Reflections and Projections – 2008 Outlook

Outlook Summary

The year 2007 marked a mixed but mostly favorable year for the major equity market indices, with the Dow Jones Industrial Average gaining approximately 9% for the year, while the S&P 500 gained 5.5%. Major indices lost traction as the year progressed; as concerns escalated that a weak housing market and a restricted credit environment would damper corporate and consumer spending, and perhaps lead the U.S economy into weaker growth expectations and/or recession. Key events affecting the markets which occurred during 2007 included:

- Oil prices climbed to a record high, ultimately peaking at over $100 per barrel;

- A credit crisis began early in 2007 with rising delinquencies in the subprime mortgage sector. These difficulties spread throughout the global financial system as investors realized these low quality mortgages had been securitized, pooled together and sold to financial institutions around the world. Bear Stearns warned in June that two of its hedge funds had taken significant hits on mortgage investments. These were dwarfed in October when Merrill Lynch announced it would be writing down nearly $8 billion as a result of bad bets in the mortgage market, which led to the demise of its chief, Stanley O'Neal. Then, in November, Citigroup's embattled CEO Charles Prince resigned shortly after disclosing the company's losses in the credit markets might reach $17 billion -- nearly three times more than the company estimated in October.

- A housing slowdown continued in 2007, with housing metrics continuing their decline from 2006. Inventories of new homes rose to a 9.3 month supply in November of 2007, and builders typically have to wait 6.2 months to sell a completed home, the longest period since July of 1993. The oversupply in housing inventory caused home prices to decline in 2007, which also placed pressure on collateral values for financial institutions holding mortgage credit. Finally, many consumers were left holding properties they could not sell, in many cases financed with adjustable rate mortgages due to reset with higher rates, and hence higher payments.

- Federal Reserve policy shifted over the course of 2007, from a bias towards inflation, to having risks to growth and inflation appearing balanced, to what currently seems to be a policy combating an increasing risk of recession. To combat the liquidity and credit concerns, the Federal Reserve and other central bankers around the world injected liquidity into the financial markets; and the Federal Reserve reduced its target rate by 100 basis points to 4.25%.

2007 Index Returns

Equity Indices:	
S&P 500 Index	**5.49%**
Dow Jones Ind. Avg.	**8.88%**
NASDAQ Composite	**9.81%**
Russell Midcap	**5.69%**
Russell 2000	**(1.57%)**
DJ Wilshire REIT	**(17.56%)**
MSCI EAFE (Intl)	**11.17%**
MSCI Emerging Mkt.	**39.39%**
Bond Indices:	
3-Month T-Bill	**4.77%**
LB Aggregate Bond	**6.97%**
LB High-Yield Corp Bond	**1.87%**
LB Int. Govt/Credit	**7.39%**

As investors prepare for the year 2008, we expect a number of factors to influence the capital markets, including:

- Tempered U.S. economic growth, with GDP rising 1.50% to 2.00% year over year;
- Below average earnings growth for S&P companies, with earnings growing 3% to 5% year over year;
- Continued heightened levels in energy prices, with crude oil prices trading in a range between $80 and $100 per barrel;
- Continued weakness in the housing market;
- A more stable U.S. dollar;
- The Federal Reserve will likely remain stimulative in 2008, given our projection for below average GDP growth in 2008;
- Continued strength in corporate balance sheets. Cash constituted 4.5% of the total assets of U.S. non-financial companies as of June 30, 2007. Since 1960, that average has been 3.8%. With company coffers loaded with cash, the latest trend involving increases in stock buybacks, mergers/acquisitions and dividend payouts should continue;
- Core inflation (less food and energy) will remain close to current levels, with the core rate of inflation ranging somewhere between 2.0% and 2.50% year over year;
- The U.S. unemployment rate will hold steady or increase slightly, ranging between 5.00% and 5.50%. Companies should continue hiring additional workers, but not at a rate that will facilitate significant wage inflation.

Investment Themes and Opportunities for 2008

- We expect equities (S&P 500) to post a total return of 3% to 5% (excluding dividends) in 2008. Factoring 1) projected 2007 S&P 500 earnings of approximately $89.00, 2) 2008 earnings growth rate for S&P 500 companies of approximately 5%, and 3) a P/E multiple of 16.5x, this equates to a level of approximately 1,542 for the S&P 500. This level represents a return of 5% for 2008. Finally, because of the current and projected slowdown in economic expansion, we have gravitated to a more neutral stance on equities, recognizing there is increased risk to consumer spending if incomes do not expand to offset current weakness in the housing market.
- We expect international equities to continue to outperform U.S. equities. We base our expectations for international equities primarily on continued expansion of profit margins abroad.

