FOXHALL CAPITAL MANAGEMENT, INC.

THE FOXHALL GLOBAL OUTLOOK

Dear Paul,

How will the presidential election affect the economy?

We are now living through the most serious economic crisis since the Great Depression. Warren Buffett has called this crisis the economic equivalent to Pearl Harbor.

The economy clearly affected the presidential race. But how will the election results affect the stock market?

It is true that past performance is no indication of future performance, but it's hard to resist looking back at how the markets have responded to presidential politics.

Stock market consultant and analyst Barry Mendelson has written about this issue and has put together the following statistics and trends:

WHO'S VOTING?

This year's record-setting voter turnout caps a trend that has been building over the past two decades. During the previous three presidential elections, the total number of voters as a percentage of total eligible voters increased significantly (see Table 1). (This year's final numbers were not in at our press time.) Electoral votes show a landslide in 1996, while the Republican wins in 2000 and 2004 were very close.

Table 1: More Voters

Year	Total eligible voters*	Total voters*	Percent of eligible voters that voted	Electoral Repub/ Demo
1996	197	96	49%	159/379
2000	206	105	51%	271/266
2004	221	122	55%	286/251

**in millions. Data: www.archives.gov*
Source: CMC EResearch

STOCK MARKET PERFORMANCE DURING ELECTION YEARS

Here are some interesting observations on market performance related to presidential election years. Will all these trends continue to bear out?

When the economy has been in a recession or entering one during a presidential election—1920, 1932, 1944, and 1960—the S&P 500 has fallen 3% on average. The incumbent party lost three of those four elections.

Measured by the returns of the DOW JONES INDUSTRIAL AVERAGE, there have been 15 bear markets since 1958, and four started in a presidential election year—1960, 1968, 1976, and 2000 (although only 2000 ended in the red).

Over half of election years since 1952 have posted a negative return for the first four months, but all except 2000 recovered before year's end. See Table 2 below, for term-year returns and Table 3 below, for market troughs by presidential term.

Pharmaceuticals and biotech have consistently underperformed in election years, but they tend to bounce back strongly in the first year of the new presidential term.

Defense stocks have outperformed the market by +19% over the last eight election years—irrespective of the party in power.

Table 2: Returns by Term Year

Term year	Avg annual return
1 - Post-election (1 yr. after election)	7.4%
2 - Mid-term election (2 yrs. after presidential election)	10.2%
3 - Pre-election (1 yr. prior to presidential election)	22.3%
4 - Election year	12.2%

Data: Standard & Poor's. S&P 500 Index returns with dividends reinvested, 1948-2007
Source: CMC EResearch

Table 3: Presidential Term Year & Market Troughs		
Presidential term	Month/year of market trough	Presidential term year
2005 - 2008	4/05	1st
2001 - 2004	10/02	2nd
1997 - 2000	8/98	2nd
1993 - 1996	4/94	2nd
1989 - 1992	10/90	2nd
1985 - 1988	12/87	3rd
1981 - 1984	8/82	2nd
1977 - 1980	3/78	2nd
1973 - 1976	10/74	2nd
1969 - 1972	5/70	2nd
1965 - 1968	10/66	2nd
1961 - 1964	6/62	2nd
1957 - 1960	10/57	1st
1953 - 1956	9/53	1st
1949 - 1952	6/49	1st

Data: Closing price of S&P 500, Stock Trader's Almanac 2008 and Yahoo! Finance
Source: CMC Research

POLITICAL PARTY AND MARKET PERFORMANCE

Perhaps surprisingly, records show that from 1926 to 2000, the broad STANDARD & POOR'S 500-STOCK INDEX performed better under Democrats than Republicans, 15.24% vs. 10.78%. When a Republican president held office, the value-weighted equity return delivered a nearly 2% premium over the Treasury bill (see Table 4). When a Democrat held office, the premium was nearly 11%.

Table 4: Excess Returns of CRSP Indexes vs 3-Month Treasury Bill, 1927-1998		
Portfolio	Returns under Republican administrations	Returns under Democratic administrations
Value weighted	1.7%	10.7%
Equal weighted	-0.01%	15.2%

Data: Journal of Finance, Center for Research in Security Prices; Source: CMC EResearch

These results were generated by higher real returns and lower interest rates under Democratic administrations. Business cycle fluctuations analyzed in a number of studies showed no correlation to the results, demonstrating statistically significant outperformance for the Democrats regardless of underlying economic conditions. Value-weighted portfolios posted a steady 10% premium in favor of the Democrats, while equal-weighted portfolios came in at around 20%.

Examination of business-cycle variables show that expected returns (those anticipated by the markets) were 1.8% higher under the Republican administrations, while unexpected returns were 10.8% higher when Democrats were in power, suggesting that stock market results may be driven by Democratic policies that surprise investors. **Interestingly, the results do not show up close to election dates, but rather grow over time during the president's term.**

President Eisenhower (1953-1961) was the only Republican to hold office during a statistically significant period of market outperformance, while President Roosevelt (1937-1941) was the only Democrat to preside over a massive underperformance. Furthermore, an equal number of presidents from each party (two and two) held office when the numbers came in roughly at par with the benchmark index.

