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Investment Outlook First Quarter 2008

2007 Year in Review

The first quarter of 2007 began much like 2006 ended with strong corporate earnings growth offset by soft economic growth. Two years of Fed interest rate hikes ending in July 2006 created the intended effect of slowing economic activity while preventing recession. The Fed appeared successful in engineering the elusive soft landing as U.S. real GDP growth slowed to an average of 1.5% for the four quarters ending in 2007's first quarter and then rebounded sharply to an average of 4.35% in last year's second and third quarters. Underlying this robust recovery, trouble was brewing in the credit markets. With the housing market continuing to unravel, mortgage credit concerns began to appear in the second quarter. The first signs of danger revealed itself in June when Bear Stearns and Goldman Sachs were forced to inject billions of dollars worth of capital to rescue several hedge funds they had sponsored who were hurt by leveraged bets on sub-prime mortgage securities.

DJIA

S&P 500

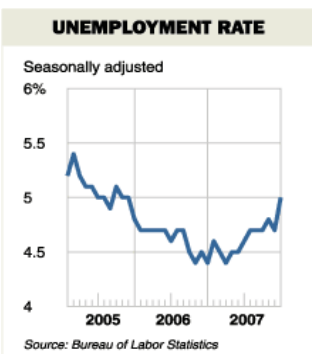
NASDAQ

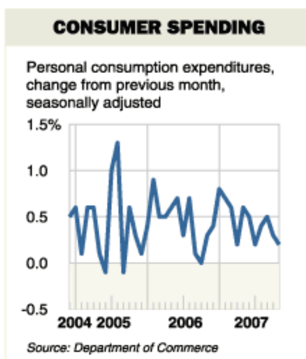
The DJIA surged to an all-time high above 14,000 by mid-July as the stock and bond markets initially shrugged off sub-prime credit worries as manageable and contained. That analysis quickly proved itself wishful thinking as credit markets deteriorated and stock markets around the world tumbled by upwards of 10% within a month. The Fed found it necessary to suddenly reverse its focus from fighting inflation to stabilizing U.S. and world credit markets and slashed the discount rate (the rate at which the Fed lend money to member banks) by 50 basis points and central banks around the world injected massive monetary reserves into their financial systems. One of the consequences of lower U.S. interest rates was a tumbling dollar. However, when the Fed lowered the Fed Funds rate (the rate at which banks lend to one another) and the discount rate by 50 basis points at their September 18, 2007 Federal Open Market Committee (FOMC) meeting, investors ignored the negatives and world credit and stock markets responded favorably. The U.S. stock market embarked on a rally that culminated in another all-time high for the DJIA above 14,000 by mid-October. Unfortunately, that advance proved to be short-lived as major banks and brokers around the world began to provide disturbing insights into the magnitude of sub-prime and other mortgage-related losses and write-downs. As the year came to a close, the odds of a housing related and consumer led recession had increased to nearly fifty percent. Major U.S. stock market indexes posted modest gains for 2007 with the DJIA up 6.4%, the S&P 500 higher by 3.5% and the Nasdaq rising by 9.8%. Excluding the performance of Research in Motion, Amazon.com, Apple and Google, Nasdaq would have appreciated by only 4% indicating the overall number was distorted by these four momentum names.

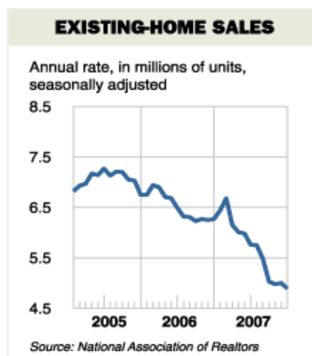
2008 Economic Outlook

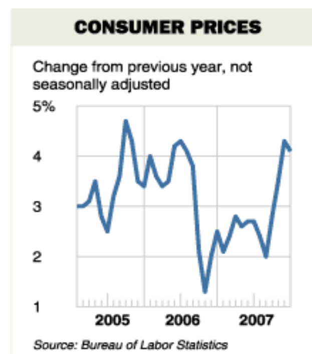
Within the first week of 2008, two new reports re-set expectations for U.S. economic activity for the year ahead. On January 2, the ISM index, a key measure of U.S. manufacturing activity, was released revealing a sharp and unexpected contraction. The sudden decline in new orders signaling slower future business activity may indicate trouble for the overall economy. With consumer spending already under pressure, the economy can ill afford weakening in manufacturing and business activity. As if that weren't enough, a few days later, the December jobs report was released indicating much slower than expected job creation and a big jump in the unemployment rate from 4.7% to 5.0%. These two reports have heightened worries that the housing downturn is spilling over into a growing list of goods producing industries and increasing the risks of recession. As a result, most economists now believe the likelihood of recession in the first half of the year is almost seventy percent. With U.S. and global stock markets collapsing to near bear market territory (typically defined as a decline of 20% from the peak) in rapid fashion, monetary authorities and the Federal government have reacted with the type of alacrity not often seen. In a bold move, the Fed lowered rates by 75 basis points just a week before a regularly scheduled FOMC meeting. Within the same week, in a rare display of bipartisanship, the President and Congress agreed in principle on a short-term economic-stimulus plan they hope will forestall a recession. Cynical observers might point to 2008 as being a year in which both U.S. presidential and congressional elections are held as the real reason behind this bipartisan effort as neither party wants to be viewed as non-responsive to voter's economic ills.

