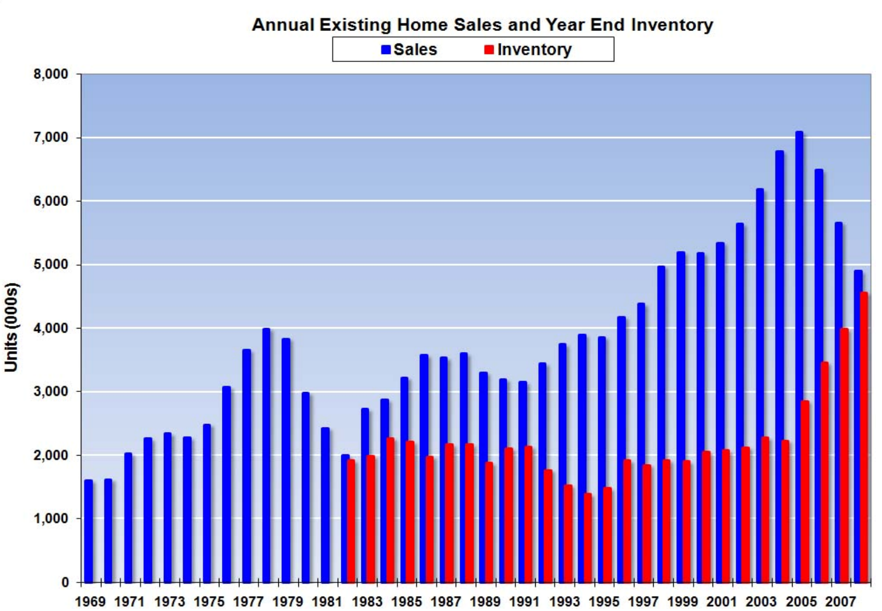
Second Quarter 2008

Market Index Total Returns as of June 30, 2008

Market Index	YTD 6/30/2008	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poor's 500 (Large Cap)	-11.9	-13.1	4.4	7.6
Standard & Poor's 400 (Mid Cap)	-3.9	-7.3	7.4	12.6
Russell 2000 (Small Cap)	-9.4	-16.2	3.8	10.3
MSCI EAFE (Foreign)	-11.0	-10.6	12.8	16.7
Lehman Bros. Aggregate Bond	1.1	7.1	4.1	3.9
Lehman Bros. Municipal Bond	0.0	3.2	2.9	3.5

Record high energy prices and credit fears continued to roil financial markets during the second quarter of 2008. Major stock market averages ended the period just slightly above bear market territory, commonly defined as a decline of 20% or more from the last high. In this case the S&P 500 index ended June down 18% from its high reached on October 9th of last year while the Dow Jones Industrial Average ended the quarter down 19% from its recent high. Oil traded above $140 per barrel during the quarter, up from $14 per barrel as recently as 1998. High food and gas prices have stoked inflation fears across the globe while economic growth has slowed and employment in developed economies has declined.

The financial sector continues to lead the stock market's downward trend as banks, brokerages and insurers announce more charges resulting from the growing credit problems that started with the sub-prime mortgage debacle that we have been following for the last 18 months. The chart below clearly illustrates the situation in housing today. The combination of a large backlog of unsold new homes, falling prices on existing homes and rising default rates has created a situation that will obviously take many months to work through. What started with mortgage defaults among the financially weakest borrowers has morphed into a widespread financial crisis that has affected borrowers and lenders throughout the economy. Lenders have tightened standards to the point where access to capital has virtually dried up, putting the brakes on economic growth and resulting in rising default rates. Since the financial sector serves as the lubricant to keep the economy moving, a pullback like this serves as a huge drag on growth. Whether it is the purchase of a home or car, the start of a business or the sale of a company, a transaction generally does not happen without some form of financing.



All data actual annual data except 2008 which is actual data through April annualized.
Source: National Association of Realtors, 2008

Led by Ben Bernanke, the Federal Reserve has worked steadily to shore up the banking system over the last year by lowering interest rates, arranging the buyout of Bear Stearns Cos. by JPMorgan Chase and making capital available to weakened banks. However, with oil and other prices surging, the Fed finds its efforts to stimulate the economy at odds with its responsibility to fight inflation. Normally a slowing economy naturally eases inflationary pressures but with global growth still clipping along, especially in emerging economies like China, we are seeing higher prices on commodities begin to leak through and show up in pricing for any number of goods and services consumers and businesses depend on every day. The Fed's typical response to inflation is more restrictive monetary policy (higher interest rates) while its typical response to a slowing economy is monetary stimulus (lower interest rates). This is a delicate balancing act but so far one that the Fed has managed well enough to keep the economy moving forward.

