



WEALTH DIMENSIONS

April 10, 2008

"When the tide goes out, we find out who has been swimming without a bathing suit."

It was a difficult first quarter for many investors, as most equity markets experienced their worst start in years. The decline in financial stocks led the markets lower with the S&P 500 losing 9.45%¹ for the quarter. International stocks experienced similar declines as the MSCI EAFE (Europe, Asia, Far East) Index was down 8.82% and the MSCI Emerging Markets Index fell 10.92%². Among the few bright spots in the quarter were real estate investment trusts and bonds with the Dow Jones Wilshire REIT Index gaining 2.1% and the Lehman Brothers Aggregate Bond Index finishing ahead 2.17%³.

Fallout from the subprime mess continued to dominate the news and officially claimed its first victim with the Federal Reserve brokered takeover of Bear Stearns by JP Morgan. The takeover price on March 16 was \$2/share, or about \$250 million, which represented a 98.4% loss for investors compared to Bear's 2007 peak. JP Morgan agreed to a \$10 price later in the week in an attempt to placate Bear Stearns employees to avoid mass defections. Bear as a firm is gone, its assets absorbed by JPMorgan, and they will no doubt dismiss a large number of Bear's nearly 16,000 employees.

Why all the naked swimmers?

Warren Buffett captured the essence of what has taken place in this latest financial bubble by saying, "When the tide goes out, we find out who has been swimming without a bathing suit."

Certainly, "swimming without a bathing suit" characterizes investor behavior during this latest financial bubble that began to deflate last summer. Financial sector participants indulged in unprecedented amounts of leverage, financial

engineering and risk-taking between late 2002 and mid-2007. Now that the tide has gone out, it has become painfully evident that there were a number of naked swimmers in the water.

Financial bubbles typically share some commonality in psychology. In each one, investors become excited about the prospect of a new investment success. As they reap some reward, they begin to dismiss the likelihood of failure and take progressively more risk at the same time prices are rising. Ultimately, they become certain that prices will continue to rise. These overly optimistic assumptions add to the risk and eventually lead to the end of the bubble.

An historic, "two-headed" bubble

This latest bubble had two heads. First, consumers gorged themselves on real estate, incentivized by historically low interest rates and dramatically rising prices. Secondly, the mortgage industry seized the opportunity to generate unprecedented fees through mortgage originations. Then, these mortgages were often sold to investment bankers, who in turn packaged and sold them to investors as low risk investments. These investments were in-fact high risk based on the poor underlying credit quality. The problems were magnified when hedge funds, like Carlyle Capital Corporation, borrowed to invest in these so-called Triple-A rated securities. In Carlyle's case, for every dollar they invested in the bonds, approximately 97 cents was borrowed. When the values decreased by a mere 3%, the portfolio was forced into liquidation and their entire equity investment was erased.

The bursting of the bubble has manifested on all fronts. Tight credit, rising foreclosures, and high housing inventories have led to double-digit declines in housing values, with further declines expected. The mortgage industry has seen massive job losses and two of its largest participants pushed to the brink of bankruptcy. Further, banks, hedge funds and brokerage firms have taken losses in excess of \$300 billion dollars on their investments in mortgage-backed securities.

Make no mistake about it, this double bust is a momentous event. It is far larger and more generalized than the savings and loan crisis of the late eighties, the emerging market debt crisis in 1998, or the more recent dot-com bubble – if for no other reason than the fact that the value of the real estate and bond markets are many times the size of the stock market.

We continue to maintain that the most appropriate response to this financial turmoil is to let the free markets work through the challenges so that they will come out stronger on the other side. It was important for the Federal Reserve to let a firm like Bear Stearns fail to underscore the danger of taking on too much risk. The Federal Reserve and Treasury are working in concert and have taken several unprecedented steps to assure that the markets remain as orderly as possible, while not favoring those who accepted too much risk. In total, the Fed and U.S. Government have injected almost \$1 trillion dollars of liquidity in an attempt to counteract the bursting of the financial and real estate bubble and have stated that they are prepared to do whatever is needed going forward.

Where do we go from here?

As always, it is futile to attempt to predict exactly where we are in an economic or market cycle. Currently, there are as many opinions as there are economists regarding the probability, severity and length of a potential recession. In many cases, recessions are nearing an end before data confirms that we are actually in one, while markets tend to be forward-looking and generally react six to nine months ahead of a change in the economic cycle.

We're pleased to say that, the diversification and structure of our portfolios continues to demonstrate its mettle. It has been and will continue to be our philosophy to use this structure and diversification as a means to leverage the strengths of the markets while mitigating the risks. This provides protection from the fallout of run-ups and bubbles.

We remain vigilant in understanding the market dynamics that matter and assisting you in achieving your long-term financial goals.

We appreciate your continued confidence in our services.

Wealth Dimensions Group, Ltd.

¹ www.standardandpoors.com

² www.msibarra.com

³ www.morningstar.com

Investment indices are represented by the S&P 500, MSCI EAFE, and Dow Jones Wilshire REIT Index. Performance of these indices is not indicative of any particular investment. The indices are unmanaged and individuals cannot invest directly in any index. The Lehman Brothers U.S. Aggregate Bond Index is comprised of a variety of taxable bonds, and is used as a measure of the US bond market. No strategy including diversification can guarantee a profit in a down market. Past performance does not guarantee future results. Nothing contained in this letter should be construed as advice for the purpose of avoiding taxes.