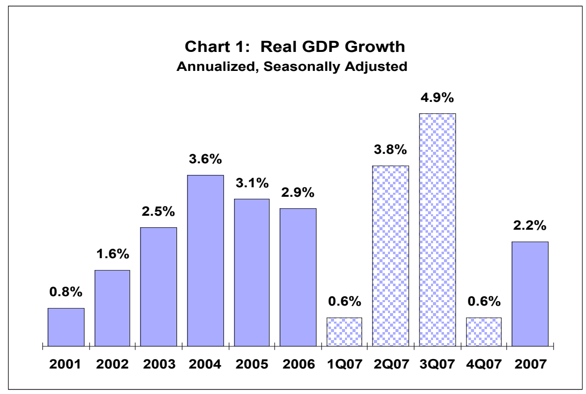
Investment Update

First Quarter, 2008

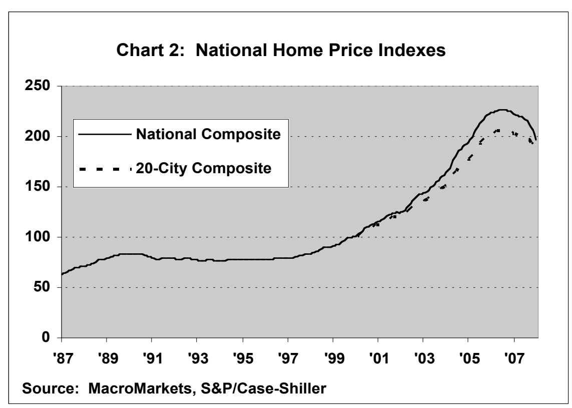
Economy

The U.S. economy slowed considerably at the end of 2007, growing just 0.6% in real terms in the 4th quarter versus an average of 4.4% over the prior two quarters. Much of this slowing was probably due to housing weakness and extremely volatile credit markets, which made everyone more cautious. Weak trends continued into 2008, and credit market conditions deteriorated enough to warrant unprecedented action by the Federal Reserve to contain damage from Bear Stearns' collapse. With this ongoing weakness, the economy may already have tipped into recession.



Then again, it may not have. The National Bureau of Economic Research is a private nonprofit generally considered the definitive arbiter of when recessions begin and end. It closely follows a number of economic indicators to judge whether the economy is contracting. If a contraction continues for more than a few months and affects the economy broadly, that defines a recession. The primary indicators are industrial production levels, real personal incomes excluding transfer payments, employment, and real total sales. Though each of these indicators has turned down in the last few months, they are each showing positive growth year over year and are well above the levels that have preceded recessions in the past.

Whether we are in or about to begin a true recession or a mere slow-down, things could easily be improving by the time it becomes clear which of the above this period is. What is clear is that the economy has lost momentum. With housing still weak, inflation picking up, and employment trends weakening, consumers have predictably hunkered down. Interestingly, individuals still are quite optimistic about their own circumstances, much more so than they are about the overall economy. Consumer spending is still holding up and not declining, but this major economic component is not contributing much to growth so far this year.



Residential construction (or the lack thereof) is still subtracting from economic growth, though of course fewer new-built homes are exactly what is needed before home prices can stop declining. Through January, prices at the national level have declined about 13% from the 2006 peak.

Two areas of the economy that had been strong have slowed: non-residential construction is coming under some pressure as borrowing costs have increased, and business investment has also cooled. This slowdown in business capital spending may prove to be temporary. Businesses may have delayed spending decisions as they waited to see the details of any investment tax credit provisions of the Economic Stimulus Act of 2008.

Exports are still the strongest segment of our economy. A weak dollar has played a large part in the surge in net exports over the past year. But whatever the future course of the dollar, higher economic growth abroad will probably continue to benefit U.S. exporters. Key to this outlook is that foreign economies will decouple somewhat from the U.S. economy. While less U.S. demand for imports will affect the rest of the world, most of our trading partners, especially in the developing world, have sufficiently diversified their end markets and have growing internal markets such that they are not as dependent on the U.S. consumer.

