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ECONOMIC UPDATE

John C. Beuerlein
Managing Director,
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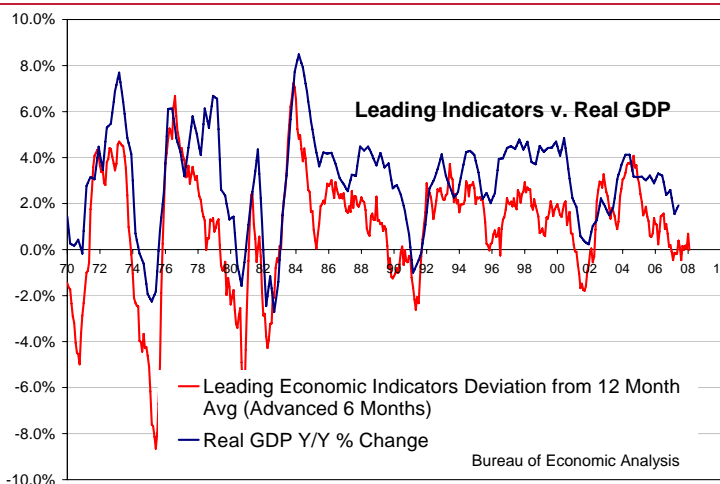
In last quarter's economic update, I described the economy as being in a mid-cycle slowdown. GDP was slowing, although corporate profits were still positive. Core inflationary pressures were lowering, but employment growth was relatively steady. The housing sector detracted from overall economic growth, but was not expected to broadly impact the system. The economic scale seemed poised between the possibility of rising inflation, which would lead to higher interest rates, and weaker growth, which would portend the lowering of interest rates. In such ambivalence and uncertainty, increased volatility in the markets was likely to occur.

Looking back over the past quarter, we have seen several significant developments. Concerns about the "spill-over" of underperforming sub-prime mortgage debt into the bond market led to a temporary liquidity crisis, as even credit-worthy borrowers had limited access to funds. This caused the Federal Reserve to lower the Fed Discount rate on 8/17 and again on 9/18, and to lower the Fed Funds rate by ½% on 9/18. Although the Fed remains very attentive to inflationary pressures, its recent statements have noted that the downside risks to growth have increased appreciably, and thus its focus will also be on economic growth.

Here are some specific measures of the past quarter and indicators of what may lie ahead.

ECONOMIC GROWTH

The preliminary reading on 2nd Quarter Real GDP is that it increased at a 4.0% rate. This is the strongest quarterly growth rate since first quarter of 2006; however, the yearly growth rate remains anemic at 1.9%, well below the historic long-term growth rate of 3 – 3.5%. Personal consumption expenditures were up only 1.4% in the 2nd quarter, down from the 3.7% increase in the first quarter. The relationship between Real GDP and Leading Economic Indicators suggests that economic activity is likely to remain below trend for the upcoming 2 quarters, particularly in view of the current liquidity crisis.



INFLATIONARY PRESSURES

Core inflationary pressures continue to drift lower. For the 12 months ending July, the Core PCE is at 1.9% -- just below the upper bound of the Fed's target range for inflation. Significantly, despite a weak dollar, relatively strong commodity prices, and historically low interest rates, inflationary pressures have remained subdued since the mid-1990's due to productivity improvements, globalization, and credibility of the Fed's monetary policy.

EMPLOYMENT

After averaging gains of 188,000 new jobs per month in 2006, employment gains in 2007 have slowed to an average of 108,000 per month for the first eight months of the year. There is no doubt that the August employment numbers released on September 7 were a surprise to most—including the Federal Reserve. August employment actually declined for the first time since 2003. This factor, together with the impact of the troubles in the credit market, played a significant role in the lowering of the Fed Funds rate by ½% on 9/18/07.

