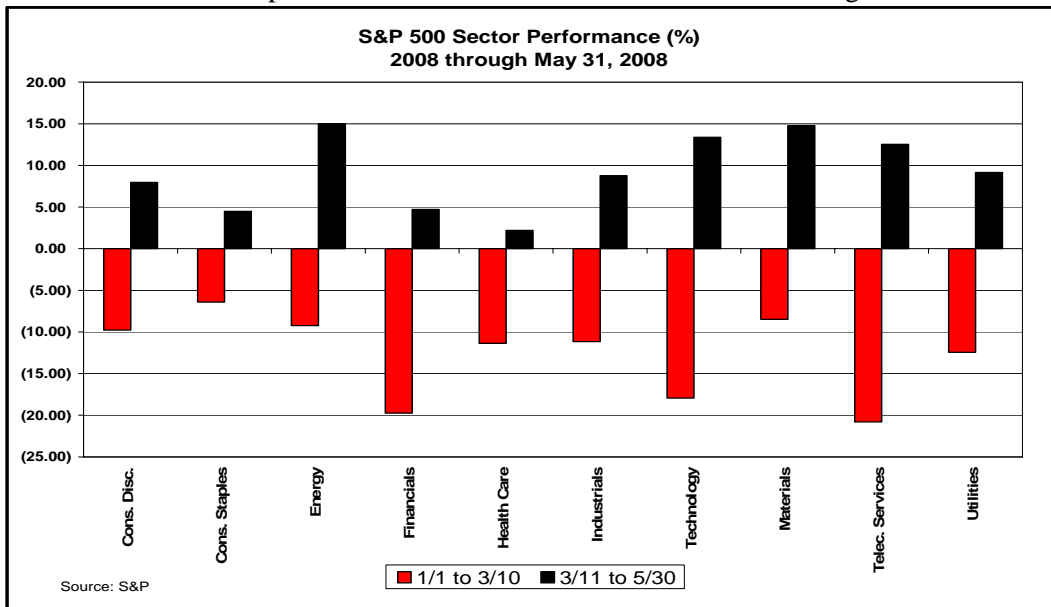


Market & Wealth Management Update May 31, 2008

Markets Rally from March Lows, Looking Beyond Economic Data – Too Soon?

U.S. stock markets ended May down 3.8% for the year-to-date on a total return basis as measured by the S&P 500. As in other times during the past few years, the path taken to the year-to-date number is a tale of two markets. From January 1st to March 10th, the S&P 500 declined 12.9%. Since the March lows, the market has rallied back over 9%. Not surprisingly, the leading sector now for the year is energy, which has gained 15% since its lows. The rally has been strong in growth oriented sectors such as technology stocks, which have gained 13% since March. The chart below shows the performance of each sector of the S&P 500 through March 10 and since then.



What should investors make of the improvement in Wall Street’s outlook since March?

The markets are clearly stating that they do not believe a recession is as likely, or that any slowdown is going to last long, and that the stresses on the financial system have eased. We continue to believe that challenges faced by the economy are greater than recognized by the market and that earnings estimates remain too high. The exception may be energy stocks, with the upward march of oil prices this spring, as seen in the chart below:

Market Statistics May 31, 2008		
	Level	YTD%
Dow Jones	12,638	-4.7%
S&P 500	1,400	-4.6%
NASDAQ	2,522	-6.7%
MSCI EAFE	2,145	-4.8%
Oil (WTI)	\$127.35/bbl	
Lehman Agg Bond Index		+1.2%
Federal Funds Rate	2.00%	
6 Mos Treasury Bill	2.01%	
2 Year Treasury Note	2.65%	
5 Year Treasury Note	3.42%	
10 Year Treasury Note	4.06%	



Economic Data Present a Differing View

The markets have staged a considerable rally since March given that the economic numbers, which ultimately pass through to corporate earnings, continue to paint a picture of tepid (or worse) manufacturing, employment, housing, and consumer situations. Recent manufacturing data show factory activity continuing to contract, as measured by the ISM data. Employment numbers for the last five months have shown an accelerating decline in payrolls.

The latest housing data reflect home prices falling 14% on a year-over-year basis, a change that while necessary to clear the huge overhang of inventories of unsold homes, creates a negative wealth effect on existing home owners. Sales of new single-family homes fell a whopping 43.4% in April compared to one year ago, according to the Bureau of the Census. New single family homes for sale stay on the market for an average of eight months now, up from an average of just four months last year. Condominium sales are particularly weak after the building boom in states like Florida. A recovery in housing may be some time off and prices may need to fall more.

Data on new fronts raise questions about whether a rebound of economic activity is on the horizon; Federal Reserve surveys show that banks are tightening lending standards substantially on most kinds of loans, including commercial debt and home equity loans. Consumers can no longer borrow on the inflated values of their homes, leaving one to question how they will find the money for discretionary purchases in the face of high gas and food prices. The conclusion we draw is that consumers may need to pull back even more. Strong numbers from discount retailers such as Big Lots, Wal Mart and Costco suggest how more shoppers are seeking deals.

Wall Street – Seeing Across the Valley or Too Complacent?

We believe that the rally since March may have difficulty sustaining itself in the near-term. The markets have been rising in anticipation of the economy reaching a bottom soon. However, warnings by consumer and financial firms, combined with the recent trend in U.S. economic data, present a case for being highly selective when buying domestic and foreign stocks at current valuation levels. We do continue to find good values in high quality stocks that can sustain through the current economic cycle, but otherwise remain cautious on the market.

Overall, the market may have become too complacent, as seen in the chart below, showing a decline in volatility despite the economic data and reflecting optimism that earnings will climb beyond already high expectations. Our discipline continues to produce investment returns in core portfolios that are significantly better than the market, with less volatility. Our cautious and patient approach allows us to be nimble in picking stocks at attractive valuations, selling those at target and avoiding pitfalls identified by our fundamental analysis.



Christopher H. Lyford
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Senior Vice President, Chief Investment Officer

Acadia Trust, N.A. is a Maine-based wealth management firm, with a distinctive approach based on our disciplined research process, value-oriented style of equity investing and our high quality approach to fixed income investing. As a trusted advisor to our clients, we provide portfolio management, trust, estate, financial planning and retirement plan services throughout New England.

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