While the combination of rapid Fed easing coupled with federal fiscal stimulus may not be enough to avert recession, it should cushion the decline and stands a good chance of preventing a long and deep downturn. And although the housing market may still have more downside, the combination of lower prices and mortgage rates near 5% should allow a bottom to be reached sometime this year. With energy and many commodities prices beginning to fall from recent highs as global economic growth expectations begin to wane, consumers should experience the beneficial effects of lower inflation and lower interest rates as the year progresses. In summary, we would expect a weak first half for the U.S. economy followed by improvement in the second half, partly orchestrated by artificial, and most likely, short-lived fiscal stimulus engineered by the federal government.







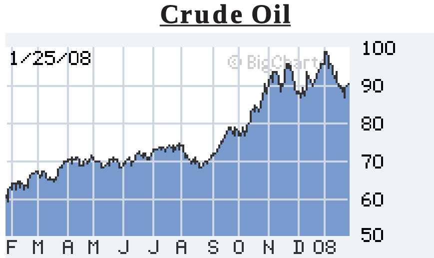


Capital Markets Analysis

Recession fears and Fed action have caused bond yields on investment-grade instruments to plummet in the past several months to levels not seen in four years, near the depth of the last Fed easing cycle. Six-month U.S. Treasury Bills currently yield 2.4%; five-year Notes yield 2.8% and ten-year Notes yield 3.6%. With this in mind, we prefer to reinvest maturing bonds in short-term vehicles awaiting higher rates sometime in the future, perhaps as soon as the second half of the year as investors react to dual fiscal and monetary economic stimulus and with investors seeking a safe haven in government securities, yield spreads between high-grade and high-yield (lower-grade) fixed income instruments are at the highest level seen in five years and well above the average spread witnessed in the past. At these yield levels, some exposure to below investment-grade fixed income securities makes sense as investors are being more than fairly rewarded to the tune of almost 7% excess yield spread over U.S. Treasury securities for the average high-yield bond (junk bond).

10 Year US Treasury Yield

Crude Oil



Gold

With U.S. equity markets having already corrected between 15% and 20% from their October highs, one must contemplate whether stocks are headed for a sustained bear market, or whether the market will quickly rebound from these depressed levels. Given reasonable valuation metrics, already low inflation and interest rate levels and aggressive monetary and fiscal stimulus, we don't believe bear market conditions are likely to last very long. This doesn't mean investors should expect a sharp or sudden reversal to the upside anytime soon as history suggests credit market disruptions generally take time to repair. A bottoming process may take another quarter or two and no sectors are likely to be spared as corrective action normally rolls from one group to another until nearly every segment of the market suffers some pain.

While much of the damage may have already occurred, erratic and volatile stock price swings will continue as investors react to rumors and economic headlines. When stocks no longer sell off on bad news, we'll have a better sense that a bottom has been reached and opportunistic long-term investors are taking advantage of bad news or lower prices to build strategic positions. By the second half of the year, when the economic stimulus begins to be felt, stocks should move noticeably higher. International equity markets should follow a similar path as U.S. stocks with weakness in the first part of the year followed by increasing strength as the year progresses. We favor Asian and Latin American markets vs. European markets however, as Europe appears to be following the U.S. economy with a lag and the European Central Bank has stubbornly refused to lower short-term rates, choosing instead to focus on fighting inflation. When the ECB finally recognizes the need to cut interest rates, the Euro should begin to weaken against the U.S dollar and the Japanese yen. Oil prices, after briefly touching $100 per barrel, have declined to the high $80s as of this writing and could weaken further in the short-term as demand abates along with slower global economic activity. We are still of the opinion that oil and commodities are in the midst of a long cycle which will lead to higher prices again when global economic growth begins to reaccelerate. Speaking of commodities, a number of clients have inquired about investing in gold. Today's gold investors are hoping that gold will help protect against the effects of inflation, recession and volatile stock prices. Based upon ongoing concerns in these areas, the price of gold could continue to rise. As to real estate, with residential prices expected to bottom sometime later this year, commercial properties should follow suit given a low interest rate environment and much more equilibrium between supply and demand. With many Real Estate Investment Trusts (REITs) having lost more than one-third their value over the past year, we find current valuations and dividend rates to be attractive for selected REITs for long-term investors.