Table 5: Returns Under Democrats and Republicans

	Democrat	Republican
S&P 500 price return over entire term	66.0%	44.7%
S&P 500 relative compound annual return	6.7%	4.6%
U.S. long-term govt. bond total return	2.7%	7.9%
Small stocks vs. S&P 500	8.2%	-3.5%

Data: Morgan Stanley Equity Research (1901-2000); Source: CMC EResearch

For the first time since 1952, there was no incumbent president or vice president running in the election. Not including 2008, the country has had eight races without an incumbent since 1900—and Republicans won seven of them. The only exception was in 1960, when John Kennedy beat Richard Nixon by only 118,574 votes out of more than 68 million votes cast.

On the other hand, voters appear to get tired of a political party after two terms in office. Since 1948, only the Republicans have held the office for three consecutive terms; that was from 1981 to 1992.

Despite statistical significance, there are many fundamental reasons that presidents and administrations may have less effect on the stock market than the numbers show. There are timing lags that must be considered; policies developed during a president's term influence the economy with long and variable lags. There are external factors that must be considered as well, including congressional majorities and the international geopolitical climate.

POTENTIAL IMPACT ON ECONOMIC SECTORS

A more useful way to approach this information is to consider the potential impact of the election results and candidates' policies on various economic sectors.

- **FINANCIAL.** Financial services firms face increased regulation due to rising mortgage and credit card delinquencies.
- **DEFENSE SPENDING.** Whether or not the new president withdraws the troops from Iraq, defense spending will increase given national security concerns and the state of our military readiness.
- **INFRASTRUCTURE.** Shoring up aging bridges and roads may well become a bipartisan initiative, and companies that upgrade infrastructure stand to benefit.
- **HEALTH CARE.** The call for universal health care would affect profit margins of private hospitals and pharmaceutical companies. Historically, drug stocks have lagged when prospects for a Democratic candidate are good because of expectations of controlled drug prices. Insurance companies stand to benefit from the emphasis on private health insurance for everyone.
- **ENERGY.** There appears to be a bipartisan interest in decreasing reliance on expensive foreign oil, which could benefit companies that focus on alternative energy source development but could hurt the oil companies.
- **ENVIRONMENT AND ALTERNATIVE ENERGY.** Short-, medium-, and long-term investor psychology and capital market conditions are likely to be affected by the next Congress's stance toward regulation and taxation of selected industries.

A Republican victory potentially would have benefitted asset managers, coal, selected industrials and materials companies, high-dividend-yielding companies, large-cap pharmaceuticals, managed care, oil and gas companies, student loan providers, and so on.

The Democratic victory's potential beneficiaries include biofuels, high-dividend yielding companies, selected industrials and materials companies, generic drug companies, geothermal, health care, Medicaid companies, natural gas companies, solar power companies, wind power companies, and so on.

Of course, there are other issues that can affect the market, such as tax policy, interest rates, and global trends, to name just a few. And it may be years before the economy pulls out of its current tailspin. History is just a chronology of past events. There's nothing to stop it from being different this time.

THE BOTTOM LINE

To summarize some of the most important findings in other studies…

- In election cycles since World War II, the DOW JONES INDUSTRIAL INDEX has posted bigger average returns under Democratic presidents according to the STOCK TRADER'S ALMANAC. It is a myth that Republican presidents are better for stocks.

- However, historically, according to strategist Jeffrey Kleintop, stocks tend to perform better in periods of legislative gridlock, when presidential power is offset by the opposition party controlling Congress. That will not be the case this time with the Democrats decisively controlling both houses of Congress.

- NED DAVIS RESEARCH noted in the PRESIDENTIAL CYCLE that the S&P 500 INDEX posted its weakest returns in the first year of the four-year election cycle. (2009 WILL BE THE FIRST YEAR IN THIS ELECTION CYCLE) Since 1900, stocks have gained just 3.4% on average in the post-election year, compared with gains of 4.0% in the mid-term year, 11.3% in the pre-election year and 9.5% in an election year.

- How have stocks fared historically from Election Day to the end of the year? NED DAVIS RESEARCH concludes that historically, when Democrats win, stocks have lost 1%, while rising 4% if a Republican wins.

WHAT WILL FOXHALL CAPITAL DO?

Consistent with some of the statistics and trends outlined above, I believe the economy will continue to decline in 2009 and the stock market will hit new lows next year. That is why FOXHALL CAPITAL will continue to maintain a 100% allocation to our **defensive strategy. Currently that strategy consists of U.S. Government short-term Treasury bond funds and money market funds.**

I believe we will see an end to this bear market in late 2009 or the beginning of 2010.

