



**AND THAT’S THE “QUARTER” THAT WAS...  
For the Quarter Ended March 31, 2008**

*Market Matters...*

Market/Index	Year Close (12/31/07)	Qtr Close (03/31/08)	YTD Change
Dow Jones Industrial	13,264.82	<b>12,262.89</b>	<b>-7.55%</b>
NASDAQ	2,652.28	<b>2,279.10</b>	<b>-14.07%</b>
S&P 500	1,468.36	<b>1,322.70</b>	<b>-9.92%</b>
Russell 2000	766.03	<b>687.97</b>	<b>-10.19%</b>
Fed Funds	4.25%	<b>2.25%</b>	<b>-200 bps</b>
10 yr Treasury (Yield)	4.04%	<b>3.43%</b>	<b>-61 bps</b>

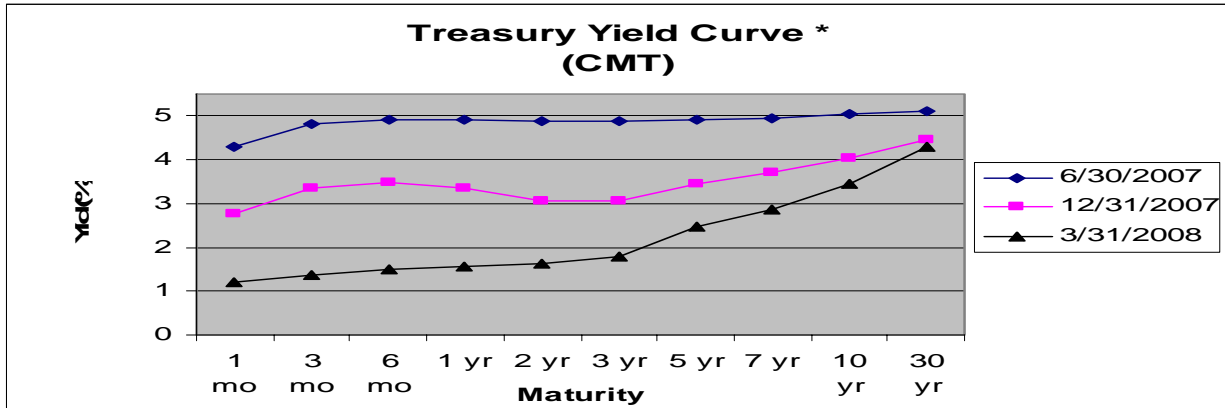
The three months ended March 31, 2008 may forever be known as “the quarter of Bernanke” (or even Spitzer, but that’s an entirely different story). Once known only as that bearded fellow who replaced the legend Alan Greenspan, the Fed Chair went a long way toward creating his own legacy with some creative maneuvers to help save the economy (and markets and financial institutions) from further deterioration. A scholar of the Great Depression, Gentle Ben was not about to allow the credit crisis to lead to economic collapse during his watch. So while politicians, financial execs, and regulators engaged in finger pointing and blame placing and offered few real solutions, Bernanke was busy earning his “lofty” government pay. During the quarter, his team lowered the funds rate by 200 bps including one inter-meeting rate cut of 75 bps in late January. He added liquidity to the system by expanding the auction process and allowing more mortgage-related products to be used as pledge-able assets. He initiated a direct lending program for investment banks (similar to the discount window for commercial banks). And, for good measure, he orchestrated a “bailout” of **Bear Stearns** via an acquisition by **J.P. Morgan Chase**. (By the way, rumor has it, his bracket is leading the Final Four pool at the Fed...Go UCLA.)

The Bear/JP Morgan deal highlighted the negative news among financials which saw **Citigroup** and **Merrill Lynch** post record losses and suffer through the worst quarters in their illustrious histories. **Lehman Brothers** fought off speculation that it would be the next to falter and remained alive and kicking at quarter-end. Congress and the Prez put partisanship aside (not really) and initiated a \$168 billion stimulus package that relied heavily on “W” favorite cure-all, tax cuts (or rather rebates, in this case). Late in the quarter, Treasury Secretary Paulson announced a controversial proposal for widespread financial regulatory changes, though the current Administration will be long gone before any of the plan is ever approved.

