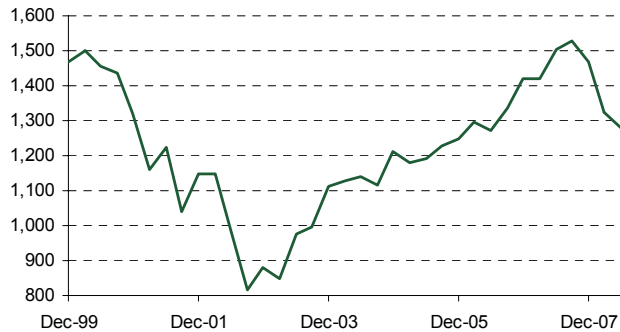




## Financial Review

After recovering briefly in April and May, equity markets finished the second quarter on a particularly weak note. For the first six months of the year, the S&P 500 Index has fallen 11.9%, while the MSCI EAFE Index declined 10.9%.

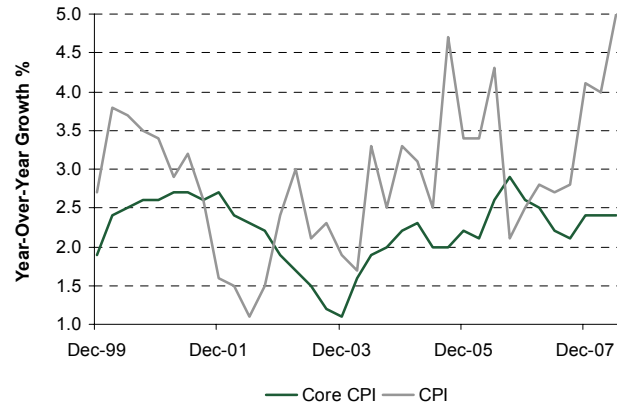
S&P 500 Index



Since peaking early in the final quarter of 2007, most market indices have declined by over 20%, causing many to define this as a “Bear” market. Despite the recent losses, the S&P 500 has still held onto most of the gains realized during the 2003-2007 “Bull” market.

Although many attribute the weak stock market to slowing economic growth worldwide, we believe a significant contributor to the decline in June (and early July) is heightened concern with inflation.

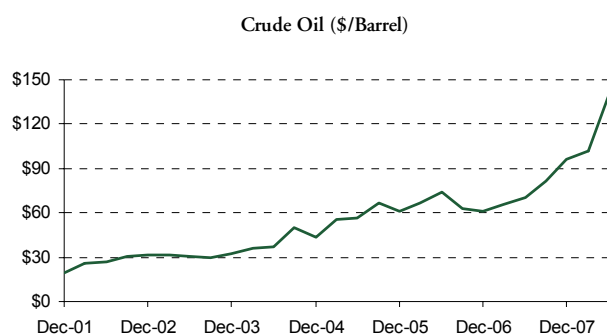
Inflation



As the chart above shows, inflation as measured by the Consumer Price Index has been on the rise for most of this decade. Although “Core” inflation, which excludes the direct impact of food and energy prices, has to date only shown modest increases, many observers are concerned that the higher food and energy costs will soon translate into higher prices in other categories.

Anecdotally the evidence seems to support these concerns. In June, Dow Chemical announced it would raise prices on products by an additional 25% only a few weeks after raising prices by 20% - as the company attempts to offset the effect of higher oil prices on its cost structure. Shipping companies (and others) have increasingly added fuel surcharges to customer invoices as a means of combating higher gasoline prices. Food prices have soared as well, with the price of corn nearly doubling in the first half of the year.

June 30, 2008



The recent decline in the stock market seems to be particularly correlated to spikes in energy and food commodity pricing, as investors worry about these costs impacting corporate profitability and consumer spending. An expectation of persistent inflation is a double whammy for the stock market, as it not only reduces current earnings (lower profit margins), but also reduces the value investors place on future earnings – which is reflected by valuing stocks with lower P/E ratios.

We are encouraged that in mid-July commodity prices have begun to retreat meaningfully off their June highs. If this trend continues, we believe the view toward inflation may improve sufficiently to allow for a more favorable investment environment for stocks.

## Core Equity Portfolio

During the quarter, we initiated positions in Dow Chemical and Accenture.

Dow provides chemicals, plastics, and agricultural products to consumers and corporations around the world. Earnings for the company have declined for the last few years, as the company's margins have been adversely impacted by the high cost of oil. The company operates numerous joint

ventures with other multinational manufacturers - these JVs hold significant value but are largely ignored by the investment community. We anticipate earnings/cash flow growth will improve dramatically over the next 5 years as margins improve in a more constant commodity environment.

Accenture is a global management consulting, technology services and outsourcing company. The company is well positioned to capitalize on global growth in applications, enjoying significant exposure to the fastest growing segments. The company has achieved organic growth of over 10%, thanks in part to Asia Pacific revenue growth in excess of 30%. Despite the economic slowdown in many of the markets Accenture serves, orders have been growing at a more than respectable level. The company has generated substantial free cash flow, which is in part being used to aggressively buy back shares.

In the quarter, we eliminated positions in EOG Resources, Consol Energy, Pfizer, Sun Microsystems, and Viacom.

