



THE FOXHALL GLOBAL OUTLOOK



SEPTEMBER 4, 2008

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Dear Paul,

You have often written that “HARD ASSET” commodities and Asian markets are in “LONG-TERM BULL MARKET INVESTMENT UP-TRENDS.” But FOXHALL CAPITAL has recently moved most of your holdings to bonds because commodities like oil and gold, as well as Asian markets have gone down

recently in short-term stock market corrections. I know investors should not pay attention to short-term stock market movements, but when do you think commodities and Asian markets will start going up again?

ANSWER:

At FOXHALL CAPITAL we “FOLLOW TRENDS” rather than try to predict short-term stock market ups and downs.

People tend to have short memories—In August 2007, oil prices dropped about 20%—just as they have this year after first climbing to new highs. I remember receiving calls from investors asking if they should move their portfolios out of commodities like oil and gold.

Just like today, TV pundits were predicting that the bull market in oil and other commodities was over and I remember one commentator predicting that oil would be down in the mid-\$30’s per barrel this year.

Well, we all know that didn’t happen and now, one year later, we think \$110 per barrel of oil is cheap.

While there has been some recent “investment speculation” in the oil market, almost all of the top global energy analysts believe that oil and other commodities will start going up again by the end of the year or the first quarter of 2009.

One of those who believe in this trend is one of the greatest investors in the United States, MOHAMED EL-ERIAN. He is the former head of HARVARD UNIVERSITY’S \$35 billion endowment fund and now he is the co-CEO of PIMCO, the world’s largest bond investment firm.

In a recent article in BARRON’S his “PORTFOLIO FOR A NEW ERA” calls for investment portfolios to allocate 27% in real assets like oil, gold, etc. and an additional 5% in infrastructure investments that use hard asset commodities.

IDENTIFY TRENDS IN THE MARKET’S NOISE.

He says the next few years will belong to those who can manage risk and “IDENTIFY TRENDS” in the market’s noise.

In a recent article, El-Erian said he believes that governments as well as individual investors need to appreciate the dynamics of the global economy in order to successfully navigate these new economic realities.

I have just finished reading his new book, which I highly recommend. It is called, “WHEN MARKETS COLLIDE: INVESTMENT STRATEGIES FOR THE AGE OF GLOBAL ECONOMIC CHANGE.” He says there are THREE LESSONS investors will need to learn in the future.



“IT WILL NO LONGER BE SUFFICIENT TO JUST INVEST IN THE UNITED STATES, EUROPE, AND JAPAN. WE WILL ALSO HAVE TO GET EMERGING-MARKET ECONOMIES RIGHT.”

“First, IT WILL NO LONGER BE SUFFICIENT TO JUST INVEST IN THE UNITED STATES, EUROPE, AND JAPAN. We will also have to get emerging-market economies right, which involves an understanding of rapidly changing economic and financial conditions and behaviors.

Second, El-Erian argues that investors and policy makers need a better understanding of the increasingly influential role played by new pools of capital, including sovereign wealth funds and the contributions of developing countries.

Emerging economies are having and will continue to have an increasing influence on the global economy’s rate of growth. In fact, they are already the most important contributor to global growth, and they have captured a large and growing

share of the world trade.

This will result in a greater emphasis on the domestic components of demand within the emerging markets, and a greater degree of interactions among emerging economies, ESPECIALLY ASIA.

As these economies gradually shift FROM BEING PRODUCERS TO BECOMING CONSUMERS, the rate of imports in these



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countries will increase over their exports. THIS MAY BE ONE OF THE MOST IMPORTANT INVESTMENT TRENDS IN THE FUTURE.

Third, understanding economic and financial fundamentals will no longer be sufficient. Investors also need to understand the technical dimensions of markets—how financial innovations influence the fundamentals in what are increasingly two-way interactions.”

THE MESSAGE IN THE NOISE

“**T**o navigate in these uncertain times, investors must understand that the market is telling us something. For example, we need to acknowledge that the decline in housing prices is placing pressure on consumers. Because consumers cannot rely on housing prices to go up, the credit they relied upon in the past is no longer available. Consequently, consumer spending is slowing and hurting the economy—A PERFECT EXAMPLE OF YESTERDAY’S MARKET COLLIDING WITH TOMORROW’S REALITY.”

According to El-Erian, we need to expect more bumps like these in the years ahead; we can’t treat them as one-off events. In the past, these bumps would not necessarily affect our long-term outlook. NOW WE MUST QUESTION OUR ASSUMPTIONS AND THINK ABOUT HOW CYCLICAL EVENTS AND LONG-TERM TRENDS AFFECT OUR INVESTMENTS.”