CORPORATE PROFITS

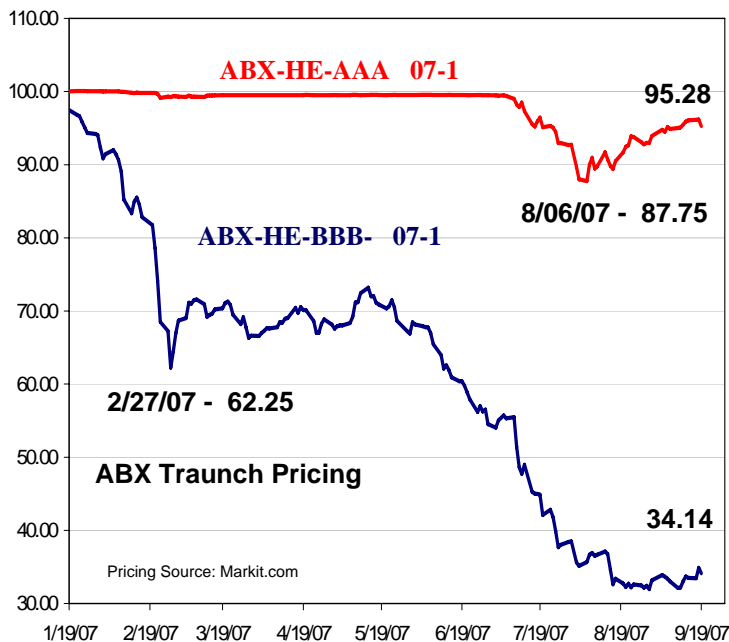
Second quarter operating earnings were 9.9% higher than those of the second quarter of 2006; however, the expectation for profit growth in 2007 is in the 5 – 7% range. Liquidity remains near its low levels of the past 2 years, although it appears to be forming a trough. An increase in liquidity would typically improve retail sales and profit growth.



INTEREST RATES

Expectations for future rates have fallen sharply since the beginning of July, accelerated by the recent cut in the Federal Funds rate. Forward rate curves for 12/31/07 and 6/30/08 indicate that the markets are expecting the short end of the yield curve to decline by another 50 basis points over the next 9 months. While the spread between high yield bonds and 90 Day T-bills has widened 280 basis points over the past 6 months, it is still about 100 basis points below its ten year average. Spreads for higher quality paper are 50 to 75 basis points below their 10 year averages. The flight to quality reached a zenith on 8/20/07 when the short term T-bill rate registered 2.40%. While it has rebounded to the 3.75% range, it is a situation that requires constant vigilance by the Fed.

The ABX-HE index is the asset backed index for home equity. It is a synthetic index consisting of 20 residential mortgage-backed securities issued within the past 6 months. A new index is created every 6 months. The AAA quality index started in January 2007 (at a base of 100), dropped to 87.75 on 8/06/07 and rebounded to 95.28 as of 9/19/07. This is in contrast to the BBB- comparable index, which dropped to 34.14 by 9/19/07.



The commodities (CRB) index has reversed its 5-year uptrend, signaling to the Fed that inflationary pressures are beginning to subside. Another round of interest rate increases is not likely to commence until commodities give evidence of another sustained uptrend.

HOUSING

Based on July data, new home sales were down 10% compared to a year earlier, and have fallen 37% from their peak in 2005. Housing starts are at 14 year lows. Existing home sales were down 9% on a year/year basis through July, and have fallen 20% from their 2005 peak. The median price of homes sold (new or existing) remains essentially flat on a year/year basis. Several different analyses indicate that home prices need to fall at least 10% in order to make a substantial improvement in the inventory overhang of unsold homes.

STOCK MARKET

The typical drivers of equity performance are interest rates and earnings trends. The recent liquidity crisis has added another variable that is having a significant impact on the immediate direction of equity prices. Whether or not this crisis has long-term ramifications to the direction of the equity markets, it is the source of the increased volatility we are experiencing today. Recent action by the Federal Reserve to cut the Federal Funds and Discount Rates has helped to stabilize investor market psychology, although the economic impact of these actions typically is not evident until several months after the action.

Comparisons have been made to 1998 when markets fell 20% in 2 months. (Most domestic equity indices corrected 10% from their July 2007 highs). Fortunately, valuations are more attractive today on an absolute basis and on a relative basis to bonds. Forward P/E's today are around 15 compared to 20 in 1998. Measures of corporate indebtedness are also more favorable today.

FINAL THOUGHTS

The recent easing in interest rates by the Federal Reserve was supported by three fundamental economic factors: 1) inflation was within the Fed's target range; 2) economic activity has been growing below the long term average for 4 of the last 5 quarters and was at further risk due to the current liquidity crisis; and 3) the overall credit system is suffering from a lack of confidence and a constriction of liquidity. The Fed does not want the economy to grind to a halt due to the inability of credit worthy entities to access the credit markets. But it also does not want to be viewed as bailing out entities that have incorrectly evaluated risk in the markets nor does it want to give birth to another wave of speculation by providing an excess amount of liquidity to calm the current situation. If push comes to shove, however, it is likely that the Fed will err on the side of providing too much liquidity instead of withholding it. Although recession risks have certainly increased since the beginning of the 3rd quarter, the more likely result continues to be that the Fed will supply the needed liquidity to keep the economy growing without a recession, albeit at a below-trend pace.

