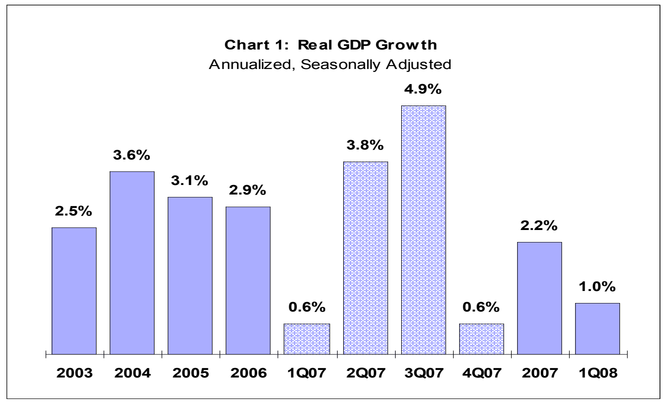
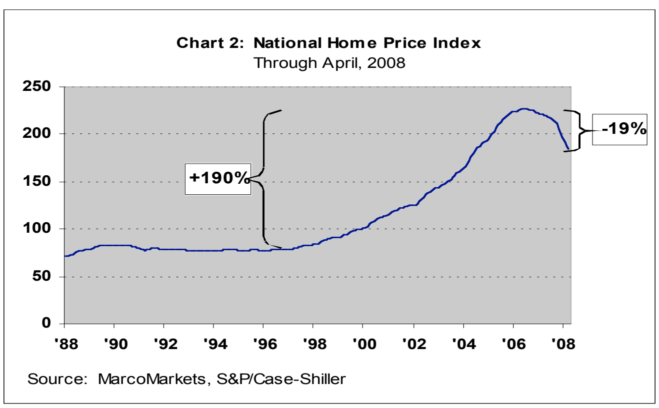
Investment Update
Second Quarter, 2008

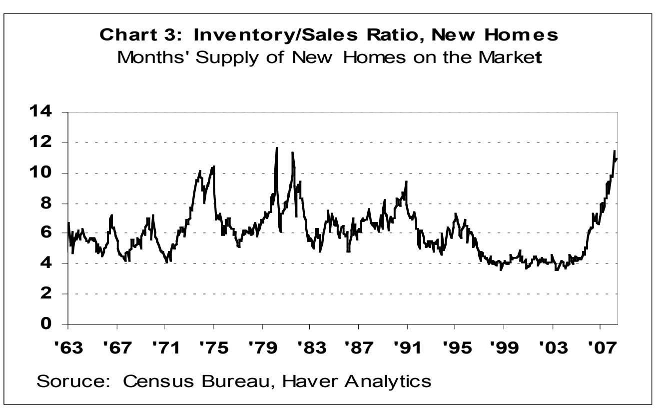
Economy

Until recently the major economic concern was the fear of recession. The slump in housing activity, higher fuel prices, and credit concerns combined to make this outcome almost a foregone conclusion, but so far the recession has not materialized. The first quarter real GDP growth was reported at 1.0% following a 0.6% increase in the fourth quarter. With the favorable impact of tax rebate checks on consumer spending, we expect the second quarter will also be positive. Another area of major strength is exports. The declining dollar has improved the competitive position of domestic exporting industries resulting in an output surge. At the same time the dollar impact has increased the price of imports and made domestic producers more competitive. This is good news, but the economy's rate of expansion remains quite low and not sufficient to absorb growth in the labor force resulting in an up tick in the unemployment rate to 5.5%. Also, a major uncertainty remains as to what happens when the impact of tax rebates is exhausted.



Turning to housing, the two most telling statistics are the home price index and the ratio of housing inventory to current sales. The data for April 2008 showed an average 19% price decline from the 2006 peak in 10 major metro areas. This decline effectively offsets all home price appreciation for the past four years. The May inventory-to-sales ratio of 10.5 months is the highest in 20 years. On a positive note the price decline does improve affordability for many potential buyers, but any sustained turnaround will require evidence of price stability, since many prospective home buyers are unlikely to purchase in a falling market. It will then be necessary to work through the inventory of homes until a more typical level of 5 to 6 months is achieved. It is unlikely that any growth can be realized from housing construction until the end of the year at the earliest.





