



Quarterly Commentary: April 1, 2008

“The Chinese use two brush strokes to write the word ‘crisis.’ One brush stroke stands for danger ‘危’, the other for opportunity ‘機’. In a crisis, be aware of the danger – but recognize the opportunity.”

- John F. Kennedy

Even the most optimistic investors are finding it difficult to see through their rose-colored glasses these days. Seemingly every day a new crisis unfolds related to the free-falling real estate market, a crunch in the credit markets, the collapse of the dollar, inflation fears, spiking oil prices, weakening consumer spending or the near-bankruptcy of a Wall Street power. Commentary relating to whether or not we will enter into a recession has grown stale, and the press has begun speculating about the likelihood of a depression.

The market’s performance this year has reflected this uncertainty, with volatility on both the up- and down-side in reaction to the latest economic data point, rumor, or headline. Year-to-date, the markets, as measured by the S&P 500 and Dow Jones Industrial Average, are down 9.9% and 7.6%, respectively. We recall a period similar to this one nearly three decades ago, when *BusinessWeek* ran its “Death of Equities” cover story. The article captured the sentiment of the time – and it preceded a long and tremendously profitable bull market. Periods of extreme pessimism, like the present, are what lay the foundation for major upward moves in stocks.

Perhaps the most noteworthy event of the quarter was the Federal Reserve’s intervention and orchestration of JP Morgan’s acquisition of Bear Stearns. This move effectively saved the firm from bankruptcy. The Fed’s action was unprecedented in that it marked the first time the Federal Reserve has offered its own funds to back an acquisition of a financial institution by a public bank. Fortunately, the Fed and the U.S. government have been aggressive in their attempts to restore confidence elsewhere. In addition to “saving” Bear Stearns, Bernanke & Company have slashed interest rates and pumped liquidity into the economy. Housing lenders, namely Fannie Mae and Freddie Mac, have been granted greater lending capacity to stimulate demand, and Uncle Sam is sending checks to the consumer to encourage spending. Like any crisis, this one will pass with time, and the above-mentioned actions will accelerate the healing process.

The one crisis that remains to be addressed and has proven to be the most difficult to remedy is the crisis of confidence. On the corporate side, managements are openly cautious and actively tightening their belts. Financial sector players – namely banks, brokerages, mortgage lenders and hedge funds (ironically, the cause of much of these crises) – have lost confidence in one another and have dramatically slowed their business activities. Lastly, the current reading of the Consumer Confidence Index, a widely followed metric, shows consumer confidence at its lowest level in 5 years and, even worse, expectations about the future are at their lowest level in 35 years. Our experience tells us that such widespread pessimism typically signals the end of a market downturn.

Where does this all leave us and what is our current outlook for the market? The second sentence of the John F. Kennedy quote introducing this commentary sums up our current thinking: *“In a crisis, be aware of the danger – but recognize the opportunity.”* Everyone is aware of the dangers, with the S&P 500 now down 15.5% from its October 2007 high. But herein lies the opportunity. In fact, the stock market today, as measured by the S&P 500, trades at the same level it did nearly ten years ago. There have been two



other stagnant periods like this one since the 1920's. One unfolded during the Great Depression, and the other came during the 1970's – a period characterized by war, political scandal, high inflation and soaring oil prices. When we look back at the decades following these two periods, the market returned 164% and 205%, respectively. The opportunity is here.

Investors have become myopic in their focus on the current short-term problems of the U.S. economy. The opportunity that the market is currently ignoring is the tremendous long-term impact that the industrialization of China, India and southeast Asia is having on the global economy. The U.S. economy is no longer the epicenter of global economic growth; it accounts for only 30% of global GDP. The economic expansion that is occurring in these regions amounts to the largest shift in economic power and accumulation of wealth in history. This wealth will invariably make its way into the consumption of goods and services produced by the companies held in your portfolios. On average, approximately 50% of the revenues and earnings of your companies are generated from outside the United States. In fact, some of the “dangers” the economy is facing will actually work to benefit your companies. A weakened dollar benefits these businesses by making their products cheaper to the foreign consumer. Soaring oil prices bolster the earnings of your energy holdings. But most importantly, the businesses in your portfolio trade at valuations that are among the cheapest we have seen in years.

A final thought regarding the opportunity the stock market is presenting us. We know that investment capital ultimately flows to the area of greatest relative value. Where can an investor presently find a decent rate of return? Treasuries are yielding negative real returns, the housing sector remains expensive, many emerging markets are overvalued, and commodities prices have gone parabolic. Eventually this money will find its way into the types of businesses that you own in your portfolios. We encourage you to add additional capital to your accounts to take advantage of this especially good buying opportunity and also encourage you to introduce us to people you love and care about.

During the quarter, in order to better serve our clients, we strengthened our Private Client Group with the addition of Deborah Baur and Jessica Serrano. Deb serves as a relationship manager and brings to us over 15 years of accounting and finance experience, most recently with Banc of America Securities. Jessica is an associate relationship manager and most recently worked at First Horizon Investment Services. We are also pleased that Morningstar again awarded our Equity, Equity-Income, and Balanced portfolios a five-star rating for their five-year performance records as of the end of the 4th quarter 2007.

As always, we have included with this commentary your quarterly performance figures, management fee invoice(s), and a copy of your portfolio allocation as of 3/31/08. We have also included our firm's privacy statement, which discloses how we manage the personal information that is entrusted to us. Lastly, we are required to offer you a copy of our latest Form ADV, which is our registration statement with the SEC and state regulators. If you would like to receive a copy, please let us know and we will be happy to send you one.

Our best regards,

The Golub Group

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