Pugh Capital Management INCORPORATED

4th Quarter 2008 Market Outlook/Strategy

This U.S. recession is destined to become the deepest and most destructive economic event since the Great Depression. Many of the trends that developed in 2008 will carry over to the New Year. The cumulative effects will test the capabilities of fiscal and monetary leaders in navigating treacherous and uncharted waters. The deleveraging process and tight credit conditions will continue to pressure asset valuations. As businesses downsize in response to the slowing economy, escalating unemployment will further depress consumer spending. Accelerating global economic weakness will translate into lower inflation.

Consumer wealth has been decimated due to weakness in housing and equity markets over the past two years. Housing market prices peaked in 2007. Equity market indices were down over 30% in 2008. In 2009, unemployment will rise above 8% to perhaps as high as 10%. This third strike against the consumer will cause a marked shift in behavior from a spending to a saving philosophy. Consumer spending accounted for 72% of GDP in 2007 up from a long term average of about 66%. While consumers continued to spend in recent recessions, this time the economy will be devastated by the magnitude of the consumer-led slowdown. The U.S. savings rate will rise as consumers repair their balance sheets.

Inconsistent government policy initiatives were instrumental in deciding winners and losers this past year. We expect significant fiscal stimulus and continued use of TARP money during 2009. Other initiatives that will directly impact investment grade securities are policies targeting housing and mortgage markets. While there are tremendous resources being allocated to the economy and markets, it will not be sufficient to halt the first half decline in the economy. The current credit crunch, combined with a recessionary environment is potentially hazardous to investors. It will be important to study government policies and position portfolios to benefit from their initiatives.

Pugh Capital's strategy for 2009 will be to increase exposure to the corporate, CMBS, MBS and ABS sectors. We view valuations as attractive and believe Government stimulus and resources being targeted to jumpstart the economy and the markets will ultimately prove successful. Deteriorating economic conditions, combined with illiquid financial markets favor a high quality emphasis within the portfolio. Liquidity will also be an important screen for new purchases to minimize the impact of wide bid/offer spreads. Careful security selection will be a key to outperforming the market, as the number of fallen angels, defaults and bankruptcies are expected to rise. Pugh Capital began moving to an overweight position in the fourth quarter. We currently expect to move to a significant overweight in spread product in the first quarter. New issue bonds that are priced with attractive concessions will be utilized as a strategy to add high quality, liquid corporate bonds to the portfolio.

Core and nominal inflation have both dropped precipitously. The global economic slowdown solidifies our expectations for lower inflation. As inflation declines, it will be positive for longer duration securities. The portfolio will be positioned to benefit from yield curve flattening. Pugh Capital will maintain a neutral to slightly long duration position relative to the Index. Interest rates are at record low levels, but given the weak economy there is limited risk of a significant increase in interest rates.