Fulton Financial Advisors

Capital Markets Outlook

The Economy ♦ Fixed Income ♦ Equities

OVERVIEW

The YTD performance of the S&P 500 is -11.7% and has fallen about 2.5% since our March report which was -9.24%. But the components are vastly different. Large Growth improved nearly 1.3% to -8.7% YTD from -9.98% in March. Large Value lost 4.8% more to -13.4% YTD on the heels of weak financials and a weak bond market, which reversed its rally of the first quarter as rates began to move higher. The second quarter of 2008 delivered more disappointing and unexpected news from the financial sector while the economic news has been surprisingly better than expected with the consumer spending more than predicted.

The Dow Jones Industrial Index has fallen about 19% from its October high but is still shy of a 20% drop reserved for a bear market definition. Here is the scoreboard with our major products and their performance as of June 26, 2008:

	June to Date	Year To Date	12-Month Return
Strategic Growth Portfolio	-5.50	-7.49	-2.38
Common Stock Fund	-5.44	-7.42	-2.30
Retirement Common Stock Fund	-7.52	-7.88	-7.17
Russell 1000 Growth	-6.84	-8.70	-4.87
Value Stock Fund	-10.46	-15.47	-20.99
Russell 1000 Value	-9.39	-13.40	-17.93
S&P 500 Index	-8.21	-11.70	-12.28
MSCI EAFE Index	-8.12	-10.90	-9.65
Lehman Inter Govt/Credit Index	-.02	1.39	7.60

Comments and Outlook for the Balance of 2008:

The Economy

- Our view is that the economy has postponed a possible recession. The current unexpected strength from the stimulus package and low interest rates is being challenged by persistent increases in energy across the board. The oil market has escalated the uncertainty for the economic environment and some experts call it a “bubble” in the making.
- This mild economic growth should continue as the FED rate cuts work their way through the system and GDP growth for 2008 will be unchanged to + 1%. Typically rate cuts take from 6 to 12 months to have the desired effect.
- Our position remains that core inflation will remain above the Federal Reserve’s (FED’s) target range of 1-2%, but will not spin out-of-control, because wages are contained and housing weakness will anchor consumer spending.

The FED

- The FED has completed its easing cycle according to most pundits and will watch and observe whether its efforts and the rebate program will cause acceleration in inflation. Indeed, since last August FED funds have dropped from 4.5% to 2% and crude oil has risen from $75 a barrel to the current $135.
- The persistent problem for the financial sector has been the premium rates borrowers must pay for loans or bond offerings in the credit markets. As the FED lowered rates last year, the premiums expanded and have risen further, i.e., the yield on 5 year US Treasury bonds has gone up from 2.25% in March to 3.5% currently. Bond buyers and

other providers of credit are still skeptical because of housing weakness, rating agency turmoil, lack of transparency in reporting, and unexpected losses like that announced by AIG.

- We continue to expect the FED Funds rate, which is 2%, and the 3-month Treasury bill rate, which is now 1.88%, to eventually converge as in other cycles. If the 3-month Treasury bill rate exceeds FED Funds for a few weeks, we would expect the FED to be inclined to raise rates. The potential for an additional round of lower rates would be caused by accelerating weakness in the economy.

The Bond Market

- Last quarter our position was that US Treasury bonds offered little value relative to inflation. Bond rates have risen and are now above their January 1 levels owing to the uncertainty of oil, commodities, and thus inflation.
- We recommend purchase of high quality corporate bonds in the 1 to 3 year maturity range and government agency bonds that are callable 12 months and longer.

The Stock Market

- Corporate profits should decline this year with weakness in the financial and the consumer discretionary sectors.
- Oil consumption as a percent of GDP is rising and approaching the levels of 1980 and 1981, which caused a worldwide economic recession. Today's low rates and strong foreign economies should prevent a repeat.
- The degree to which the FED is successful in avoiding a recession will be the dominant factor for the outcome for stocks in 2008.
- Stocks will rise moderately from here as multiples expand. Profit margins are key.
- Volatility will be a continuing characteristic of the stock market in 2008. Past periods of volatility have presaged leadership changes in the stock market. We are on guard for new emerging leadership.
- We continue to emphasize large-cap over small- and mid-cap stocks; and favor large growth over large value.
- International investments should do well on the back of the weak dollar.

Risks

- Unexpected expansion of the oil crisis, credit failures, housing foreclosures, and derivatives problems.