Our rationale for selling EOG and Consol was due to the respective share prices exceeding our price targets. EOG benefited from growing natural gas production, as well as a strong commodity pricing environment. Consol, the leading coal producer in the eastern U.S. enjoyed robust demand for their high sulfur coal. In each case, the expected surge in profits was already reflected in their respective share price, resulting in us exiting the positions.

We decided to eliminate Pfizer, Sun Microsystems and Viacom due to each company's inability to execute in a difficult environment. Sun Micro did not work out the way we hoped when making the initial

June 30, 2008

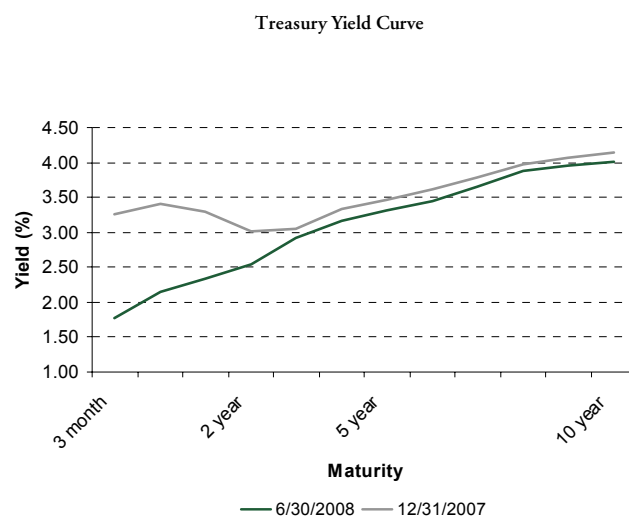
investment, as internal issues (failure to generate sales growth as well as adequately cut expenses/improve margins) as well as the disruption in financials (representing one of their major customer groups) has caused them to disappoint investors - with limited signs that a turnaround is imminent. Pfizer was originally purchased with the belief that the company would successfully launch new drugs to help offset the looming loss of patent protection on Lipitor – unfortunately the company has been mostly unsuccessful in getting these drugs to market, putting their future generation of cash flow at significant risk. Our original view on Viacom was that the company's broad range of cable and media assets were undervalued under the organizational structure in existence at the time. Although the company has reorganized and corporate earnings have grown over the past couple of years, our concern has increased that the future environment for advertising spending and original content will prove quite difficult.

As is evident by the portfolio changes over the last few quarters, we have been more active selling out of positions than purchasing new stakes. In part, this has reflected the impact of an uncertain near term economic outlook on our confidence in earnings power for prospective companies. Although the economy may remain mired in substandard growth for several quarters, we are poised to initiate new positions when the balance between risk and reward shifts more toward the latter.

## Fixed Income Markets

Due to continued weakness in the economy, the Federal Reserve lowered short-term rates for what some observers believe will be the last time in this cycle, as inflationary pressures

may force the Fed to consider shifting future monetary policy.



The municipal market, after experiencing unusual volatility in the first quarter, settled down in the second quarter. Although most municipal bond yields have returned to more “normal” levels, many tax-free bonds still trade at attractive levels, especially relative to taxable bonds.

## Alternative Investments

One of the largest hedge fund administrators indicated that at the end of June **Equity Long/Short** funds experienced record net outflows, which likely contributed to the losses these funds experienced as the quarter came to a close.

**Long Credit** managers experienced a volatile quarter despite flat overall returns. In April and May spreads improved across most fixed income instruments, but in June bonds sold off sharply again. Contributing to the reversal were concerns about the bond insurers, auto and airline companies, regional banks and changes in capital adequacy accounting rules.

June 30, 2008

The credit crisis also continues to make **Merger Arbitrage** a difficult strategy and results are flat-to-down for the year. Unrelated to the credit issues, unresolved situations like Microsoft-Yahoo demonstrate how problematic these deals can be. On the other hand, a positive for the strategy this year has been the rising market volatility, which increases the value of both their put and call options.

It should come as no surprise that opportunities are increasing for **Distressed** investing. Banks and other financial companies are being forced to sell assets to meet capital requirements, and hedge funds are filling this capital need. As an example, leveraged buy-out (LBO) debt stuck on an investment bank's balance sheet is being sold at 70-75% of face value with the bank providing some financing for the purchase. Everyone is wary of committing too much capital to this space too soon, but activity is definitely accelerating.

## Other News

In September, all of us will be moving to a new, larger Chicago office at our 120 South LaSalle Street location. Details to follow.

## One Year Economic Overview

		Jun 2008	Jun 2007
<b>Stock Market</b>			
S&P 500 Index	▼	1,280.00	1,503.35
Russell 2000 Index	▼	689.66	833.70
<b>Fixed Income Yields</b>			
3-Month Treasuries	▼	1.77%	5.05%
5-Year Treasuries	▼	3.32	4.90
10-Year Treasuries	▼	4.02	5.07
30-Year Treasuries	▼	4.52	5.12
<b>Inflation Monitor</b>			
CPI-Trailing 12-Month Growth	▲	5.0%	2.7%
CPI-(Excluding Food/Energy)	▲	2.4	2.2
Market Expectations*	▲	3.1	2.4
Gold (per ounce)	▲	\$925.40	\$649.65
Crude Oil (per barrel)	▲	140.00	70.68

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