We are heading into the strongest seasonal time for the equity markets (October – April), and we are heading into a presidential election year (historically, a relatively strong time for the markets). Couple these tendencies with low inflation, a supportive Federal Reserve, a growing economy (outside of the housing sector) with accompanying growing corporate profits, and reasonable equity valuations, and it appears that most long-term fundamental and technical factors are supportive of the equity markets. These factors don't preclude ups and downs, but are supportive of the continuance of the primary trend in equities, which is up. In addition, the global profit expansion has been the strongest on record, enabling foreign markets to decouple from the influence of the U.S. and provide returns that have been relatively stronger than those in the U.S. over the past 5 years. This trend is expected to continue.



TOOLS OF THE FED

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*Senior Vice President,
Senior Investment Officer*

Two of the primary missions of the Federal Reserve, the nation's central bank, are to pursue "maximum employment, stable prices and moderate long-term interest rates" and "to maintain the stability of the financial system and contain systemic risk that may arise in financial markets."¹ It is no wonder then, that the Chairman of the Federal Reserve has been called the second most powerful person in America. But, with the exception of economists, most of us do not pay much attention to the Fed until an economic event puts it in the forefront of the press.

Recent events have again put the spotlight on the Fed. While lively debates about **what** the Fed should do are common, **how** the Fed achieves the desired results are oftentimes less understood. In this article, we will examine the tools the Fed has at its disposal to help the economy stay on an even keel. These tools include:

THE FEDERAL FUNDS TARGET RATE

This is the most commonly used tool. It is the rate at which depository institutions borrow money from each other to maintain the required level of reserves with the Fed. The Federal Open Market Committee (FOMC) sets a target rate for this key short-term interest rate based on its view of the economy and inflation. The actual mechanism through which this rate is achieved is through the buying and selling of government securities by the Fed in the open market. Simply put, the Fed can purchase government securities from member banks, thereby increasing the banks' cash reserves, enabling them to loan out more money at lower interest rates. Conversely, the Fed can sell government securities to member banks, thereby decreasing their cash reserves, restricting their lending capacity, and causing interest rates to rise. The most recent reduction in the Fed Funds rate on September 18 was effected with the hope of preventing any further slowdown in the economy by providing additional liquidity.

THE DISCOUNT RATE

While banks' first source of short-term borrowing is from other member banks, they may secondarily turn directly to the Fed. The "discount window" of the Fed allows institutions to borrow funds to meet temporary shortages of liquidity caused by internal or external disruptions. The discount rate is generally higher than the Fed Funds rate. Again, on September 18 the Fed also lowered this rate to provide additional liquidity to the monetary system.

OTHER LIQUIDITY INJECTIONS

The Fed can also temporarily impact the Fed funds rate by adding or withdrawing reserves from the banking system through the buying or selling of repurchase agreements (Repos). This is a valuable tool if the Fed does not wish to permanently change the rate.



RESERVE REQUIREMENTS

The Fed has the authority to require that depository institutions maintain a percentage of their deposits on reserve with Federal Reserve Banks. While the Fed can change the reserve requirement rates, it does so infrequently, preferring to use this tool only in the face of a significant financial event.

JAWBONING

Through speeches and testimony the Fed Chairman (and key Fed officials) can often obtain the desired result, disclosing how the Fed would likely interpret certain economic conditions or activities.

WORKING WITH FOREIGN CENTRAL BANKS

In today's globally entwined economy, it is critical that central banks do not take actions that contradict each other. The Fed does its best to coordinate its actions with other central banks.

WORKING WITH CONGRESS AND THE ADMINISTRATION

The Fed will work publicly (see "jawboning") or behind the scenes to suggest or dissuade legislation that can help ease certain dislocations. Recently, the Fed Chairman has been recommending that Congress go slow in reacting to the housing issue.

The Fed does its best to prepare the markets for its actions. It is critical that the Fed appear to be in control of a situation. If not, the financial community may believe the Fed is "behind the curve". The resulting loss of confidence in the Fed's ability to balance economic growth and inflation could in turn be very detrimental to the financial markets.

