ASSET MANAGEMENT, INC.

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FOR QUARTER ENDING SEPTEMBER 30, 2008

TIGHT MONEY

ABOUT LEGACY

Legacy Asset Management, Inc. is an independent Registered Investment Advisory firm, committed to providing the best solutions for our clients' success.

We offer professional money management and sound objective advice throughout a full range of investment and Qualified Retirement Plan consulting services for the institutional and high net worth client.

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Changing Landscape

Like an expectant father, I spent what would normally have been a gorgeous fall weekend, nervously checking the internet looking for any indication that lawmakers in Washington would come to an agreement on what is now being called the "Emergency Economic Stabilization Act" (EESA). The free market proponents on Capitol Hill, who question the urgency and structure of the proposed intervention, are terribly misguided. The credit markets are tight, as banks are unwilling to lend because rapidly declining mortgage values are pressuring bank mandated capital requirements needed to cover their lending operations. Basically, financial institutions are hoarding cash because they don't know what their assets are worth. You know the situation is dour when AAA rated companies like General Electric (GE) can't get funding for 270 days (the typical duration for commercial paper), because lenders are uncertain about whether the company will be able to repay the loan. This unprecedented mistrust among lenders is putting significant strain on our financial system. Since the beginning of July, the entire financial landscape has undergone colossal change—insurer American International Group, IndyMac, Fannie Mae and Freddie Mac have essentially become nationalized, while Lehman Brothers, Merrill Lynch, Wachovia Bank and Washington Mutual have either filed bankruptcy or have had to merge with competitors in order to avoid bankruptcy filings. Goldman Sachs and Morgan Stanley (for capital reasons) recently filed regulatory papers to change their charters to depository institutions. These two companies will no longer be classified as investment banks, rather as traditional regulated commercial banks. In three short months, Wall Street as we knew it, no longer exists.

The Rescue Package

Why is this proposed legislation so controversial? First, size - $700 Billion (this is just the starting point) makes up 5% of the entire United States economy. Second, there is general mistrust of the government. The thought of having an appointed official overseeing a new federal agency with few rules, little oversight and no transparency or accountability as to how our tax dollars will be spent, is less than ideal. Additionally, there was a complete disconnect between the message and the messenger. Treasury Secretary Paulson and Fed Chairman Bernanke will never be confused as public relations experts. The dynamic duo was unable to: (1) clearly define the problem, (2) explain that this is not a bail-out but rather a loan from taxpayers to open a temporary clearing house, (3) detail how the proposed agency would operate to solve the problem and (4) show how all of this would benefit working families. Finally, ideology is having a huge impact on the success or failure of the legislation. Conservative Republicans and "Blue Dog" Democrats would prefer a private sector solution while liberal Democrats feel that the government is best suited to handle this crisis.

A New Market

It's tiring listening to the media mischaracterize the proposed legislation as using Main Street's, a.k.a ordinary Americans', money to bail out Wall Street. In reality, Secretary Paulson is proposing to establish a new market, where a separate government agency would operate as the clearing house. The market would be specifically designed to take questionable mortgage loans, derivative assets linked to mortgages, and credit default swaps off the balance sheet of U.S. banks and financial institutions and holding them until confidence can return to the housing market. Ideally, the Government would sell the mortgages and derivatives to private and public

investors (willing to take on the long-term risk of default) at a price in excess of their cost, making a profit if possible. Having the government step up and create a floor pricing mechanism attaches a minimum value to the troubled assets. With the pricing uncertainty eliminated, banks will be able to write-down the value of their mortgage portfolios to the floor value, enabling the lender to proactively address their capital needs for the future. As a result, financial institutions should regain both the ability and willingness to get back to the business of lending money.

I know this next statement might surprise many of you, but I think this piece of legislation must pass for two reasons. First, the only entity with the ability to quickly establish a new market with instant credibility, capital and the capacity to accurately facilitate trading in a non-liquid market is the U.S. Government. In addition, the Government has the only commodity that no other private or public institution has – time. With the speed in which the financial landscape is changing, the government is the only institution that has the luxury to wait for the housing market to improve without having to worry about its short-term capital adequacy.

Wall Street and Main Street Collide

Investors should not expect the equity markets to rebound quickly. Keep in mind that this rescue package is not designed to directly affect the equity markets. Rather, encourage lending and borrowing via the credit markets. With lending non-existent, companies can't get funding for either daily operations or capital growth projects such as new plants, equipment or product launches. Corporations respond by initiating layoffs, transitioning to lower production and cutting other operating costs where appropriate to maintain profitability. This translates into higher unemployment, lower wages and a significant reduction in consumer spending. Did I mention that equity prices will fall (savings deteriorate) as corporate profitability shrinks? If mom and pop store owner can't sell their goods because the consumer won't spend, then that store will not be in business very long. Therefore, in a convoluted way, what happens on Wall Street does significantly impact all socio-economic levels of Main Street. This is why I believe the media and politicians have this whole debate backwards. The mantra should be "Let's rescue Main Street, by supporting what's left of Wall Street".