MARKET HEADWINDS—THE LONG-TERM TRENDS

One of the emerging long-term investment trends, which he calls “HEADWINDS,” is the continued bull market in commodities and the companies that use them. He believes that “INFRASTRUCTURE COMPANIES,” both here in the U.S. and in Asia and Latin America will be the GREAT GROWTH COMPANIES IN THE FUTURE.

Going forward, El-Erian believes there is a long-term secular trend toward higher commodity prices for obvious and not-so-obvious reasons. It is widely accepted that emerging economies are becoming an important factor behind the surge in many commodity prices.

He believes emerging economies in Asia and Latin America are going through the first of three distinct phases of development. “The first—TRANSACTIONARY DEMAND—reflects an economy’s use of a commodity as a way to meet some sort of demand. The second—PRECAUTIONARY DEMAND—is driven by an economy’s desire to take possession of the commodity in the event of an unanticipated development. The third component—SPECULATIVE DEMAND—provides for the possibility of exploiting a wealth-creating opportunity.”

EMERGING MARKETS CONTINUE TO BE BIG CONSUMERS OF COMMODITIES

El-Erian suggests that these three components have been in play in the commodity sector, and that the emerging economies’ rate of growth has made them a bigger everyday consumer of commodities. “Now, it is not just the demand for immediate consumption that drives commodity prices higher, but the desire of these wealthy developing countries to build inventories to enhance their commodity security.”

“With emerging economies providing a demand floor, investors have rushed in to take money on the back of what appears to be dependable fundamentals. The result is higher





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investor financial demand occasioned by strategic, structural, and tactical drivers. Anyone who has seen oil double in price in the past six months is familiar with this phenomenon.”

To make it even worse, El-Erian suggests that if emerging economies maintain their high growth rates, they will become even larger users of natural resources. Nor will the United States' declining demand fully offset these economies' higher demand—they are less efficient users of these types of energy and will remain so for a while.

THE LONG-TERM TREND IN COMMODITIES IS UP

His advice, “in light of this ongoing trend, commodities and other natural resource funds should play an important role in every portfolio, along with other real assets that can hedge against inflation.”

It is this thoughtful long-term investment trend analysis that has made El-Erian one of the most successful investment managers in the world.

ONE CAN ALWAYS LEARN FROM THE BEST!

One can always learn from the best, and he mirrors our view at FOXHALL CAPITAL that over the next few years, the best portfolio performance will be those investors who overweight their investments in the great global super-cycle trends of (1) Asian and emerging market's economic growth and (2) the growth of their infrastructures and (3) the hard asset commodities and natural resources that will be needed to build these massive governmental infrastructure investments.

LONG-TERM TRENDS STILL REQUIRE ACTIVE MANAGEMENT

No market goes straight up! The commodities market has become exceptionally volatile recently—both up and down. Investors are now feeling downside volatility more strongly than upside, which has turned a normal pullback into a sharp correction in these markets.

Even in a long-term uptrend, Foxhall does not believe in ‘just riding it out’ when sharp corrections occur. We have responded with decisive defensive actions throughout the year as segments of the financial markets have deteriorated one by one. Our current heavy allocation to short and intermediate term treasuries, as noted in the question, is the result of these actions.

Just as Foxhall responded decisively as the markets deteriorated, we will respond when the current correction ends and upward momentum resumes.

UNTIL NEXT WEEK...

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PORTFOLIO COMMENTARY AND ALLOCATIONS

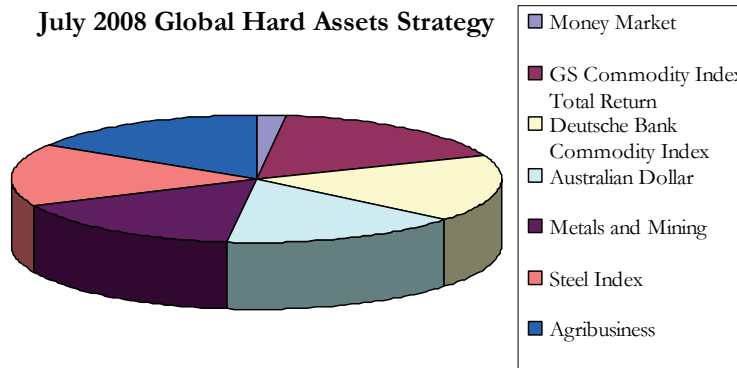
GLOBAL HARD ASSETS JOIN DEVELOPED MARKETS & EMERGING MARKETS ON DEFENSE

Foxhall's investment process in action in 2008:

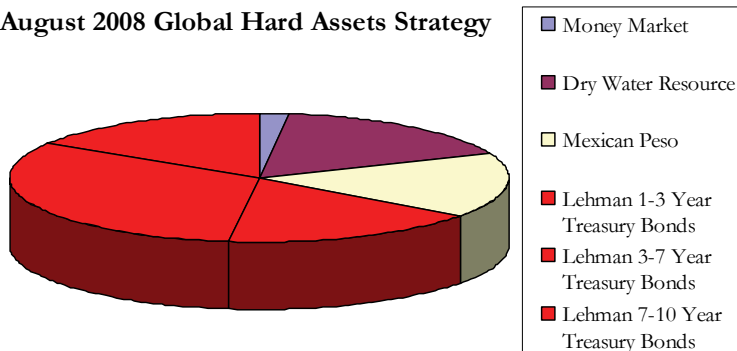
- January 10 - developed markets allocation moves to defense as bull market ends and bear market begins.
- Q2 - emerging markets transition to defense as momentum is lost.
- August 4 - global hard assets move to defense as long running global commodity markets correct.

This demonstrates Foxhall's rigorous disciplined response to changes in the market trend. Let's compare the 'before and after' allocations reflecting the shift to a 'defensive' position in August.

July 2008 Global Hard Assets Strategy



August 2008 Global Hard Assets Strategy





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As you know, we believe the long term trend in the commodities market is up! However, the current correction in that trend has prompted this decisive move to a substantially defensive position in direct response to rapidly deteriorating market conditions. Foxhall has taken this action to protect client assets from the possibility of a continuing decline.

With that in mind, let's look at what has happened to the prices of the holdings that were sold at the beginning of August:

Global Hard Assets Holdings Sold on Aug 4	08/04/08 Price*	09/04/08 Price	% Change
GS Commodity Index ETF	63.84	57.51	-11.01%
DB Commodity Index ETF	38.63	36.05	-7.16%
Australian Dollar ETF	92.47	82.47	-12.13%
Metals & Mining Index ETF	70.65	60.98	-15.86%
Steel Index ETF	80.93	68.29	-18.51%
Agribusiness Index ETF	51.55	45.25	-13.92%

* Prices reflect total returns including dividend. Source: www.fasttrack.net

Foxhall's objective in selling these holdings was to protect against possible further decline. Mission accomplished!

Clearly 2008 demonstrates that as market conditions deteriorated progressively - Foxhall **RESPONDED** decisively!