¹For additional information, refer to the Federal Reserve System Purposes & Functions available at <http://www.federalreserve.gov>.



"I need some short-term economic stimulus."

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WORKING WITH YOUR PROFESSIONAL ADVISORS TO KEEP YOUR ESTATE PLAN ON TRACK

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It is not surprising that so many of us put off estate planning. Contemplating possible incapacity and certain death is uncomfortable. As well, estate planning often involves making difficult decisions on sensitive family issues. Another major reason for procrastination is simply our natural reluctance to make decisions in the face of a seeming sea of change - changes in one's family, financial situation, personal goals and objectives, as well as changes in tax law. "I'll do it when things are more settled," we tell ourselves, though deep down we know that change is one of the few constants in modern life.

And yet, the costs of delayed and inadequate estate planning can be enormous. The costs are measured not only in monetary terms (avoidable taxes and expenses), but in the lost opportunity to ensure your wealth will ultimately be used to best benefit the people and purposes you care most about.

What to do? To begin, accept that estate planning is an ongoing process, not a one-time event. Your estate plan in your 30's will undoubtedly look very different than the plan you may have in your 60's. The best you can do, and the minimum you should do, is to plan for your situation today, hoping that you will have opportunities to adjust your plan as future developments warrant. Since you can't know precisely when your plan will "mature," it is vital to always have a plan in place that addresses one's current concerns and issues.

The burdens of planning your estate can be greatly eased by working with the right team of professional advisors. First and foremost, it is crucial to work with a qualified estate planning attorney with whom you feel comfortable and can have an ongoing relationship. To enable your attorney to craft and maintain an estate plan for you that accomplishes all it should, he or she will need detailed information about your family and financial situation, as well as a deep and full understanding of your goals, objectives, and risk tolerance. Make sure to inform your estate planning attorney when you have a significant personal or financial change in your life. Even if no major changes have occurred, it is an excellent idea to meet with your estate planning attorney every two to three years to confirm your plan is still on track.

In the best case, your professional advisors - attorney, tax accountant, investment advisor, and insurance specialists - will work together as a team to share information and perspectives. Holding periodic group meetings will insure that all available information and viewpoints can be considered and efforts on your behalf are coordinated and integrated. You and your team must also have a "commitment to completion" for your estate plan, making sure that there is follow-through on the details and a clear understanding of responsibilities for completing necessary tasks. Have beneficiary designations for your retirement plans and insurance policies been correctly completed? Are assets titled in the manner contemplated by the plan? Failure to attend to these types of matters can wreak havoc on even the most expertly conceived plan.

These statements are the opinion of Marquette Asset Management, Inc. and are subject to change without notice. This information is not intended to be used as the primary basis for investment decisions and should not be construed as advice designed to meet the particular investment needs of any investor, as individual investment plans will vary based on investment objectives and a number of additional factors. Please remember that past performance is no indication of future results and this publication makes no representation concerning actual future performance of the markets or economy. Please consult with your tax preparer and/or legal counsel as appropriate. Trust services are provided by Marquette Trust, an office of Meridian Bank, N.A.

It is also important to understand the roles you and your advisors should play in your estate planning journey. Your role is to determine the "destination" - identifying what you want to accomplish with your wealth that is important and meaningful to you. The role of your advisors is to help you determine how to get there most effectively and efficiently. A proper functioning team of advisors will have the skills to ask the right questions and help you articulate your concerns and clarify and refine your objectives. As unique as your situation is, your professional advisors have faced many of these issues before with other clients and their experience can be invaluable in helping you explore solutions.

Working with your professional advisors to design and maintain an effective estate plan is time and money very well invested. You owe it to yourself to spend the time and comparatively small expense to make certain your plan reflects and fulfills your goals and values.



INTRODUCING...

Ben Peyton
Relationship Manager

We are delighted to introduce Ben Peyton, our new relationship manager. Ben will work with John Pohlad and John Fabie in developing new client relationships for the firm. Prior to working at Marquette, Ben worked at Cargill in the commodities trading group, and prior to that in the reinsurance and commercial real estate industries. He is actively involved in Courage Center and is a past board member of Free Arts Minnesota. Ben received his B.A degree in Economics and a minor in Mathematics from the University of St. Thomas.

OUR GUIDING PRINCIPLES

- Integrity** The core of who we are and the way we live
- Expertise** Knowing our profession and practicing it with passion
- Advocacy** Being active champions of our clients' financial interests
- Confidentiality** Ensuring client privacy