



Les Jepsen

**Investment Management  
Retirement Planning  
Goal Setting / Achievement**

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Dear Investors,

Simply and directly, here's an economic update.

Are we in a recession? If you ask 100 economists to define the term recession, you'd get 100 different answers. Business cycles (recessions included) are a normal part of a world of inexact balances of supply and demand. In the last 150 years, the U.S. has gone through 32 economic cycles; an expansion averaging 38 months, a recession averaging 17 months. **Recessions are ultimately good for the economy.** For example, they eliminate unnecessary employment and pave the way for expansion with new and better future employment. The stock market has increased on average 2.5% during a recession.

Charles Schwab & Company has **no exposure** to any of the sub-prime mortgages, illiquid securities and other "toxic" investments troubling many firms. Schwab has an extremely strong corporate financial position. Net capital balance is \$1.1 billion, \$912 million in excess of the regulatory minimum required regulatory net capital. Schwab has extra SIPC insurance through Lloyd's of London to cover \$149.5 million for each customer. Customer assets are always kept separate from corporate assets.

Funds such as the iShares Lehman 7-10 Year Treasury Bond Fund, iShares Lehman 20+ Year Treasury Bond Fund and iShares Lehman Inflation-Protected Government Bond Fund are valued on the treasury bonds and cash held in each fund. Based on the independently calculated Lehman bond indices, they are not managed or controlled by Lehman. Also, Schwab money market funds do not hold any Lehman securities and continue to maintain the \$1 net asset value for your investments.

The financial challenges facing Lehman, Merrill Lynch, Bear Stearns, AIG and others are stemmed from owning certain mortgage-backed securities, such as "sub-prime collateralized debt obligations". They borrowed and re-borrowed to own these risky assets to attempt to boost their corporate bottom line. When the unraveling began, they were caught holding the bag, resulting in a myriad of credit and balance sheet problems. Their management was unwilling to understand and face the risks in an overheated real estate market. Thus, tens of billions of these securities are being written off with losses totaling up to \$1 trillion.

The current turmoil in the financial world will reshape and reorganize the financial landscape with the ordinary cost of financial change having winners and losers. **The good news is this was not caused by a lack of demand for products and services. It's now truly survival of the fittest**; the companies making the most prudent, time-tested choices are being rewarded now and in the future.

Should the government intervene? Yes, and only if a case is in the best interest of the American people. The government took over Fannie Mae and Freddie Mac; also temporarily took over control of AIG with an \$85 billion loan and an 80% equity stake. More government action will be necessary; an overhaul of mortgage regulation should have happened years ago.

Stock market pullbacks happen quickly and they don't follow a recession - they come prior to a recession. In just four trading days the Dow lost 30.7% of its value, culminating with a 508 point Dow drop on Black Monday, October 19<sup>th</sup>, 1987. That's an equivalent of over a 3,500 Dow point drop today. The lesson learned is the Dow ended up 2.6 percent for the year in 1987, and **it was best to stay the course**.

Ten years ago the same type of financial pullback occurred, with the Dow backtracking 20% in less than six weeks, culminating with a 6.4%, 513 point drop on August 31<sup>st</sup>, 1998. The Dow went up over 55% from there in 17 months. Again, **attempting to jump out and back in is not the answer**.

Thank you very much for your business; it's a pleasure to serve you!

Sincerely,

A handwritten signature in black ink, appearing to read 'Les Jepsen', written in a cursive style.

Les Jepsen, MBA  
Jepsen Consulting