



Financial Review

Financial markets in the first quarter of 2008 were quite volatile as investors were confronted with a number of negative events throughout the New Year. Although the markets were clearly affected by restrictive credit, hundreds of billions of dollars in asset write-downs at financial institutions, deteriorating economic data, fraudulent behavior (a rogue trader at Societe General generated losses for the bank in excess of \$7 billion), and illiquidity of previously regarded liquid investments (auction rate bonds), the most significant event was the near collapse/bailout of Bear Stearns.

Many stories concerning Bear Stearns have been written in the last month – can a made-for-TV movie be far behind? Rather than exploring all the complex aspects leading up to the Federal Reserve/Treasury Department/JP Morgan bailout in March, it is more appropriate to discuss what we believe the consequence of this event is to capital markets in the weeks and months ahead.

If the Fed/Treasury did not intervene, Bear Stearns would have been forced to declare bankruptcy on March 17th, an event that very likely would have triggered market declines of 10% or more that day due to the breadth of “systemic” exposure to Bear Stearns. Furthermore, it is probable that markets would have remained in a constant state of fear for several quarters, perhaps leading to longer-term ills for the broader economy.

A coordinated effort between government agencies and JP Morgan was successful in avoiding a failure of Bear Stearns (and the likely destruction that would ensue). The

appropriateness of the actions/interference by the government will be debated for years to come. Regardless of one’s conclusion, we have little doubt that the effects of the positive outcome (positive other than for the employees and shareholders of Bear Stearns) have meaningfully altered market sentiment - to the point where investors now are seemingly more confident that the Fed and the Treasury are fully engaged (and have the resources) to confront this liquidity/credit crisis.

Do we believe markets are poised to begin a new bull market?

We view it highly unlikely the markets will stage a meaningful rally over the next few months. We believe the Bear Stearns episode signals a new proactive role of government in the capital markets suggesting that the downside potential is perhaps more limited with this assumed backstop. Based on our view that the economy will take longer to recover from this morass, we believe the stock market will be range-bound for the next few quarters, with the second quarter perhaps more volatile as earning reports offer potential clues as to the effect the economic slowdown is having on corporate profits.

Core Equity Portfolio

During the quarter, we initiated a position in Smithfield Foods, and exited LabCorp and National Semiconductor.

Smithfield Foods is the world’s largest hog producer and pork processor. We recently

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purchased shares primarily due to two trends in Smithfield's favor. In the short-term, domestic demand of pork (relative to beef), may benefit in a more difficult economy, as preferences may continue to shift toward cheaper sources of protein. In early January, domestic pork production exceeded beef production for the first time ever according to the USDA. Longer-term, Smithfield stands to be a major beneficiary of global demand growth for hogs, particularly in developing countries like China.

We originally purchased LabCorp, a provider of clinical laboratory tests, in 2003, after the stock was unfairly punished due to concerns that hospital labs would eat into LabCorp's share of the testing market. Over the ensuing five years, management successfully fended off this competitive challenge, growing share and margins sufficiently to produce average earnings growth of 18%. Recently, our analysis concluded that the stock price adequately reflects the prospects for the company, leading us to eliminate our position.

National Semiconductor, a manufacturer of semiconductors addressing consumer and communication end markets, was originally purchased in 2001 as the company was successfully adding new features on its wireless phone circuits in order to garner greater revenue per phone. Despite volatile end-market demand, National Semi generated substantial earning growth over much of the ensuing period. Due to our belief that these markets are susceptible to deterioration in the current economic slowdown, we decided to exit our position.