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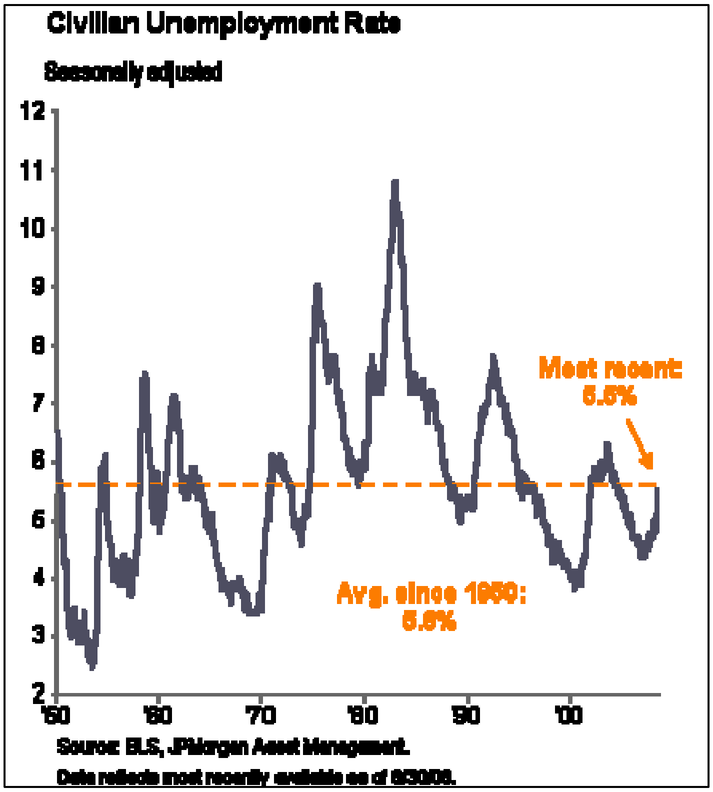
Indeed, despite all the bad news, economic output has yet to register as negative. The commonly used definition of recession is two consecutive quarters of negative growth in gross domestic product (GDP). Real GDP was a mere 0.6% annualized in the fourth quarter of 2007 and only 1% annualized in the first quarter of 2008. While these are pretty anemic growth rates, most economists have been surprised that we have yet to register a negative number for economic growth given the headwind from high energy prices and the credit crisis. This resilience is likely a result of our still high rate of employment at 5.5% (see chart below) and the fact that consumer spending (which makes up nearly 70% of our gross domestic product) continues to hold up fairly well despite worsening reports of consumer sentiment over the last few months. According to the Bureau of Economic Analysis, personal disposable income increased 5.7% in May compared to the previous month. Even after factoring out the $50 billion in "tax rebates" that mostly were mailed in May, this income figure was still positive, signaling that the consumer is still in the game.



So where does the market go from here? Is a decline of 20% going to do it? We certainly have some more bad news to come: more bank write-offs, consumer bankruptcies, declining earnings, job losses, inflation or maybe even deflation. Much of this is already factored into today's stock prices but we certainly may see the market decline further. At some point however, the market will hit bottom and then it will go up. There will be a new catalyst for growth. It may simply be the fact that we now have a growing global economy with millions of new consumers to buy our products. Yes our products; the US remains a huge manufacturer of products despite our much-publicized loss of manufacturing jobs. In fact US manufacturing output hit an all time high just last year. Meanwhile 94.5% of Americans who want to work are working.

Another catalyst for a turnaround results from high energy prices. Huge investments are being made and thousands of jobs are being created in the area of green technology, including alternative sources of energy. Auto companies, oil companies, farmers, inventors, scientists and entrepreneurs alike are scrambling to create new power sources. The incentives are huge and they are driven by the potential for profit, not by legislation or fear. Many efforts will fail but the winners will be rewarded and society will be better off as a result. We are seeing economist Adam Smith's "invisible hand of capitalism" in action. It may take time but the economy will get past the trying issues of today and we will move forward again. As always, the market will be well ahead of the good news that will certainly be coming at some point.

Final Word

And here's my anecdotal evidence that we are not in recession. It is Friday evening, July 4th as I write. Twenty minutes ago I was out on the beach with my extended family (all 26 of us) watching my brother-in-law set off fireworks to celebrate the birthday of our great republic. Now I'm no expert on fireworks, as Dad always told us to stay away from them. He put them in the same category as motorcycles, cigarettes, fast cars, fast women...but I digress. Anyway, I was at a safe distance from the action but easily close enough to enjoy the show. I would say our firepower tonight could be described as a traditional assortment: bottle rockets, roman candles, black cats, lightning rods, smoke bombs and a few M-80s thrown in for good measure. My brother-in-law later told me he spent about $150 on the whole show, a respectable sum by anyone's measure but especially for my brother-in-law who is known as a man who can squeeze a nickel. But here is the hard evidence that the economy is not in recession. While we spent $150 on our show, there were folks up and down the beach from Pawley's Island to Garden City who must have spent thousands. The folks on either side of us each set off more fireworks than I have ever seen at a professionally orchestrated event like WBT's "Sky Show Charlotte." I have never seen so much discretionary income burned up in thirty minutes. My brother John was there and he wholeheartedly agreed with me. Recession – no way!

Money blowing in the wind aside, it was great to celebrate this wonderful country we call home. The US has taken some blows of late but we're still strong and it feels good to wave that flag.

I hope you enjoyed your celebration as well. As always, thank you for letting us help you with your planning and investing.

Sincerely,

Benton S. Bragg

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President, Bragg Financial Advisors, Inc.