



Third Quarter 2008

Market & Economic Conditions

Major Indices	3Q, 2008 Returns
S&P 500	-8.4
Dow Jones	-3.7
NASDAQ	-9.2
Russell 1000-Growth	-12.3
Russell 1000-Value	-6.1
Russell 2000	-1.1
MSCI EAFE	-20.6
Lehman Aggregate	-0.5
Lehman 2% Issue Constrained High Yield Index	-8.6

The third quarter of 2008 marked a startling number of watershed events in the world financial markets. The quarter began with oil prices near record highs reaching a record high on July 11 (\$147.27) and significant concerns about how that might impact economic growth and inflation expectations in the immediate future. Energy and other commodity prices have now cooled markedly and fears have shifted to the stability of the overall financial system. While the credit crisis has been in the forefront of the news for more than a year, perhaps first capturing the public eye with the collapse of mortgage REITs American Home Loan Mortgage and New Century Financial in the first quarter of 2007, events spiraled downward in July with the announced insolvency and federal seizure of IndyMac Bank. The banking crisis continued throughout the quarter, culminating with the federal seizure and subsequent sale of Washington Mutual to JPMorgan Chase and the near failure and pending acquisition of Wachovia by Citigroup. These examples are eerily reminiscent of depression-era “runs-on-the-bank.”

Elsewhere in the financial system, government intervention has been front and center as well. After decades of operating under a government charter, and in the eyes of the investment community an implicit government guarantee, mortgage finance companies Fannie Mae and Freddie Mac necessitated a federal rescue, overcome by immense leverage and massive mortgage defaults, which posed a threat to the entire mortgage market. The world’s largest insurance company, American International Group, buckling under the weight of implied leverage contained in its complex Credit Default Swap (CDS) portfolio, required an \$85 billion government rescue. After the historic events of the quarter, it seemed fitting that it would end on a cliffhanger. In the closing days, Congress, the White House, Treasury and Federal Reserve debated the merits, terms and vagaries of an estimated \$700 billion rescue plan whereby the federal government would buy impaired assets from financial institutions in order to shore up their balance sheets; a plan reminiscent of the Resolution Trust Corporation enacted in the wake of the savings and loan scandal of the late 1980s.

Where the government refused to step in, financial institutions, such as Lehman Brothers, collapsed under the weight of their own leverage, and Merrill Lynch sold itself to Bank of America. By organizing

themselves as bank holding companies, investment banks Goldman Sachs and Morgan Stanley came under the protection of the U.S. Treasury, securing permanent liquidity and funding. These events marked the end of an era. Wall Street as we knew it, populated by investment banking behemoths, disappeared. Indeed, as the fourth quarter commences it is hard to find an example of an independent investment bank with a market capitalization in excess of \$1 billion. This is in stark contrast to the beginning of the year when the combined market capitalization of the five largest investment banks topped a quarter trillion dollars.

From an investment returns perspective, the quarter could not end soon enough. The volatility continued right to the end of the period. The last 48 hours saw the largest one day point decline in the history of the Dow Jones Industrial Average, followed by a 5% rally on the quarter's close. For the third quarter, all the major U.S. equity indices declined. However, small cap value, microcap value and REITs managed to post gains. In broad domestic equity, small cap weathered the storm best (Russell 2000: -1.1%). Midcap issues performed the worst (Russell MidCap: -12.9%), while the large cap indices split the difference (S&P 500: -8.4%). Large cap value stocks (Russell 1000 Value: -6.1%) sharply outperformed their growth counterparts (Russell 1000 Growth: -12.3%).

Within the primary sectors of the S&P 500, Energy and Materials both fell by more than 20%. Consumer Discretionary, Health Care and Financials essentially treaded water, leaving Consumer Staples as the only meaningfully positive sector, up nearly 5%. Despite the crisis in Financials, the sector managed to nearly pull even on the promise of a bailout, which drove bank shares sharply higher.

International equity markets fared substantively worse, with both developed (MSCI EAFE: -20.6%) and emerging stocks (MSCI Emerging Markets: -26.9%) posting double-digit losses. On a country basis, Ireland, Austria and Norway ranked the worst among developed nations, experiencing declines in excess of 40%. Switzerland performed best, down 13%. Among developing nations, Russia and Argentina came in last, each losing more than 40%. The Philippines' small, but meaningful 3.5% gain turned out to be one of the best performances.

Fixed income investments fared no better during the quarter as the mortgage crisis and credit crunch rippled through the market. In yet another watershed event, on September 19, the yield on the 30-day U.S. Treasury actually turned negative for a brief period. Investors, fleeing from "risky" money market funds in the wake of the Lehman Brothers bankruptcy, bid up the price of Treasuries to the point that they were effectively paying for safety. With that as a backdrop, the Lehman Brothers Aggregate Bond Index (-0.5%) fell slightly due in large part to a difficult market for corporate bonds. High yield bonds (Lehman 2% Issue Constrained High Yield: -8.6%) fared even worse.

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Fund Observations

MUTUAL OF OMAHA'S RETIREMENT PROGRAM PRODUCT (0.00% Class as of 09/30/08)

- For the quarter, only the Cohen & Steers Institutional Realty Shares (+4.19%) and the Guaranteed Account (+0.94%) were able to post positive returns.
- Domestic value stocks significantly outperformed domestic growth stocks during the quarter as evidenced by the performance of the Value Stock Index Fund (-6.23%) relative to the performance of the Growth Stock Index Fund (-12.35%). Longer term, value stocks have also outperformed growth stocks over the trailing 5-yr and 10-yr periods.
- On the capitalization front, domestic small cap stocks fared much better than domestic large cap stocks for the quarter as can be seen by the performance of the Small Cap Stock Index Fund (-1.13%) relative to the Stock Market Index Fund (-8.35%). Although the returns on domestic stocks were far from desirable, they were still much less damaging than the performance of international stocks as measured by the International Stock Index Fund (-19.32%).
- Performance over an extended period of time is key to successful retirement investing. Consistent with that message, 80% of the actively managed investment options found in the retirement program product with at least a 10-yr performance record have outperformed their benchmark over that timeframe.
- Mutual Directions, which are a series of five risk-based asset allocation models, continue to provide the possibility of excess long-term return for incremental levels of added risk. For the 5-yr

period ending 9/30/08, the most aggressive Mutual Directions 5 (+8.34%) outperformed the most conservative Mutual Directions 1 (+4.03%) by 4.31%.

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Figures are reported on a total return basis, which is the change in value of an investment over a given period, assuming reinvestment of any dividends and capital gains. Investments assume a lump sum is invested at the beginning of the time period shown. The results for individual accounts and for different time periods may vary.

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At The Close...

The legendary investor, Warren Buffett, once famously stated that in order to become rich you should "Be fearful when others are greedy and be greedy when others are fearful." It is fairly safe to say that the general sentiment of investors now is that of uncertainty. With all the turmoil that has taken place on Wall Street, many investors might feel insecure and move towards the most conservative vehicles they can find. Investors should take into consideration that even at retirement, their time horizon might extend another twenty plus years. With that in mind, keeping focused on a long-term investment strategy can be critical to meeting one's retirement expectations.

Source: CNNMoney.com, "Buffett: I'm Buying Stocks," October 17, 2008

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