"It's tough to make Prediction's – Especially about the Future." *Y. Berra*

Yogi Berra's gems may have their origin in baseball, but investors might think he was a commentator on CNBC, and was referring in this case to the stock market. The first quarter of the New Year saw a continuation of the volatility experienced during all of 2007 (predicted by most), more weakness in the residential housing market (predicted by many), and the collapse of Bear Stearns (predicted by nobody). The Federal Reserve Board not only served up a platter of lower interest rates in the form of both discount and fed funds rate cuts to help the slumping economy, but also threw in some other financial machinations designed to encourage mortgage lending and resuscitate the moribund housing market. The caps on mortgage lending of government sponsored Fannie Mae and Freddie Mac were increased, and the use of a relatively new monetary tool, term auction facility or TAF (just what we need, another acronym), was expanded. It is worth noting that despite this aggressive action, the rates on 30-year mortgages have not moved down in lockstep, and at present are hovering just under 6%. This suggests that lenders are reluctant to make loans to anybody, but the most credit worthy, and at rates higher than usual.

The aforementioned demise of Bear Stearns brings to mind another matter worth mentioning. Founded in 1923, the Bear had a reputation, be it deserved or not, as being somewhat of a gunslinger on Wall Street. Over the years, vast amounts of money was made by savvy bond traders who made large bets on the direction of interest rates, as well as the credit quality of the issuers. Alas, the effects of leverage are felt both ways, as by some accounts, the firm was levered out at a ratio of about 33 to 1. Being one of the most active participants in the imploding sub-prime mortgage market, it took less than a week for Bear Stearns' capital to all but disappear, forcing them to seek an acquirer to prevent bankruptcy. The point of this observation is that the use of margin to finance investments, be they stock, commodities, real estate, or any other instrument, is fraught with peril. Margin calls can destroy wealth overnight, or in Bear's case, over the weekend, as JP Morgan came to the rescue with the backing of the government.

At quarter's end the S&P 500 index has declined 16.1% from the high set early last October. Although a drop of this magnitude does not meet the strict definition of a bear market, that being a decline of 20% or more, it sure feels like a bear market. Besides, it's not worth splitting hairs over a few percentage points. This decline in stock prices has been led by continued problems in the financial sector. Losses attributed to creative but ultimately unworkable home mortgage financing products that we alluded to in our year-end newsletter are clearly the culprit. The industry shakeout affecting banks, mortgage companies and homebuilders showed few signs of abating in the first quarter. On the other hand, companies with an international reach have, on balance, performed well, given that the global economy remains strong.

Remembering that the stock market typically discounts the future, often by as much as six months or more, it appears to us that some of the pieces that presage a recovery are in place. The key is earnings reports, and more importantly, guidance offered by companies for the second quarter and remainder of the year. We expect that lower interest rates and the recently enacted economic stimulus package will eventually provide a tailwind to the economy that could well provide a bottom from which the financial markets could have a meaningful rebound. However, for now, we will heed Yogi Berra's advice about predictions and refrain from forecasting the exact timing of the coming recovery. To invoke one more Yogi-ism, *"you can see a lot just by observing",* we will watch earnings reports and corporate commentary closely to see if these tailwinds have an impact as the summer nears, and will adjust portfolios as necessary to take advantage of opportunities.

As always, we invite your comments, and if you have any questions or concerns, please feel free to call anytime. We are including a copy of our privacy policy per SEC requirements. In addition, if you would like a copy of our disclosure document (Form ADV Part II), please let us know and we will provide one to you.

Scoreboard Q1 2008

Dow Jones: - 7.6%
S&P 500: - 9.9%
NASDAQ: - 14.1%

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April 1, 2008