April, 2008

2008 First Quarter Update

Review: Stocks had a tough quarter, down 9.4%. Bonds, especially US Treasuries, had a good quarter. The Merrill Lynch Intermediate Government/Corporate Index, which is about half government bonds, returned 2.9%.

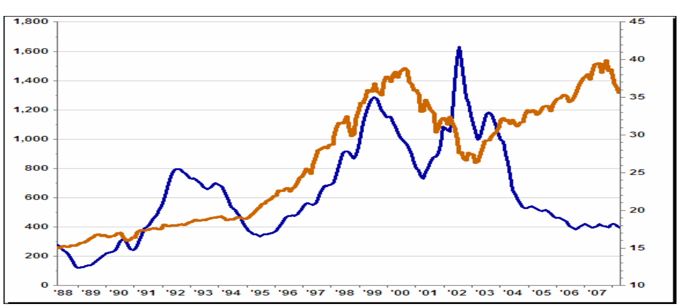
Quarters	***1Q08***	***4Q07***	***3Q07***	***2Q07***	***1Q07***
S&P 500 Index	***-9.4%***	-3.3%	2.0%	6.3%	0.6%
Merrill Lynch Int. Bond Index	***2.9%***	2.9%	2.8%	-0.1%	1.6%

The Economy: Signs of economic weakness are clear. Consumer confidence has been hurt by the continued decline in the housing market and high energy prices. Retail sales have slowed significantly. In the first quarter, the economy lost an estimated 232,000 jobs and the unemployment rate rose to 5.1%, the highest rate since 2002.

The US is clearly in a consumer-led recession. We expect that the combined effect of the unprecedented monetary actions by the Fed and the coming fiscal stimulus of rebate checks will help the economy. However, we believe the recovery will be slow and will begin late this year or early next year. For consumers, housing is a key indicator. Many analysts believe housing will not begin to recover until early 2009. Consumer confidence is not likely to improve until then.

For corporations, the weakness in the domestic economy has been offset somewhat by strength in international growth, especially emerging markets. The weakness of the dollar has helped corporations be competitive in overseas markets. With the exception of banks, corporations are in the best financial shape in years, and are well-positioned to weather the domestic economic slump.

Stock Market: As shown in the chart, stock valuations are very modest by historical measures, even on reduced earnings estimates for 2008. The S&P 500 P/E for 2008 is currently 15.7x which is reasonable.



S&P 500 (left) PE Ratio (right)

We are cautious on the economic recovery, but believe that the stock market will begin turning upward three to six months before the economic recovery is evident. Therefore, since we expect improvement by early next year, stock positions should be increased judiciously over the next three or four months.

Bond market: Bonds are not attractive, especially since higher inflation is looming, driven by the weak dollar and high commodity prices. Currently, five-year US Treasury notes are yielding just under 2.6%. With inflation as measured by the most recent Consumer Price Index report running at 4.2%, note holders are not keeping up with inflation. The Fed is concerned about the economy and is expected to cut rates further at the end of this month, but has indicated it will raise rates rapidly when the worst is past, putting upward pressure on bond yields.

Strategy: We remain cautious on consumer discretionary stocks since consumers remain under pressure from high energy prices, the housing crisis, and the weakening job market.

The financial sector was down nearly 19% in 2007, and as of this writing is down another 8% this year. The problem has been unwise lending, especially in the housing market. Our portfolios have benefited from our defensive stance on financials. Because we think the market now adequately reflects the risks, we have begun to increase our holdings in financial stocks, adding to positions in disciplined financial institutions that have strong balance sheets and will be able to grow at a time when others are capital constrained.

Global economic growth still appears to be healthy. We maintain a significant exposure to industrial stocks that benefit from the building of infrastructure in developing economies.