ECONOMIC COMMENT

While it will not be confirmed until August, it is likely that the economy was able to avoid a contraction for the first half of 2008, to the surprise of many. Economic growth in the first quarter of this year was by no means robust but did occur at an unexpected annual pace of 0.9%, and we would expect this quarter's number to be positive as well. The employment picture continues to weaken since the beginning of the year as job losses through May totaled 324,000. These were the first negative numbers since August 2003 when a total of 427,000 jobs were lost over a five-month period. Even more troubling is the jump in the unemployment rate from 5.0% to 5.5%, the highest level recorded since October 2004. However, leading economic indicators posted their third consecutive non-negative number in May, fully reversing a trend of negative data that ranged from October 2007 through February 2008. We are beginning to see some other signs of modest strength as well. Factory orders in April increased 1.1% during the month and although this was less than the rate in March, it was far greater than expected. The ISM manufacturing index for May was up to 49.6 from 48.6, even though an index of only 48.5 was forecast. Retail sales in May increased 1.0%, double the pace expected. Finally, the ISM non-manufacturing number was up 0.4 to 51.7 while a reading of 50.1 was expected. This is significant because non-manufacturing activity (services) accounts for 90% of our economy today. The housing sector continues to search for a bottom with no end in sight, while the industry's statistics remain very depressed. Pending homes sales, housing starts, building permits, and existing home sales have all contracted during the April-May period. The only bright spot was the increase in new home sales in April by 3.3% over the prior month. Many previous recessions have commenced with a weak housing market. We do believe, however, that the efforts by the Federal Reserve and the government to stimulate the economy both monetarily and fiscally will pay dividends, and we may be seeing the effects sooner than we could have imagined last quarter.

FIXED INCOME COMMENT

In the second quarter, the fixed income market reversed a trend that had begun in 2007 and continued through March of this year. The "flight to quality" mentality finally eased a bit in late April and May Agencies and corporate bonds began to outperform Treasuries as we had hoped for quite some time. The Federal Reserve, which engineered a very accommodative monetary policy in late 2007 in response to a rapidly slowing economy, appears now to have reached a cyclical bottom in their intervention. The FED has lowered short term rates by 325 basis points since last September, including several times this year, but at the most recent meeting in late April, they abstained from additional rate cuts. This was not unexpected by market participants, but it did give cause to reflect on potential moves going forward by the central bank. The concern is the current and potential rise in inflation brought on by not only higher food and energy expenditures but by the accommodative FED policy of late and the amount of liquidity that has been injected into the credit and capital markets since the beginning of 2008. The movement in price levels has been troubling to say the least. The consumer price index has risen 4.2% for the past 12 months and even when adjusted for food and energy, the number is still 2.3%, far above the FED's desired target limit. At the producer price level, which eventually flows to the consumer level, the same figures are 7.2% and 3.0% respectively. The FED made it apparent last year that stimulating the economy was more important than controlling inflation. Now, we believe the mandate has changed to one of seeking price stability. This is good news for the fixed income markets that normally sell off on higher inflation. Indeed, the market's expectation for higher interest rates is perhaps as early as the end of the third quarter. Given this adopted bias against inflation, we would continue to recommend a duration neutral position versus benchmarks and a maximum maturity in new, high quality investments no longer than three years.

EQUITY COMMENT

Large Cap Growth Strategy – Our tactical allocation favors a growth tilt in our large-cap holdings. FFA offers a number of investment vehicles to build account exposure in this area including exchange traded funds (ETF's), index funds, actively managed mutual funds, Overlay and SMA managers in addition to our own proprietary in house products - the Strategic Growth Portfolio, the Common Stock Fund and the Retirement Common Stock Fund. Our investment approach applies a top down sector and industry approach to portfolio construction in concert with a concentrated stock selection process.

Our strategy from the first quarter remains intact. We believe the economy will continue to perform poorly, exacerbated by rising food, energy, and commodity costs. We positioned the portfolios in the first quarter with this scenario in mind by overweighting sectors such as energy, consumer staples, health care and technology. Conversely, we underweighted economically sensitive sectors like consumer discretionary, materials and to a lesser degree, industrials. The portfolio construction process is further refined to the industry level within each sector. While these sector and industry bets have enhanced our returns, individual stock selection still accounts for about three quarters of our outperformance relative to the benchmark. For example, we are overweight the energy sector, which has somewhat supplemented our returns, but our subsector emphasis on oil service, drilling and exploration firms at the expense of exposure to the large integrated producers (like ExxonMobil) made an even bigger contribution to performance. However, the greatest source of outperformance can be attributed to the securities that we have selected, such as Weatherford, Chesapeake Energy, and Devon Energy all of which have all done extremely well within their respective industries. Detracting from our performance most notably, has been our underexposure to materials, especially the agricultural subsector, which we will reexamine going into the third quarter.

