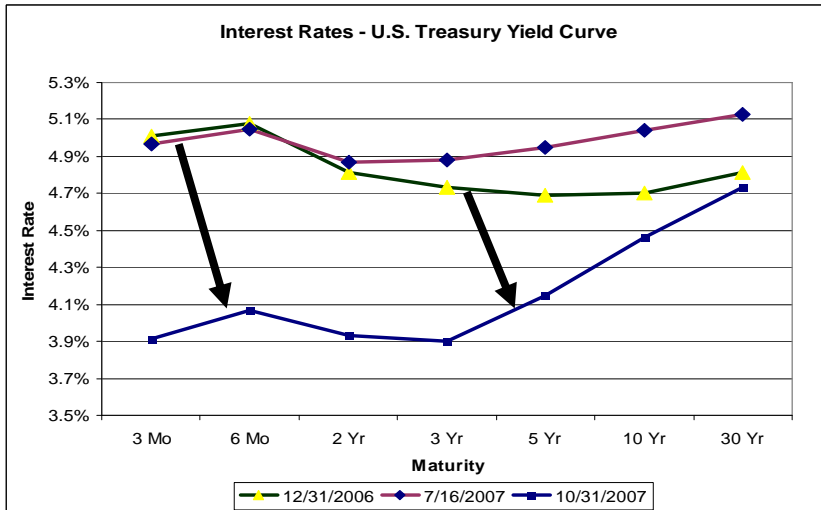


Market & Wealth Management Update October 31, 2007

No Halloween Tricks from the Fed

In a widely expected move, the Fed lowered its key interest rate by 0.25% at the end of October, bringing the cumulative total of “easing” on the Federal Funds rate to -0.75% since the end of August. Equity markets in the U.S. rallied on the news initially and, despite the subsequent sell off on November 1st, still show respectable gains for the year-to-date. The chart below shows the levels of interest rates compared to earlier times in the year, reflecting the effect of the cuts and the Fed’s response to the tighter credit markets and housing-related weakness.



Source: Bloomberg

Financial markets anticipated the Fed’s action. Increasingly many had become convinced that the credit markets’ problems from sub-prime debt and the effects of a slowing housing market on economic growth made the move necessary. Others, including ourselves, see reasons why the Fed could have refrained from lowering rates. Specifically, lowering interest rates could add to inflation by putting additional downward pressure on the U.S. dollar, thereby raising the cost of imported goods. After the Fed’s announcement, oil quickly advanced to a level ever closer to the \$100 mark. The chart below shows the surge in oil prices in 2007.

Market Statistics October 31, 2007		
	Level	YTD%
Dow Jones	13,930	11.8%
S&P 500	1,549	9.2%
NASDAQ	2,859	18.4%
MSCI EAFE	2,389	15.1%
Oil (WTI)	\$94.04/bbl	
Lehman Agg Bond Index	4.8%	
Federal Funds Rate	4.50%	
6 Mos Treasury Bill	4.07%	
2 Year Treasury Note	3.93%	
5 Year Treasury Note	4.15%	
10 Year Treasury Note	4.46%	



Chart Courtesy of StockCharts.com

Inflationary pressures have appeared to be modestly higher lately, too, primarily from the rising costs of commodities and food. Offsetting this has been evidence that not all costs are being passed to consumers.

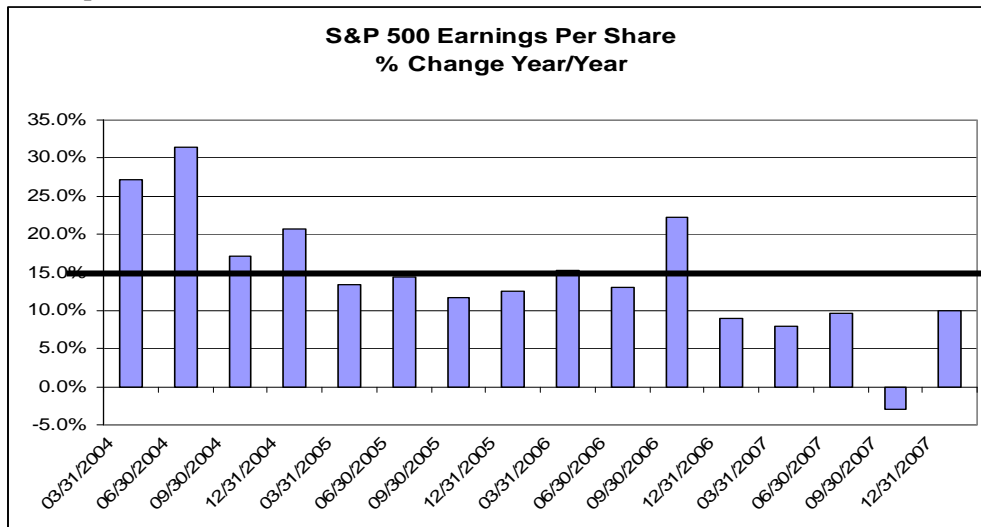
Meanwhile, the U.S. economy is producing mixed signals about its momentum, with housing data continuing to point to a long road out of its steep decline. Other indicators, such as third quarter GDP data, reflected greater than expected strength by coming in at a nearly 4% rate of growth. Most agree that the economy will slow from this pace in the quarters ahead. Recent data and comments, particularly from corporate America, match this view.