Risks

The most prominent risk facing investors is that monetary and fiscal stimulus fails to evoke the intended response from consumers and businesses. If banks and other lending institutions merely rebuild capital and tighten credit standards too severely, a longer lasting credit crunch could preclude economic activity from rebounding as anticipated. Another potential risk is a more severe slowdown in global economic activity. As the U.S. dollar weakened over the past several years, exporters have benefited from more competitive prices. Should our trading partners demand fewer of our goods and services, it will prolong the economic downturn in the U.S. as one of the few pillars of strength within our economy will have been toppled. One other economic hazard is the possibility of rapidly rising delinquencies in credit card loans, auto loans and other consumer or business debts. While a certain increase in these loan categories is expected in any downturn, a spike beyond

expectations would extend the economic downturn and deepen the current credit crunch. Further down the road, there are fears that the Fed's aggressive rate cuts could provoke inflation concerns once a recovery takes hold. Finally, in today's dangerous world, geopolitical risk is always a fear. At any time, one of the world's hotspots could erupt from a terror attack or political instability in Iran, Pakistan, Iraq, North Korea, Venezuela, the Middle East or any of a half dozen nations in Africa.

Strategy

Diversification and liquidity have been keys to successful investing over the past twelve months. Most markets having corrected substantially and risk premiums having risen from below normal to above normal, making it actually a better time to begin to deploy liquid assets on an opportunistic basis. With inflation and interest rates at low levels and valuation metrics historically reasonable, today's low prices are likely to translate into tomorrow's opportunities for those with an appropriate investment time horizon. Within fixed income, we intend to park cash in short-term investment vehicles until interest rates become more attractive.

In our U.S. equity portfolios, our plan is to use the recent market decline to rotate into beaten down sectors we have been under-exposed to such as financial services and consumer discretionary, as opportunities present themselves. With aggressive Fed action to lower lending rates, we believe it is highly likely that banks and brokers will be major beneficiaries six to nine months down the road.

With many of these companies trading near 52 week lows and in some cases more than 50% below recent highs, valuation levels have become quite compelling for the long-term investor. As these organizations realize necessary asset write-downs and rebuild capital, the survivors will be better positioned to gain market share and enhance their shareholder returns in the future. Similarly, as consumer spending has slowed, many retailers have witnessed harsh declines in their share prices. Inevitably, there will be winners and losers as the weaker players are pushed aside by stronger operators which will then be positioned for outsized gains as the economy and consumer spending recovers. We will be in search for the next crop of leaders from this beaten down sector in the months ahead. On a longer-term basis, we still believe energy and other commodity related sectors will continue in long-term up-trends after a bit of a respite as worldwide supply of many of these resources remain constrained relative to the new demand from emerging economies in southeast Asia, South America, and eastern Europe.

With economic activity in these geographies likely to grow faster than the U.S. for some time, we expect to use any continued weakness in international equities markets as an opportunity to increase exposure from 5%-10% of our equity portfolios to 10%-15%. And as indicated earlier, we believe the capital flight to safety which has depressed government and high-grade bond yields and increased risk premiums for high yield instruments, including many closed-end bond fund and REITs provide attractive entry points for patient, long-term investors.

Advisory Comment

For taxable investors, the single best advice we can offer is to reiterate the comments from our fourth quarter investment outlook regarding capital gains taxes.

Current dividend and long-term capital gains tax rates of 15% are set to expire on December 31, 2010. As we look ahead to Presidential and Congressional elections next year, there appears to be an increasing possibility that 2008 may be the last year capital gains taxes remain at 15%. While anything can happen over the next year to change the odds of a democratically controlled Congress coupled with a democratic administration, that potential seems most likely as we look forward. And we believe that if the democrats sweep, they will seek to change the tax rate on capital before the 2010 expiration through a comprehensive “tax reform” package. Though we don’t know the magniture of any rate increase, we wish to advise you of these prospects for planning purposes. If you are sitting on large capital gains and considering sale of assets or require additional liquidity at some time in the next few years, 2007 and 2008 may be more desirable to realize those gains than in years beyond these.

Also, we are preparing to begin quarterly interactive webcasts in which we will share our economic and market comments and provide an opportunity for our clients to ask questions about economic and capital market issues. We are currently in the process of recreating and enhancing our company website in order to make it more of a resource for our clients. We will keep you apprised of these developments as they unfold.