3RD QUARTER REVIEW

"Black September"

It is difficult to look back at the past quarter without most of the attention being directed towards one particular month. In July, the markets were relatively quiet. The S&P 500 lost less than 1%, which it quickly made up the following month gaining 1.5% in August. The Dow and the NASDAQ actually posted gains in both of the first two months of the quarter. Then came "Black September"! In a single month, the Dow lost 6%, the S&P fell 9%, and the NASDAQ dropped 12%. Any modest progress that the markets had been able to make in the first 60 days of the quarter was quickly eliminated. By the close of business on September 30th, the S&P, NASDAQ, and Dow had lost 9%, 9.2%, and 4.4% respectively for the quarter. These losses would have been even higher had the markets not staged a respectable rally on the final day of the month.

The key word for investors appears to be "uncertainty". While many who follow the markets closely were already well aware of the turmoil in the financial sector, and *had* been for months, it soon became too big for even the smallest investor to ignore. So, on September 29th, when the House of Representatives voted down the $700 billion dollar Emergency Economic Stimulus Package, many Americans were not willing to wait around to find out what would happen next, and a panic quickly ensued. As confidence eroded, investors fled from anything with even the slightest hint of risk and rushed to cash or Treasury bills. On that day, the Dow suffered its largest point drop in history.

It is interesting to examine the way that individual sectors were affected over the course of the quarter. For the most part, financial companies were already reflecting the current crisis in their stock values, which remained relatively unchanged. In fact, banks, as a unique division of that industry, managed to gain over 26%. Of course, despite these combined gains as a group, individual banks remain a very risky investment at this point in time. The stocks that were actually hit the hardest were those that had done particularly well over the first half of the year. Oil was down 28% for the quarter, while energy stocks dropped 25%. Looking at the market as a whole, small-cap stocks were the only group to make it through the quarter relatively unscathed, finishing the period close to where they started, while value stocks outperformed growth by an average of 7%.

From a global point of view, the U.S. emerged from the quarter on comparatively solid ground. While the Dow Jones Index dropped 4.4% over the last three months, the Dow Jones World Stock Index, which does not include American companies, dropped 22%. At the same time, the dollar strengthened 12% against the British pound and 11.8% against the Euro.

What's an Investor to Do?

There are plenty of uncertainties that are clouding the investment landscape. From politics to geopolitical and economic factors to tax policy, not to mention the viability of our financial system, investors have a plethora of factors to weigh on every decision. As you know, the financial markets don't like uncertainty. However, there are some positives that

should help ease the decision-making process. America is not going to shut down. Even in the worst case scenario – the U.S. falls into a prolonged recession – business will continue to operate. Even in the recessions of late 1989–1990 and 2000–2001, some sectors of the economy continued to operate and provide investors with decent returns. For example, consumer staples, healthcare and the utility sectors all declined less, than rebounded into higher territory before the S&P 500 could get back to even money. We like these defensive sectors as Americans must continue to buy basic necessities of life, go to the doctor/hospital when they are sick and turn on their electricity.

In addition, we continue to look for companies with a cash hoard, low debt, and those which pay dividends. According to Ibbotson, from 1927–2002, over 40% of the compounded annual growth of large-cap equity indices can be attributed to dividend payout. In this market environment, investors should review the ability of any company to sustain its current dividend policy. Examples of classic low debt, strong cash flow companies that pay a greater than market dividend include Exxon, Procter & Gamble, Pepsico, Johnson & Johnson, and Abbott Labs.

Regardless of the economic environment, these companies should survive. There are many other companies in these same sectors that we are evaluating that have attractive valuations for long-term investors willing and able to hold on to securities during these volatile times.

QUARTERLY ACTIVITY

Legacy did not add any positions to the portfolio this quarter.

Legacy liquidated or reduced positions in the following companies:

Wells Fargo (WFC): In August, we sold all of our positions in Wells Fargo due to excessive valuations relative to potential risk. At the time of execution, the bank was selling at a P/E ratio of 16X, which is a 9% and 30% premium to its two closest peers, JP Morgan and Bank of America, respectively. Its P/B ratio was even more distorted selling at premiums of 100% and 200% relative to the same two peers. What concerns us the most about Wells Fargo is the potential write-downs that we believe are on the horizon due to a jump in illiquid mortgages (termed level-three) by almost $2 billion. Most of these mortgages are classified as prime, the segment with the fastest rate of growth in defaults in the mortgage arena. In addition, another level of concern centers around its short-term borrowing which grew 60% to $86.1 billion. Management is competent, but there are many land mines that need to be avoided. We believe there are better valuations for the same risk profile.

U.S. Bancorp (USB): We sold U.S. Bancorp for much of the same reasons as those stated above for Wells Fargo. At the time we sold the stock, USB was selling at a P/E ratio that represented a 13% premium to its peer group of regional banks and a 9% premium to JP Morgan. In addition, its Price-to-Book Ratio (the standard metric for value in the sector) was almost twice as high as the median for all U.S. money center banks. U.S. Bancorp did have an attractive dividend yield. However, like Wells Fargo, we believe that the risk return profile was getting a little high for our taste.