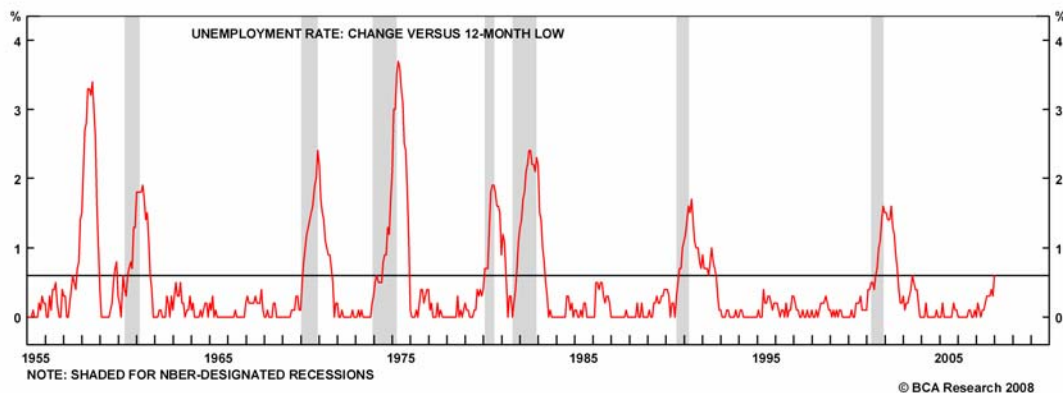


ECONOMIC & MARKET COMMENTARY

Evidence that the US economy is, at best, experiencing a sharp slowdown in growth continued to build through the first quarter. The U.S. unemployment rate moved up to 5.1% in March, bringing its increase to 0.7% from the April 2007 low of 4.4%. Historically, an increase of 0.5% or more has meant the economy is in a recession.

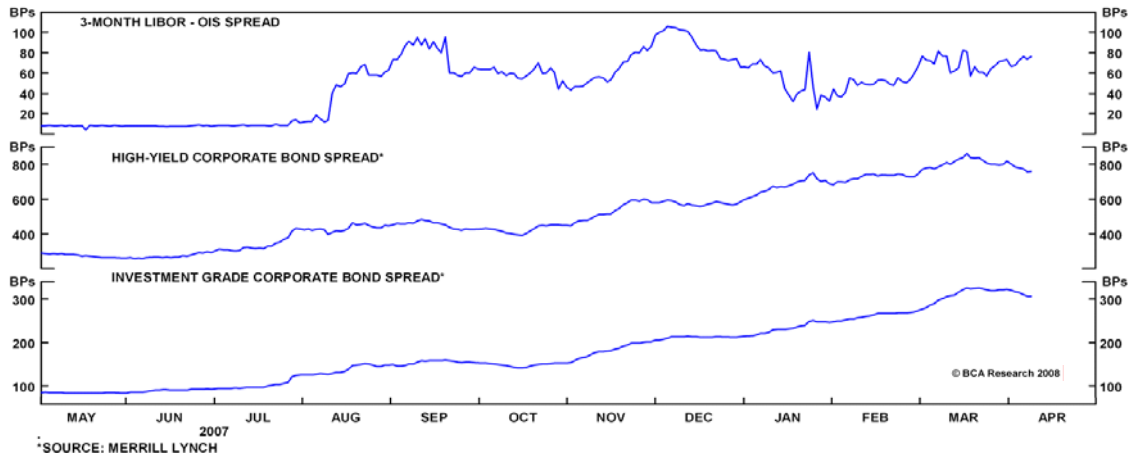


Consumer sentiment, as reflected by the University of Michigan Consumer Sentiment Survey, also at recessionary levels, is at its lowest point in 26 years. The financial markets have weighed in as well with a 20% decline in the S&P 500 from a high of 1,576 on October 11th to a low of 1,256 on March 17th. Moreover, the weakest stock market industry groups, such as consumer finance, banking and consumer cyclicals are the areas that should be weak in anticipation of a recession.

The yields on 10 year U.S. Treasury coupon and Treasury Inflation Protected (TIPs) securities, as seen below, moved to extreme lows that would usually occur in a major economic slowdown.