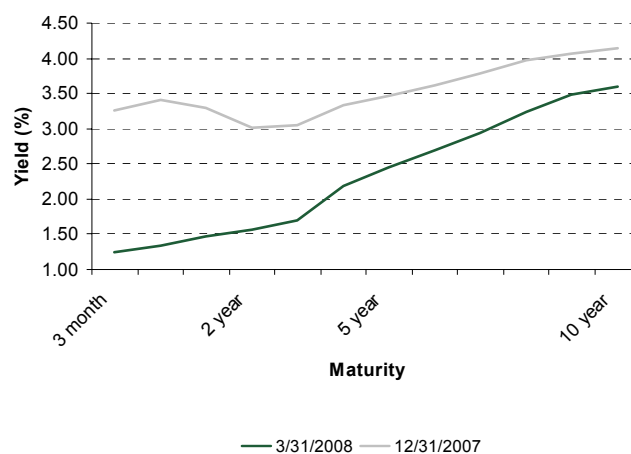
On a relative basis, core portfolios held up reasonably well in the quarter - due as much to what we don't hold (homebuilders, mortgage lenders, mortgage insurers, and

investment banks) as to what we do hold (energy and cash). We remain in a defensive mode, although at current valuations we believe some stocks are looking more attractive.

Fixed Income Markets

Troubled credit markets and signs of continued weakening in the economy forced the Federal Reserve to cut short-term interest rates an additional 200 basis points in the first quarter.

Treasury Yield Curve



The yield curve also was affected by trouble in the municipal bond market, as bond insurers saw their credit ratings reduced due to mounting losses from mortgage securities. Municipal bonds also were penalized as certain municipal bonds that are bought/sold through weekly or monthly auctions failed to generate sufficient interest on the buy side, forcing many issuers to pay a substantially higher penal rate as a result of the failure. As investors sought safety from these concerns, risk avoidance led to purchasing treasury

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securities, further reducing rates on short-term government bonds.

As a result, municipal bonds are now trading at very attractive levels, especially relative to taxable alternatives. We have recently extended out durations in portfolios and anticipate continuing this trend in the second quarter. For taxable bonds, we continue to prefer corporate and foreign bonds to treasury and agency bonds as spreads have widened to attractive risk-adjusted levels.

Alternative Investments

Equity Long/Short strategies generally lost money for the quarter, although as expected, they protected capital better than most long-only funds. Managers entered the year with lower market exposure, but they were generally long emerging markets, one of the worst performing regions.

Global merger and buyout deal volume was off more than 30% from a year ago, limiting the opportunities for **Merger Arbitrage** managers. At quarter-end, Clear Channel Communications became the latest corporate buyout victim failing to close their deal, and capital continued to exit this segment.

Long Credit managers fared poorly in the quarter. Bank debt spreads continued to widen, hurting managers who were long securities at what they believed were attractive prices. Capital requirements, lender demands and investor withdrawals propelled a vicious cycle of price declines. When managers trade out of positions for risk rather than return reasons, fundamental research in the short term creates little benefit.

The Fed intervention at Bear Stearns successfully lowered systemic risk in the

marketplace. However, this hurt several widely used shorting strategies by hedge funds. **Convertible Arbitrage** managers, for example, often short the credit default swaps (CDS) of their bond issuers. Convertible bonds sold-off during the quarter as spreads widened, and then CDS prices rallied post the Fed move. Managers lost money on both sides of the trade.

One Year Economic Overview

		Mar 2008	Mar 2007
Stock Market			
S&P 500 Index	▼	1,322.70	1,420.86
Russell 2000 Index	▼	687.97	800.71
Fixed Income Yields			
3-Month Treasuries	▼	1.24%	5.05%
5-Year Treasuries	▼	2.45	4.53
10-Year Treasuries	▼	3.60	4.66
30-Year Treasuries	▼	4.29	4.83
Inflation Monitor			
CPI-Trailing 12-Month Growth	▲	4.0%	2.4%
CPI-(Excluding Food/Energy)	▼	2.3	2.7
Market Expectations*	▲	2.5	2.3
Gold (per ounce)	▲	\$916.88	\$663.79
Crude Oil (per barrel)	▲	101.58	65.87

*Comparison of yields for 10-Year Treasury and 10-Year TIPS