David Morton

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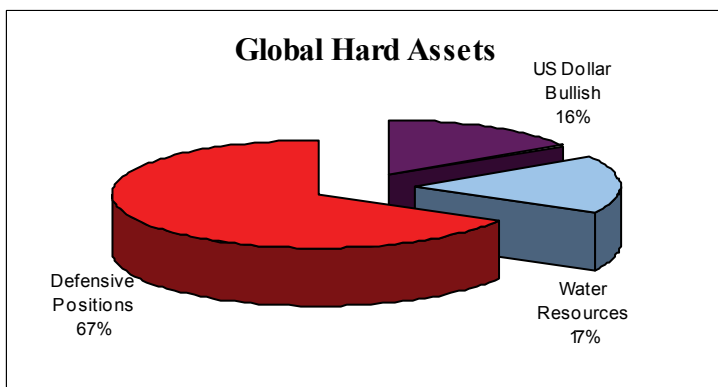
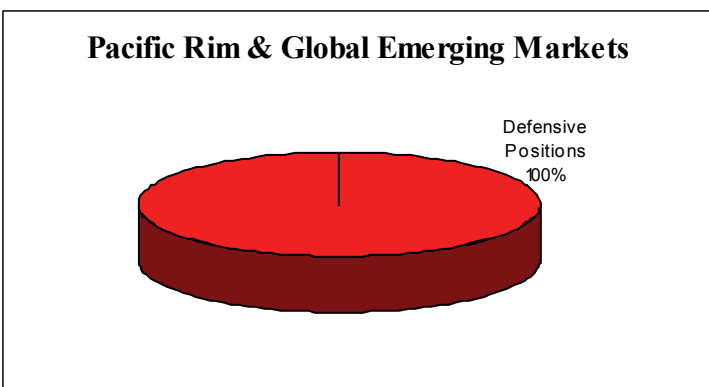
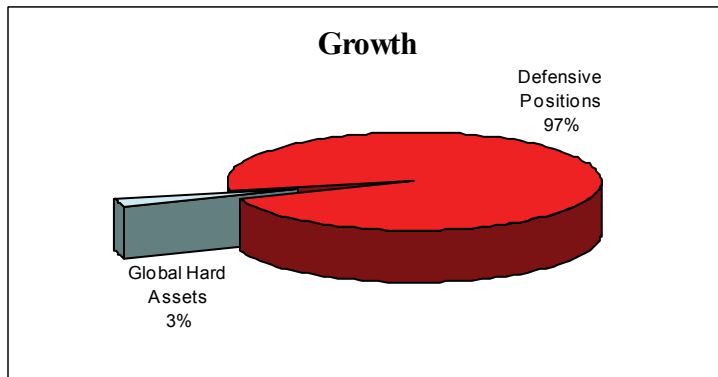
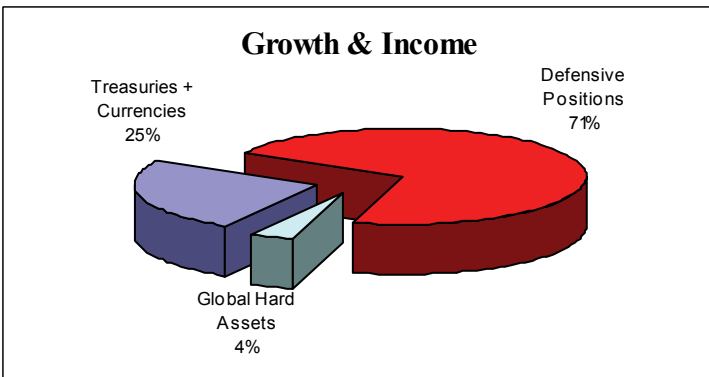
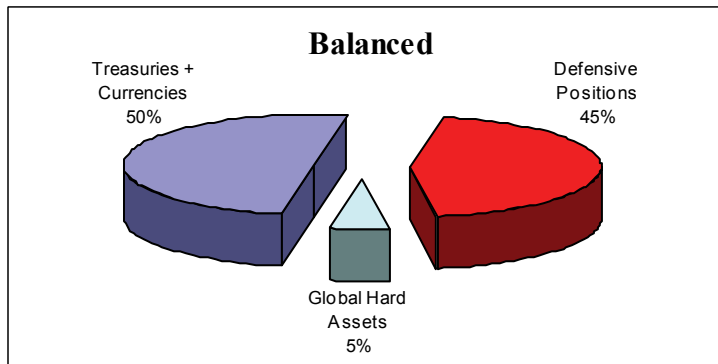
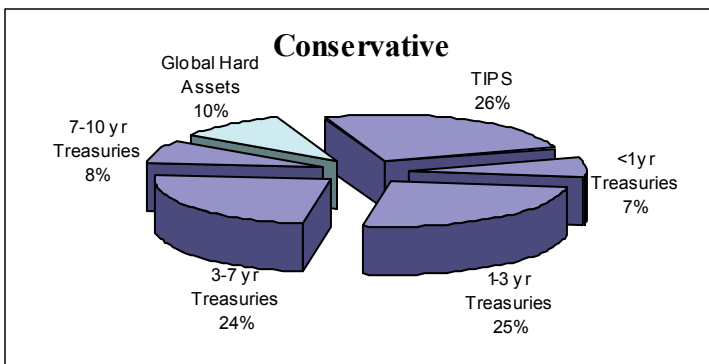
Disclosure: The opinions and portfolio information provided in the Foxhall Global Outlook are subject to change at any time, and are not to be construed as advice for any individual nor as an offer or solicitation of an offer for purchase or sale of any security. Client accounts may differ from model allocations due to many reasons. All investment strategies offer the potential for loss as well as gain. Individuals should consult with their financial professional to determine an investment strategy appropriate for their objectives, risk level, and time horizon prior to investing. Past performance is not a guarantee of similar future performance.



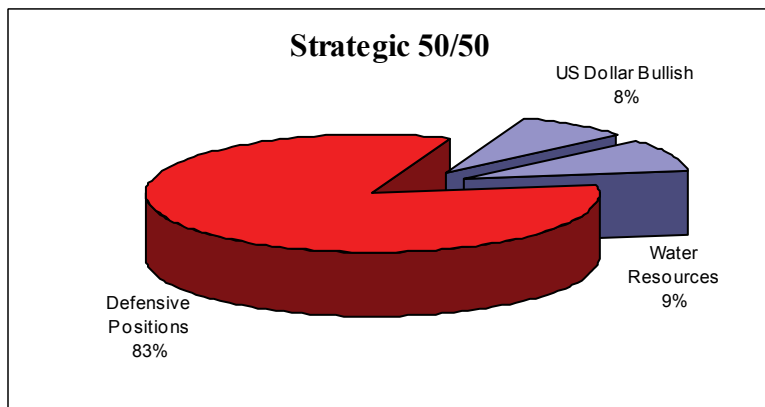
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- Emerging Markets ■
- Hard Assets ■
- Defensive Position ■



The allocations illustrated are model allocations, actual client accounts could vary due to many factors. Variable annuity/variable life accounts will vary significantly due to the availability of investment options in each contract. All allocations may change without notice.