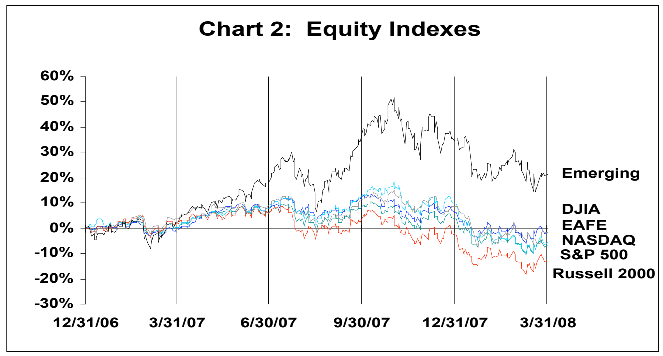
While economic conditions may worsen before they get better, we think that growth will improve within a few quarters. Housing is getting closer to a bottom. The Fed has unveiled powerful new tools to address credit market disruptions. Many of the financial sector's write-downs reflect worst case mark-to-market accounting, and could be at least partially reversed when conditions improve. The market is gradually weeding out firms and individuals that took too much risk. Outside the financial sector, corporate balance sheets are in good shape. Interest rates for borrowers with good credit are low by historical standards. Unemployment is still low and real incomes are still growing. While consumer spending may grow more slowly, it is unlikely to fall off a cliff. Tax rates are still relatively low. With regard to the future direction of tax rates, voters will soon be faced with a clear choice between a presidential candidate promising to maintain these low rates, and one promising higher rates.

Equity Markets

So far this year, there have been very few places to hide in the equity universe. Discounting slower future world growth and the increasing risks of a U.S. recession, stock markets around the world started to slide last October and have continued to fall this year. In the U.S. the best performers, with single-digit declines, were Consumer Staples, Materials, Industrials, Consumer Discretionary, and Energy. Utilities, Health Care, Telecommunications, Financials, and Technology all have suffered double-digit losses.

Where stocks are concerned, there are plenty of things to worry about, probably more now than usual. But after the large correction, equity markets are already discounting a lot of bad news.

Valuations are not on the list of things to worry about. Before the correction started the S&P 500 was priced quite reasonably at 17X trailing earnings, 15.5X forward earnings. Since then, valuations have come down sharply to 15.3X trailing earnings, 14.1X forward earnings. Currently, stocks as an asset class look relatively undervalued, especially compared to Treasury bonds, and if the focus is on individual companies, we can find numerous good investments, often at sale prices.



	2007	1st Qtr 2008	Since 9/30/07
Dow Jones Industrial	6.4%	-7.6%	-11.8%
S&P 500	3.5%	-9.9%	-13.4%
NASDAQ Composite	9.8%	-14.1%	-15.6%
Russell 2000	-2.7%	-10.2%	-14.6%
MSCI EAFE	8.6%	-9.5%	-11.4%
MSCI Emerging	36.9%	-10.7%	-7.5%

Credit Markets

Investors continue to value safety and quality over yields. As a result U.S. Treasuries, the safest and highest-quality fixed income investments, are expensive and offer very little yield compared to virtually every other credit market segment. This is particularly true in the case of municipal bonds, which are compelling values now.

The auction rate securities market has essentially failed, victim of the liquidity crunch. This market had allowed municipal issuers to borrow long- term at lower short-term rates. With the failure of this market, issuers have had to increase the supply of traditional municipal bonds to replace the auction rate securities, and this additional supply has driven municipal bond prices down and their yields up. At the same time, the general flight to quality has driven Treasury yields down.

This has produced an extremely rare situation. It is possible to buy highly-rated municipal bonds that offer tax-exempt yields (federal tax-exempt, and state tax-exempt for in-state investors) that are significantly higher than the fully taxable yields on U.S. Treasuries.