

Quarterly Review



Knowledge • Experience • Integrity

April 2008: First Quarter

PRICE CHANGES FOR LAST 3 MONTHS AND YTD

VALUE	BLEND	GROWTH	
-9.4%	-9.9%	-10.5%	LARGE
-9.4%	-9.9%	-10.5%	
-9.2%	-10.3%	-11.2%	MEDIUM
-9.2%	-10.3%	-11.2%	
-7.0%	-10.2%	-13.0%	SMALL
-7.0%	-10.2%	-13.0%	

The first quarter's stock market returns will rank as one of the lowest on record. There were double-digit price declines in almost all stock segments, as nervous investors headed for the exits. While it is typical for investors to sell across the board in anxious times, there's no getting used to it. When investors are looking to just preserve capital, they spend very little time analyzing relative valuation levels. Some sellers unload their losing positions, while others take profits in their best-performing positions. The growth stock segment usually suffers a little more than the energy and utility stock-rich value segment when sellers begin to discount an economic recession.

Of even more historic significance is what went on in the bond market. The evolving credit crunch, ignited by rising delinquency rates in the subprime mortgage market, caused credit market investors to join the exodus. Here the sellers did make value judgments. For the quarter, bonds of any company with significant exposure to the less-than-prime mortgage market took a beating with declines of 10% to 20%, depending on the stated maturity.

During the same time period, Treasury yields fell across the maturity spectrum--150 basis points on the short end and 75 basis points for the 10-year Treasury benchmark--so bond prices rose. The divergence in returns was extraordinary. Caught in the middle was everything else, like high-quality corporate bonds and lower-quality commercial real estate loans. The bond market has never seen such tumult.

The defining moment of the subprime mortgage meltdown may very well have been the Bear Stearns' rescue. The Federal Reserve's intervention told us it was not going to let a panic-induced, run-on-the-bank, credit crunch shut down the financial markets. The Fed, in essence, took this risk off the table, leaving us with the unwinding of the housing bubble.

The news on this front is not encouraging--home prices are falling, foreclosure rates are rising and, for some institutions, mark-downs on the value of their less-than-prime mortgage portfolios continue. Yet, the financial markets seem to have found a bottom. We believe this can be explained, at least in part, by all the talk about the need for a government program to help homeowners keep their homes. The market may be discounting a solution to the crisis. Worries about the moral hazard of bailing out over-leveraged homeowners aside, declining property values caused by foreclosed homes sold at auction prices impacts the value of all homes in the neighborhood. Looking out for the economic interests of the nation, which is the sum of all our neighborhoods, is an appropriate use of government resources.

In fact, we've done it before. The Home Owners Loan Corporation (HOLC) was created in Depression-era 1933 to serve as a refinancing agent for individuals who failed to qualify for bank-financed mortgages. During its 3-year operating history, the HOLC refinanced 1 million mortgage loans. While the HOLC had to ultimately foreclose upon 20% of the loans, or 200,000 homes, this was certainly better than the 1 million homes the banks would have foreclosed. The Resolution Trust Corporation (RTC), created in 1989 to oversee the disposal of assets from some 747 failing S&L's, is another example of the government committing dollars to prop up the housing market for the good of the nation.

	3/31/2008	12/31/2007	12/31/2007	QTD CHANGE	YTD CHANGE
Dow Jones Industrials	12262.89	13264.82	13264.82	-7.55%	-7.55%
S&P 500	1322.70	1468.36	1468.36	-9.92%	-9.92%
Nasdaq Composite	2279.10	2652.28	2652.28	-14.07%	-14.07%
Russell 3000	1404.66	1560.05	1560.05	-9.96%	-9.96%
2-Year Treasury Yield	1.61%	3.05%	3.05%	-1.44	-1.44
10-Year Treasury Yield	3.43%	4.03%	4.03%	-0.60	-0.60