Overall our discipline has guided us to emphasize larger capitalization companies with greater global economic exposure and the ability, if needed, to more easily tap credit markets. We continue to believe that smaller companies will continue to suffer in a weak dollar and contracting bank credit market environment.

SECTOR COMMENTS

Finance - Unlike previous cycles, financials have reacted poorly to rate cuts by the FED. US bank stocks relative to the overall market are currently down 48% from their peak in '07. This level is slightly above the lows seen in 1991 and 2000. Clearly, values are becoming attractive, however, we believe more surprises are ahead. The current liquidity squeeze, de-leveraging of capital markets and banks, the inevitable increase in government oversight, increased mortgage delinquency rates, foreclosures, and declining capital ratios ensure the process will take more time. We believe a lasting bottom in the banking subsector will occur later this year.

We favor asset management and custody banks and insurance sub sectors in the interim. We particularly like Bank of New York Mellon (BK), CME Group (CME), and Metlife (MET).

Healthcare – Since the March lows, mid-cap and small-cap stocks have outpaced large-cap stocks and the environment for mergers and acquisitions remain favorable for the sector. Historically, healthcare's strongest seasonal patterns tend to run from May through December, except during election years. Seasonal strength is muted during election years, except when the incumbent loses. Life Science tools and services, healthcare equipment, hospitals and HMOs tend to be the best performing sub-sectors in election years. For contrarian investors looking to bottom-feed, HMO's and hospitals have potential. Overall, healthcare should perform inline with the broader market during the second half of 2008.

Consumer Staples – After outperforming in the first quarter, staples have given back most of their outperformance in the second quarter, atypical during periods of economic uncertainty. However, with the market and the economy struggling to gain traction, we continue to overweight this defensive sector. We are concerned about valuations in the sector as well as continued profit margin pressure because of rising input prices and intense competition. On a positive note, the group tends to be more global in scope and their revenue growth has received a boost from the weaker dollar. The sector averaged a 12% increase in revenue in the first quarter. Many firms are increasing prices and developing initiatives to reduce operating costs. We recommend hypermarket retailers such as Wal-Mart and Costco because they are able to control costs and benefit from the economic headwinds faced by the consumer.

Consumer Discretionary – This catchall sector includes nearly 30 unique industries including durables, apparel, retail, leisure, homebuilding, entertainment, and media. Earnings expectations have been lowered substantially and the consensus growth rate has dropped from 24% to 3% currently. Despite low interest rates and relatively low unemployment, the consumer is facing a range of well-known headwinds and the expectations for consumer spending is low and getting lower. The sector typically is a strong performer following a series of rate cuts and before economic growth accelerates. We will look to move from an underweight position when valuations become more attractive by historical standards and relative to other sectors.

Technology – Corporate capital spending budgets have been shrinking, however technology initiatives remain a top priority for large operating businesses. Consistent spending bodes well for many of the large, well-capitalized companies that we continue to hold in our portfolios. With slowing revenues, companies will also focus on paying down debt to protect margins; meaning credit quality becomes all the more important when investing. Examples of some of the high quality names we like are Cisco, EMC, Intel, Apple, and Corning. Many of these companies will benefit from the specific trend of growth in Internet Video, which has grown from 5% of Internet traffic in 2005 to an estimated 30% by year-end 2008.

Energy – The price of crude oil, natural gas, and coal have risen at a record pace during the first half of 2008 with crude oil finding a new trading range of $130 to $140 a barrel. Despite a decline in domestic demand, overseas demand remains strong and geo-political tensions are heating up. Most of the energy sector, outside of refining stocks, has performed well with commodity prices soaring. The performance of natural gas exploration companies like Chesapeake, deep water drillers like Transocean Offshore and Noble Corp. have been exceptional, and we continue to like these companies. The energy sector seems poised for a pullback, but we would use such an event to add to positions. Even with a slowdown in energy demand, geo-political tensions and the approach of the hurricane season should limit the downside in energy prices.

Industrials – Despite a major economic slowdown for the U.S. economy, most of the names we cover in the industrial sector have reported solid first quarters in 2008. The strength has come from a continuation of strong international business aided by a weak U.S. dollar. We continue to market-weight the sector with emphasis on companies with strong overseas business and the ability to pass on higher fuel costs in their products and services. We recently added Harsco, which is well positioned to benefit from trends in infrastructure and industrial spending, as 66% of its revenue comes from overseas.

Materials and Utilities - We continue to favor the agricultural themes and underweight utilities.