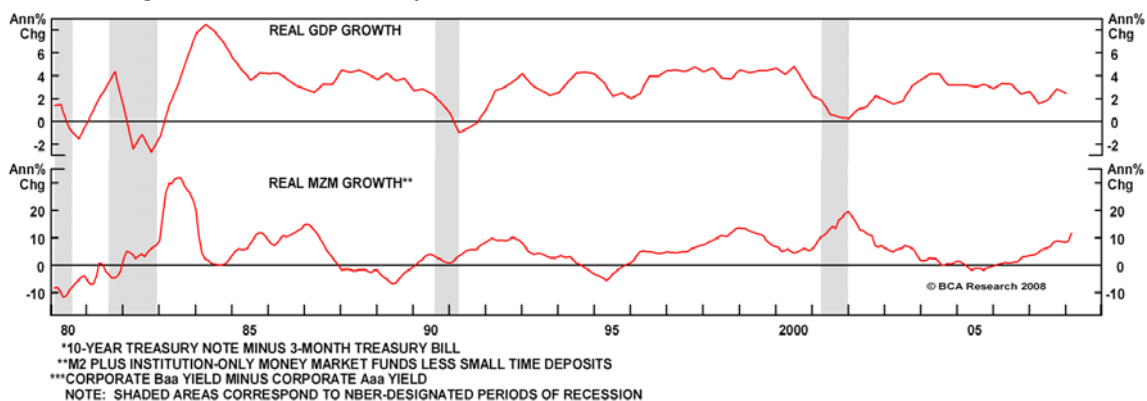


In addition, credit markets spreads (the incremental yield that an investor is paid over a U.S. Treasury security to purchase or hold a nonrisk free bond) expanded across sectors. LIBOR, High Yield (Junk Bonds), and Investment Grade Corporate spreads all widened as shown below. This widening of the spread also occurred in agencies, mortgage backed securities of all quality levels, credit cards and auto paper. Bond investors required a greater yield spread in anticipation of a recession and an increase in defaults.



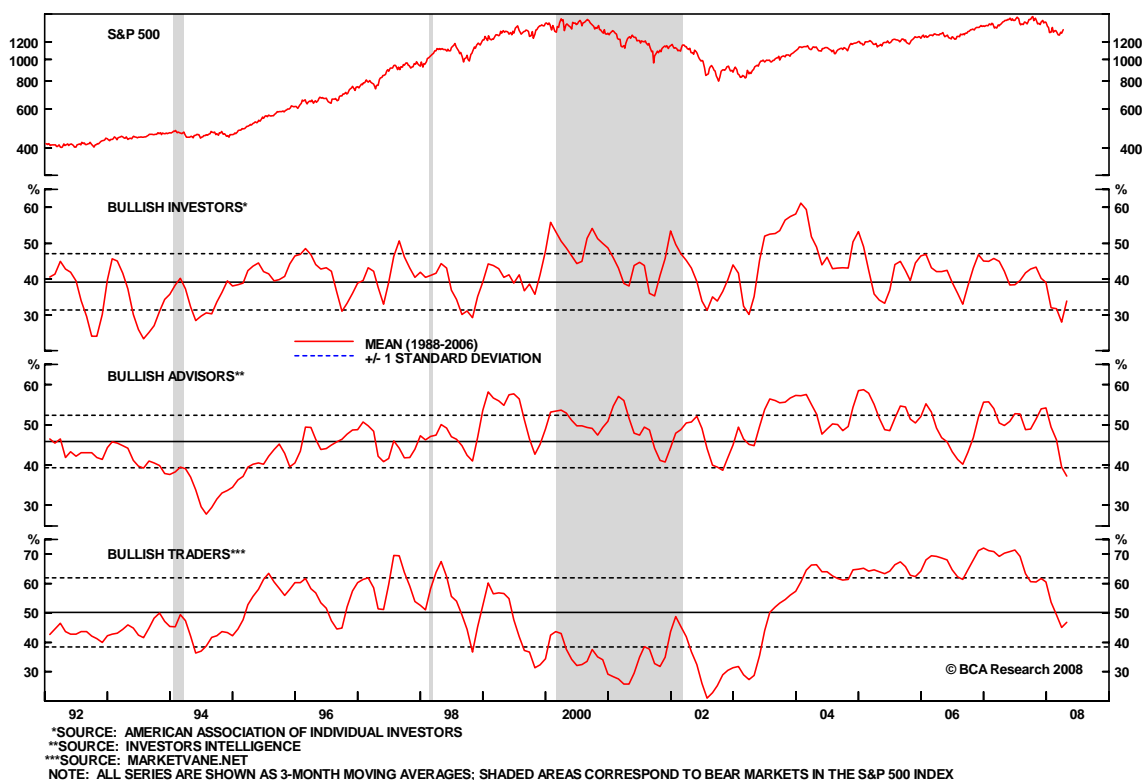
We think the evidence indicates that we are currently in a recession and this has been discounted by the financial markets. Although we may be able to navigate this slowdown without two consecutive negative real GDP (Gross Domestic Product) quarters, we believe that the technical semantics are hardly worth debating. We are in a slowdown that is centered on the financial and consumer sectors of the economy.

The good news is the Federal Reserve has recognized the severity of the problem and has increased the rate of money supply growth as shown below. High money supply growth allows the Fed to lower the Fed Funds rate. In addition, the Fed is focusing on getting financial institutions to buy and sell this liquidity and has lowered the yield spread between the discount window and the Fed Funds market. It has created some additional financing mechanisms for both commercial and investment banks. In the Fed's boldest move, it helped orchestrate the Bear Stearns "take under" by JP Morgan on March 17th. This action was basically a forced merger to prevent the bankruptcy of Bear Stearns and the possible systematic risk that Bear would be the first domino that could cascade throughout the financial system and cause numerous failures.