- We remain cautious on bonds. After peaking at 5.29% in the summer of 2007, the 10-Year Treasury yield has fallen dramatically by approximately 160 basis points, primarily due to a flight to quality to government instruments stemming from the credit and liquidity crisis and the Federal Reserve's easing of the Federal Funds rate. This resulted in a steepening of the yield curve. We continue to advocate a more defensive and diversified stance for fixed income portfolios with a duration that is neutral or slightly shorter than our benchmark, the Lehman Intermediate Government Credit Index. Regarding sectors, we remain neutral to cautious on U.S. corporate and high yield bonds based on the current economic environment, while we believe high-quality mortgage bonds may offer some value because the degree of prepayment risk has subsided. Municipal securities remain attractively valued relative to Treasuries. Finally, international bonds may provide investors with respectable returns in 2008, although we believe that the dollar should exhibit more stability in 2008.

Outside Factors That May Negatively Impact Our 2008 Forecast

There are a number of factors which could negatively impact our 2008 forecast, including:

- **A less than orderly decline in the U.S. dollar.** The United States has run a trade deficit with the rest of the world for many years. And it has funded government spending deficits by issuing debt. Some other forces that we believe will contribute to a weaker dollar include higher foreign interest rates, higher international versus domestic growth, and the possibility that oil will trade in other currencies besides the dollar. If a more rapid decline in the dollar was to occur, this could lead to a decline in demand for U.S. financial assets. A decline in the dollar causes foreign investors' returns on U.S. assets to deteriorate, thus leading to higher interest rates to re-stimulate foreign demand for U.S. financial assets. Further, a more rapid decline in the dollar can lead to inflation because goods produced overseas with little domestic competition -- such as clothing or electronics -- could end up costing more here. And if Americans keep buying higher-priced imports, that could lead to an even larger trade deficit, which in turn would put further pressure on the dollar. What's more, U.S. companies that buy raw materials and parts overseas would see costs rise in dollar terms, which could lead the companies to raise prices.

- **A more neutral or aggressive Federal Reserve, causing an unexpected rise in interest rates.** An unexpected rise in interest rates would have a negative impact on stocks as well as bonds, particularly if the increase is driven because of higher inflation. Most economists believe the Federal Reserve will elect to decrease the Fed Funds rate in 2008.

- **Geopolitical unrest and/or increased incidents of terrorism.**

- **A more rapid slowdown or collapse in the housing market.** Never has there been a tighter relationship between housing, the economy and the consumer. The decline in housing prices had a profound affect on the economy and credit in 2007, primarily because Americans invested heavily in real estate and monetized a portion of the equity from these investments over the past five years. If a housing market demise seems insignificant compared to a stock market bust, consider the range of industries that are affected by the slowdown in housing activity, including construction workers, material suppliers, brokers and mortgage bankers. All told, the industry accounts for about 16 percent of the nation's economic activity. And that is not counting the billions of dollars spent on furniture, appliances, paint and carpeting in the first few years after a home is purchased. In addition, the rise in the value of homes is translated into consumer spending fairly quickly through a well-known "wealth effect." For every dollar of increased value, homeowners spend about 5.5 cents that they otherwise would not have spent, according to one recent study. That translates to $1,100 in spending on a home that rises in value by $20,000.

- **Heightened regulatory scrutiny or corporate governance issues.** There is always the possibility for a high profile investigation to be announced and/or conducted that will have effects on certain facets of Wall Street, whether it be specific industries or corporations or other parties to the financial markets.

- **A spike in energy prices.** If energy prices were to spike to higher levels than those seen in 2007, this would have a negative impact on consumer spending, inflation, and corporate profits.

Tactical Asset Allocation – Current Stance

F.N.B. Investment Advisors, Inc.'s Investment Strategy Committee continues to suggest long-term diversified portfolios that emphasize trends evident in slowing economic growth. Therefore, the committee has moved to a more neutral allocation to equities, while overweighting cash and underweighting bonds. See the chart below for recommended tactical asset allocation for our various investment objectives.

			Aggressive Growth	Growth	Growth & Income	Balanced	Income & Growth	Income	Preservation of Capital	
Baseline Allocation	Cash Equivalents		5%	10%	10%	10%	10%	5%	100%	
	Bonds		0%	15%	30%	40%	60%	95%	0%	
	Stocks		95%	75%	60%	50%	30%	0%	0%	

Equity Allocation	Capitalization	**% Large Versus % Mid and Small** OW Large — Neutral — OW Mid/Sm <---------- **Bias Large** ---------->
	Style	**% Value Versus % Growth** OW Value — Neutral — OW Growth <---------- **No Bias** ---------->
	Global Weighting	**% Domestic Versus % International** OW Dom — Neutral — OW Int'l <---------- **Bias Int'l** ---------->
Bond Allocation	Duration	**% Below or Above Benchmark Duration** Short — Benchmark — Long <---------- **No Bias** ---------->
	Credit Quality	**Average Credit Quality Rating** AAA/Aaa — AA+/Aa1 — A/A2 <---------- **No Bias** ---------->
Other Allocation		For selected accounts where it is prudent to incorporate additional diversification in the equity portfolio, we are advocating a higher than average allocation to international markets. For selected accounts where it is prudent to incorporate additional diversification in the bond portfolio, we are advocating an allocation to international bonds.

NOT FDIC INSURED	***NO BANK GUARANTEE***	**MAY LOSE VALUE**

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F.N.B. Wealth Management – Investment Strategy

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