With regard to energy prices, we have all been shocked by the rapid increases. No doubt the decline in the value of the dollar and speculative activity has been major factors. But on the basis of purely economic data on supply, demand and inventories, the price of oil should be lower, perhaps below $100 per barrel. Though the economic fundamentals suggest that a price decline is likely, when this might occur is not clear. Increased OPEC production, the slowdown in our economy together with weakness in Europe and some degree of growth moderation in emerging markets would contribute to lower oil prices.

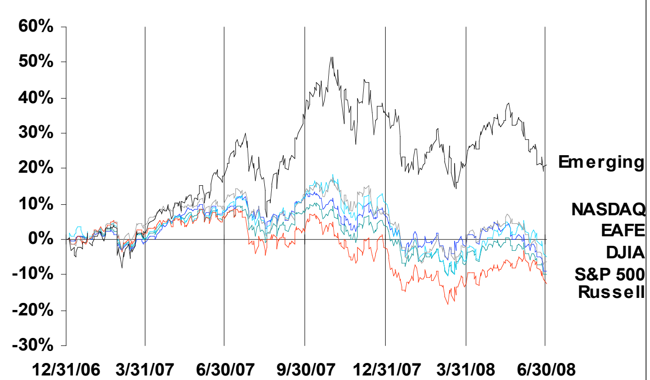
The credit markets continue to stumble along with new problems developing whenever it seems that conditions have stabilized. Our best judgment is that the write-downs and hits to financial sector balance sheets are largely complete, but that the healing process will be lengthy. Again, we expect that the balance of 2008 will be required before anything approaching a normal risk tolerance is restored.

In summary, we look for continued slow growth of less than 1.0 % in GDP for at least the balance of 2008. Significantly higher energy prices, for example if geopolitical tensions surrounding Iran increase, would likely tip our growth expectations into negative territory.

Equity Markets

Recent stock market weakness has wiped out the spring rally and placed us firmly in negative territory for the year. Stocks have been weak even though corporate profits have held up surprisingly well, except in the financial sector. A major influence has been an excellent productivity trend which is remarkable considering the softness in GDP. The investment question is the extent to which the unfavorable economic issues are reflected in current stock prices. Currently, forward twelve month price/earnings ratios are around 12.5x to 13.0x. Historically, these are conservative valuations and suggest that prices are attractive. The major risk to this argument is a jump in inflation comparable to the oil-induced experience in the 1970's. However, higher food and energy prices have not migrated to the rest of the economy so far, and the expected slow growth in GDP should reinforce this trend. Finally, the Fed has stated its clear intention to make inflation control a greater priority. We do believe that at least one increase in the Federal Funds rate will take place in subsequent meetings this year.

Chart 4: Equity Indexes



The most attractive area for equities is large capitalization domestic companies. Strong balance sheets, worldwide positions of market leadership, currency factors, and excellent cost control lend support to this thesis. The best performing area in recent months has been the emerging markets. This group of stocks is not quite as attractive on an historical valuation basis, but above average growth is still likely. In general the emerging economies have been successful in decoupling from the slower growing areas in the developed world. We continue to favor large capitalization domestic stocks and the emerging markets.

Credit Markets

Federal Reserve policy seems to be entering a period of greater monetary restriction that will lead to higher interest rates and lower bond prices. In the case of the market for Government securities there is an additional consideration. During the recent period of credit unease, investors have favored Government securities as the safest and most secure. The result has been huge demand and a decline in long term rates leading to substantial spreads in comparison with higher-risk but still good quality securities. All long-term fixed income securities are likely to decline in price if interest rates rise, but Government securities would be particularly vulnerable as spreads return to levels typical of a more risk-tolerant bond market.

Turning to tax-exempt bonds, we think that this group is still attractive in comparison to Government securities. In addition, the possibility of higher marginal tax rates under a new Washington administration makes their tax-exempt income quite attractive at this time.