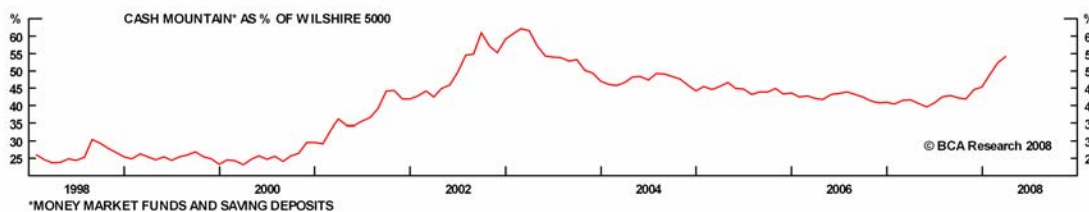




Stock investors are worried about the slowing US economy and turmoil in the credit markets. Negative sentiment is near extremes for most types of investors as shown below. Historically, this level of pessimism has occurred near market bottoms. As investors get nervous and negative, they tend to sell thus depressing valuations and creating a bottom. This appears to be the case now.



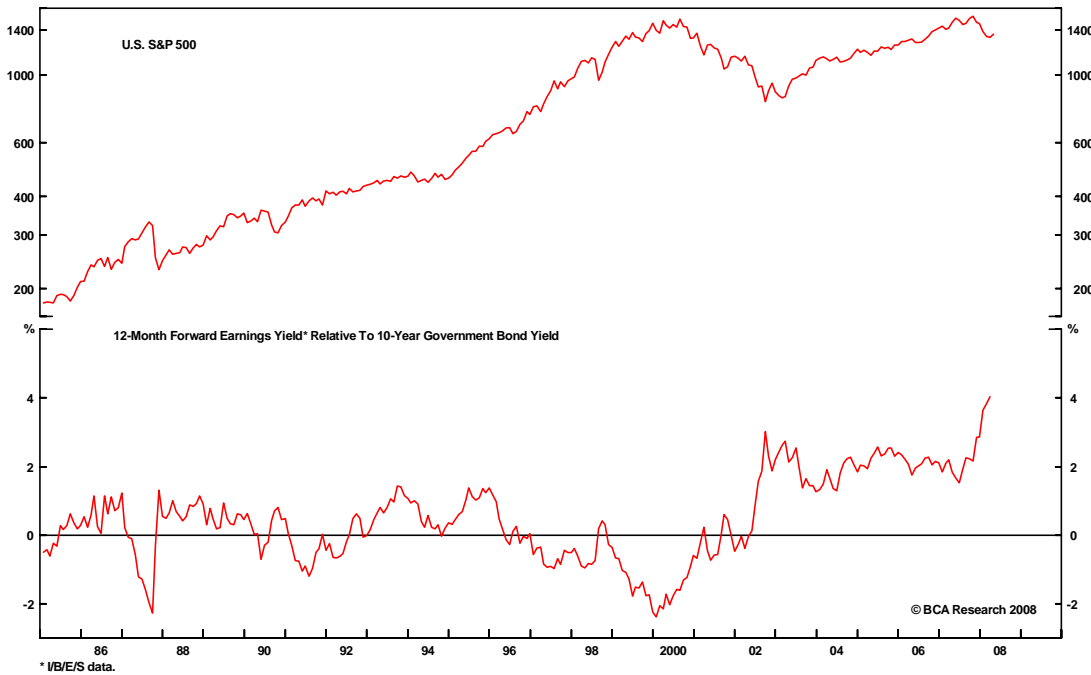
As shown below, cash as a percentage of the Wilshire 5000 (a broad stock market index) has moved up sharply, indicating many investors have moved to the sideline and are waiting for more clarity before buying back into stocks. As the US economic recovery becomes clear, investors will most likely redeploy cash back into stocks and, in our view, drive them higher.



Moreover, stocks are extremely inexpensive as compared to US Treasury yields. The bottom part of the chart below shows the stock market's earnings yield (inverse of the price earnings ratio) minus the 10 year Treasury Note. This measure of relative value of stocks versus bonds has surged to 4%. As you can see, this is an extreme high indicating stocks are cheap versus Treasury bonds.



As a point of comparison, at the market peak in March 2000 that same differential was negative 2%. The stock market's current low valuation would appear to confirm our belief that most investors are indeed negative and have raised cash that is poised to reenter the stock market at extremely low valuations.



This combination of factors should be conducive to a stronger stock market by year end, as it becomes apparent that the US economic downturn was relatively mild and short and a subdued economic recovery is indeed underway. The primary risk to our forecast revolves around the possibility that the recession could be far deeper and longer than currently envisioned. The coordinated action of monetary and fiscal stimulus should act as a support for the economy and prevent the most dire of outcomes. As discussed earlier, the likelihood of a negative cascade of failing financial institutions becomes more remote with each day and each major capital infusion. Systematic risk is contracting.

With all the negativity from consumers to small businesses or from bond investors to stock investors, it seems likely, in our opinion that we are close to a stock market bottom. The forced merger of Bear Stearns into J. P. Morgan and the ensuing angst on that Monday morning was most likely the bottom of the current bear market. Only time will tell, but investors usually feel the worst and are the most negative about the future near the bottom. That is, after all, how bottoms are made.