as our investment philosophy to get through such times.



Micheal
Kalscheur, CFP®
Financial Consultant

As the story has been for most of the correction, the financial industry has been hit the hardest, and the consumer discretionary arena has also performed poorly. The energy and commodity sectors were the only ones providing positive returns this quarter. Growth-styled investments have outperformed value this quarter while small and large companies have performed about the same. Money market rates continue to stay at a bit less than 2 percent.

Though similarities exist in market cycles, the details behind the numbers are always different. The chief villains in this particular script have been a worldwide credit crisis, triggered by falling housing prices and rapidly rising oil prices, which have crimped the consumer's budget.

What started as an issue in the sub-prime portion of the housing market has spread into a much larger problem. Banks and other lending institutions have been forced to take losses on (write down) a significantly larger than projected portion of their outstanding loans. This has caused them to take a hit to their earnings, raise additional capital at less than ideal terms, tighten lending standards and reduce the number of new loans granted. Some have also been forced to reduce or eliminate their dividend paid to investors.

This reduction in the amount of capital that is now available will serve as a significant challenge to restore economic growth in the short term. The Fed has taken measures to provide liquidity by keeping rates low and offering a temporary Term Auction Facility; where institutions can exchange some of their illiquid securities (stuff nobody wants to buy right now) for highly rated government debt that is highly liquid. These actions have been beneficial and have served to keep the wheels of the financial system turning.

There is still some time needed for the industry to work through the remainder of the credit problems. While the worst may be behind them, there will likely be some surprises yet to come.

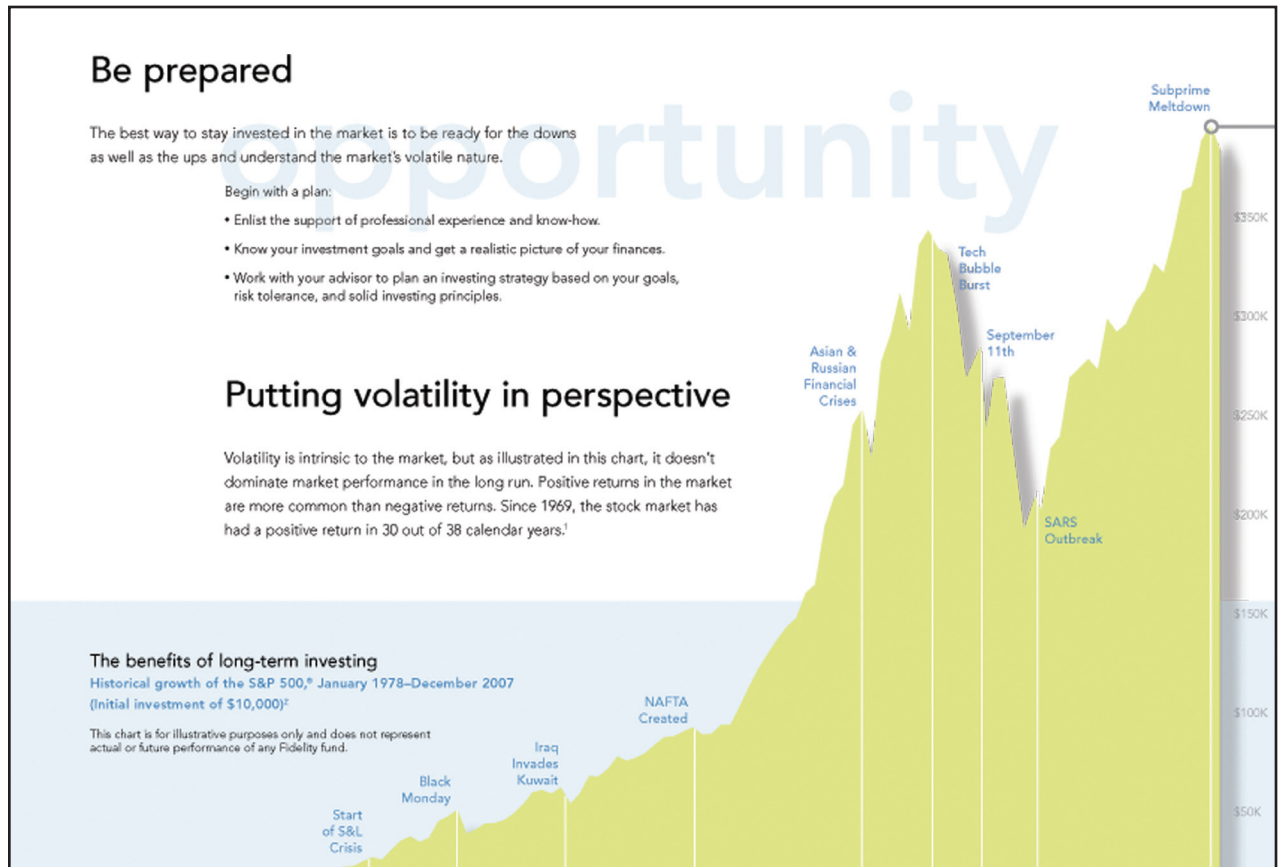
Rising inflation has had its share of the headlines lately. Energy and agricultural commodities account for 22% of the inflation rate and both sectors have seen dramatic price increases over the past year. Since wages have not been rising as fast as the cost of most consumer goods, we expect the lack of consumer demand to soften inflation in the second half of this year.

The most recent recession we had in 2001 was largely due to the cutback in spending by companies. In this current cycle, companies have done a much better job of keeping control of inventories did not overspend during the boon years and their balance sheets are in a much better situation to endure the current environment. This has been a primary reason why our country's GDP has remained positive, avoiding the technical definition of a recession.

The short-term outlook remains mixed. Consumer confidence is at a multi-decade low, but has historically improved around Presidential elections. Other positives are that the Fed has taken effective action, exports are growing, the consumer has hung in there (thanks in part to the recent stimulus package), and corporations have large amounts of cash on their balance sheets.



The problems we have discussed in this letter will continue to be an economic drag. However, this will not always be the case. We are confident that the economic system will work through these issues. Conditions will improve and good investments will be available at lower prices.



Graphic provided by Fidelity

We encourage you to remember that the long-term direction of the stock market has been and continue to remain upward, despite frequent periods of correction and the associated disappointment, as the chart from Fidelity Investments illustrates.

Continue to stay focused on patiently executing your investment strategy. In the meantime, we continue to emphasize holding higher than average amounts of cash and participating in various market neutral strategies and proper allocation and diversification.

Thank you for the opportunity to work with you in achieving your investment goals. We are committed to giving our best effort in this endeavor and appreciate the loyalty and trust you have placed with us.