Because of the growth in Asia and the expansion of so many American companies' dominance of industries overseas, the next bull market may be the greatest bull market in history. **That is the GOOD NEWS for those with patience.**

UNTIL NEXT TIME…

—Paul Dietrich
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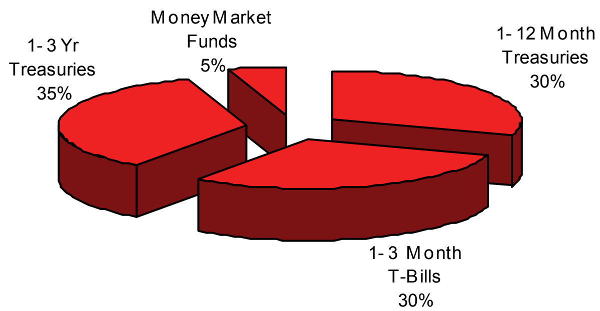
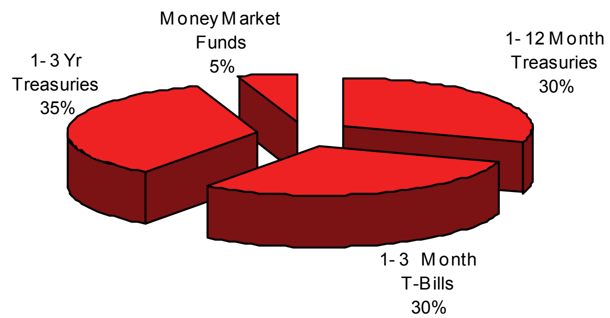
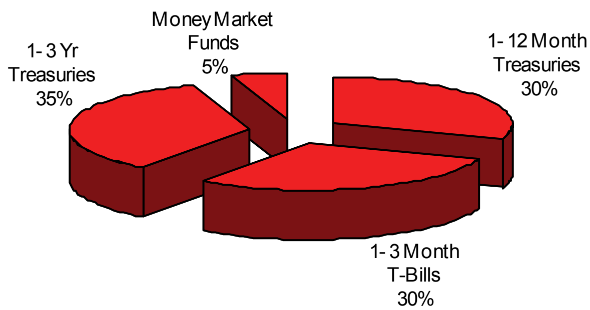
Conservative



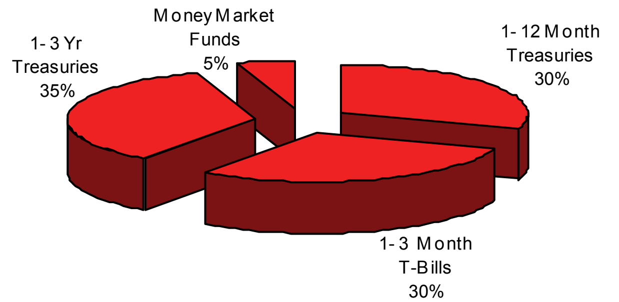
Balanced



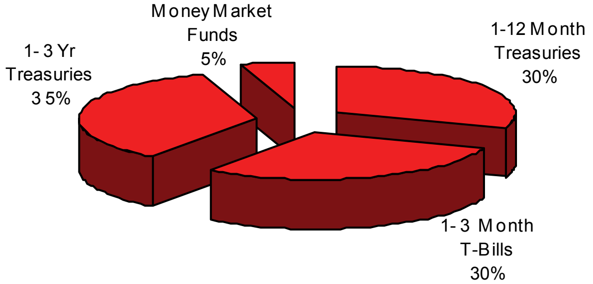
Growth & Income



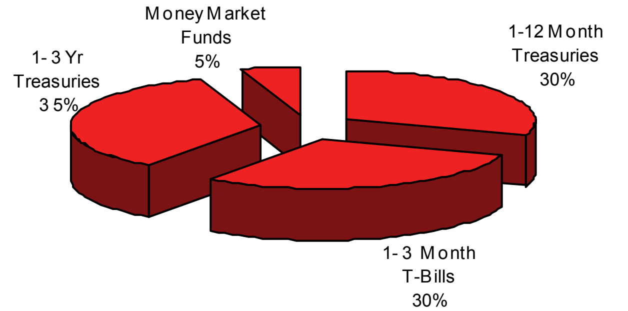
Growth



Pacific Rim & Emerging Markets

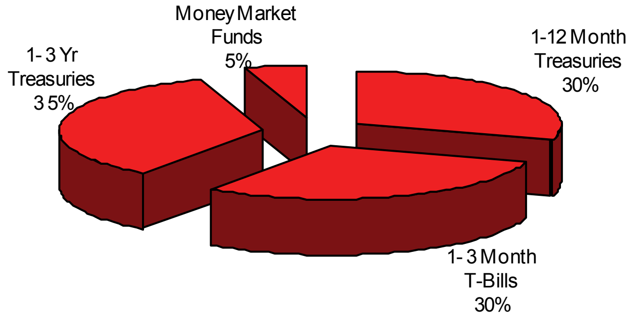


Global Hard Assets



Emerging Markets
Hard Assets
Defensive Position

Strategic 50/50



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.