As we have written in the past, the Fed's decision to lower interest rates provides more immediate relief to the markets than the economy, which will not directly benefit from a rate cut as quickly. The Fed indicated in their comments that they believe positives and negatives in the markets and economy are "roughly balanced," perhaps indicating that they may be on hold with rates until more signs emerge about inflation and economic growth.

3rd Quarter Earnings Negative, Primarily from Financials and Consumer Stocks

As of October 31st more than half of S&P 500 companies have made their third quarter earnings reports. The numbers so far show mixed results. Year-over-year earnings per share are estimated to be negative by two percent according to S&P. If this trend were maintained for the S&P 500 when all companies have reported, it would represent the first quarter since the third quarter in 2001 that earnings were down on a year-over-year basis. In fact, earnings growth per share has been above 10% for most of the quarters since that time.

The chart below shows the trend in year-over-year corporate earnings per share growth since 2003. The third and fourth quarters of 2007 are estimates from the latest bottom-up data from S&P. As the line in the chart indicates, the average over the period shown has been a remarkable 14.5%.

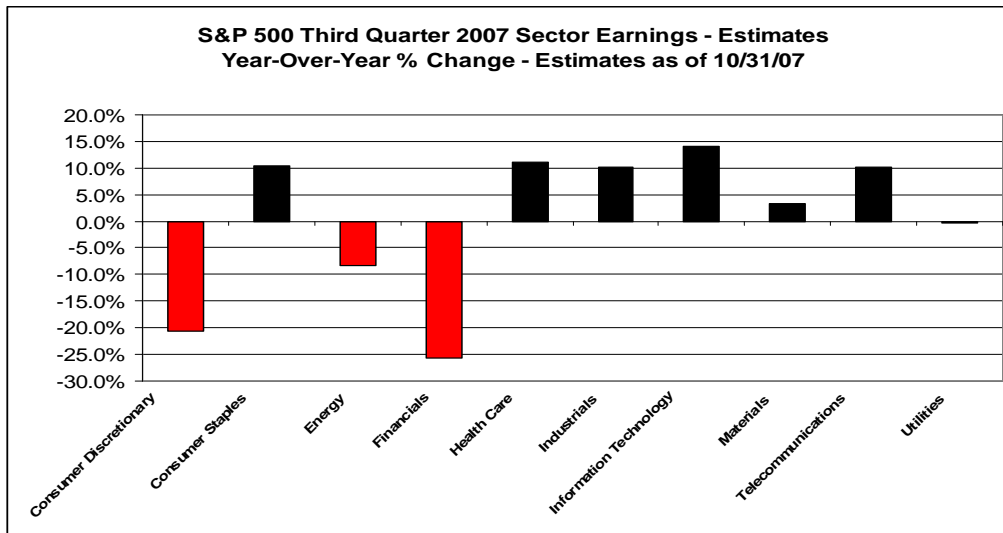


Source: S&P

On a sector by sector basis, the answer to why earnings are down overall for the third quarter after such a stellar run of year-over-year growth becomes clear. Three sectors, Consumer Discretionary, Energy and Financials, have seen lower earnings and alone put the overall numbers into the red. Otherwise, the remaining sectors of the S&P 500 continue to show positive earnings growth on a year-over-year per share basis.

The chart on the next page shows the earnings growth or decline on a year-over-year basis for each sector of the S&P 500 in the third quarter on a projected basis. The drop in the Energy sector's earnings has been expected after the record profit numbers and peak earnings levels a year ago had made those numbers hard to beat this year.

The major story in the earnings numbers reported so far is that Financial and Consumer Discretionary companies' earnings show that those sectors remain in the midst of a significant deceleration in earnings and profit margin levels, largely related to the fallout from housing and mortgage related debt problems, but also related to consumer sentiment levels.



Source: S&P

This view is backed up the performance of each sector's stocks on a year-to-date basis. Financial stocks have dropped by 8.7% in 2007 while Consumer Discretionary stocks have fallen by 4.3%. The charts below show the downward trend of the stocks in these sectors this year along with the volatility up and down along the way.



Charts Courtesy of StockCharts.com

We continue to focus on holding or buying stocks that are attractively priced, have earnings that are more predictable and have a foreign component to their earnings growth. We find such opportunities from our own bottom-up research and assessment of valuations relative to earnings. Meanwhile, we are taking opportunities to sell stocks that have met our expectations and price targets, or that no longer meet our expectations in earnings.

Christopher H. Lyford

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Vice President, Chief Investment Officer

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