Surging energy prices (and other commodities) renewed inflationary fears as oil soared above \$100 (make that \$110) per barrel during the quarter. Hugo Chavez made a few idle threats to cease oil sales, OPEC refused to increase production citing U.S. “economic mismanagement,” and Castro rode into retirement sunset. Some analysts believed the inventory readings did not justify the elevated prices, and energy supply was more than ample to meet summer demand. Sheer speculation and the plunging dollar were seen as primary culprits for the runaway prices.

The Dow suffered its weakest first trading day (in percentage terms) in 25 years and never looked back. For the quarter, it lost 7.5%, it’s worst showing in 5.5 years or just after the bursting of the Internet bubble. (Anyone still holding **theglobe.com**?) The S&P 500 (-9.9), Nasdaq (-14.1%), and the Russell 2000 index (-10.2%) followed the Dow’s lead, with the tech-heavy Nasdaq and small-cap R-2000 down over 20% from their October highs. (Of note, the traditional definition of a bear market is a 20% decline in market value.) High-quality bonds reaped the benefits of the equity downturn as investors turned to the safe-haven of U.S. Treasuries. Perhaps, the aftermath of the “quarter of Bernanke” will prove to be more positive for stocks. Keep on plugging, Dr. B.

## Economically Speaking...



\* Reflects changes in interest rates over various time frames.

Leave it to the great prognosticators to show up late to the forecasting game (again). In early January, a **WSJ.com** poll showed that 42% of economists surveyed felt that the dreaded “R” word was inevitable. By March, that number had jumped to over 70%, many of whom believed the country was already stuck in the midst of recession. By true definition, the significant economic downturn is marked by two straight quarters of negative growth. In the 4<sup>th</sup> quarter 2007, GDP climbed by a feeble 0.6%, far lower than the 4.9% rate experienced in the 3<sup>rd</sup> quarter, but still slightly positive. While recession may have not reared its ugly head quite yet, many of those same “experts” anticipate 1<sup>st</sup> and 2<sup>nd</sup> quarters 2008 data to reflect economic contraction. (If these guys/gals keep speculating, it may just become self-fulfilling...hopefully not on Bernanke’s watch.) On an optimistic note (for a change), Ned Davis Research indicated that over the last 10 recessions, equity prices have soared on average 24% within six months of hitting their lows.

The consumer remains one of the leading contributors to the overall strength (or weakness) of the economy. When 2008 began, retailers were moaning and groaning about their lackluster holiday seasons. In fact, retail sales experienced its poorest annual showing since 2002 and the National Retail Federation anticipated that 2008 would be even worse. While **Wal-Mart** benefited from a consumer shift to discounters, management pointed out that many of its sales revolved around necessities like diapers and detergents as opposed to pricier luxury items like iPods and DVD players. As the quarter came to a close, another bellwether retailer, **J.C. Penney’s**, confirmed its own reduced activity and lowered expectations for future sales and earnings. Further, the consumer confidence index recently fell to its lowest level in five years.

A frightening labor picture may prevent consumers from emerging from hibernation any time soon. Over 60,000 nonfarm jobs were removed from the economy in February as companies engaged in cost-cutting measure in light of the recessionary fears. Both the manufacturing and services sectors revealed contraction (as measured by their respective ISM indexes among other data), and inflation concerns grew as oil prices surged well above \$100/barrel. While Bernanke and friends have been hard at work managing the economic downturn, they kept watchful eyes on the various inflation releases as lower interest rates often lead to greater price pressures.

The housing market moved no closer to a turnaround last quarter as recent data revealed that building permits (considered a forecasting number) fell to its lowest level since 1991. Likewise, new home sales in February plunged to levels not seen in 13 years, even though the S&P/Case-Shiller index showed that home prices continue to plummet. For now, the negativity remains, though Bernanke is keeping his creative juices flowing and is determined to quash the prolonged downturn (despite what those great prognosticators may be saying).

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