ROOF ADVISORY GROUP, INC.™
INVESTMENT ADVISORY & FINANCIAL PLANNING SERVICES

INVESTMENT UPDATE

May 7, 2008

Economic Conditions & Market Outlook

An intrepid old salt recently shared how he had once won a sailboat regatta by dropping his anchor in the middle of the last race. When the wind disappeared and the current shifted during the final leg of the contest, he related that the fleet found itself in the unenviable position of helplessly drifting *away* from the finish line.

However, during his hasty departure that morning, this captain had neglected to remove the boat's anchor and leave it on dock, a common practice to reduce weight when competing. And while turning on the engine during the race was clearly against the rules, casting the anchor apparently was not. So when the elements shifted against their favor, he promptly dropped the hook and then watched as his hapless competitors floated on by. In essence, he moved to the head of the fleet by not losing ground. When the wind at last returned, our plucky sailor simply weighed anchor and easily tacked to victory.

The story illustrates how investors might have effectively negotiated the quixotic equity markets of early 2008 and is somewhat analogous to the approach we've taken during the first quarter of the year. If stock market returns for the final months of 2007 seemed somewhat dismal, the first three months of this year were downright depressing. Major market indices through March 31 were all notably negative; with the Standard & Poor's 500 Index dropping 9.92%, the Dow Jones Industrial Average losing 7.55%, and the NASDAQ falling over 14.00% during the period.

The stock market improved markedly during the month of April; with the S&P 500 nearly halving it's 2008 deficit, the DJIA reducing it's year-to-date losses to less than -3.5%, and the NASDAQ shaving it's red ink to just over -9.0%; still not good but certainly better. This Spring-like bounce continued as May arrived and, despite remaining negative for the year, all three indices ended the first week of this month looking somewhat rejuvenated.

But where the indices eventually ended only tells half the story. Weakness in the broader economy and ongoing uncertainty regarding the depth and breadth of the sub-prime mortgage fallout fueled a level of daily volatility in the markets that tested the mettle of even seasoned investors. As noted many times in the past, the economy and the markets do not necessarily move in lock step. However, in the early part of this year, the trajectory of both was clearly downward.

Investor and consumer confidence was also stained by the daily dose of economists, politicians, and media types all dissecting a 'recession' that just would not be. To wit, Commerce Department numbers showed that annual gross domestic product (GDP) was up 0.6% for the first quarter 2008, with reported jobless claims rising but still remaining being below the level traditionally defined as recessionary. Yet common sense indicates that the housing market malaise and home foreclosure rates, when combined with rapidly rising fuel and food prices, do not bode well for consumer sentiment and near-term economic growth.

In all likelihood, when the debate has died down and the economic data is finalized, this period of time may very well be labeled as a 'recession' by the National Bureau of Economic Research, the government organization charged with making such determinations. But this firm's oft-stated view is that spending time parsing such labels in the midst of economic shifts and market swings is an academic exercise that contributes little to bottom-line portfolio value. Our response is that if it 'looks like a duck, walks like a duck, etc.'…treat it like a 'duck'; whether it is actually deemed to be one is somewhat immaterial.

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The Federal Reserve responded to this weakness and uncertainty by continuing in earnest the rate cutting campaign it started last September, with the seventh rate cut in eight months falling on the last day of April. The Fed rate now stands at 2.00%, some 3.25 percentage points lower than where it was in September 2007

While the full impact of the Fed's economic stimulation via monetary policy, i.e. rate cutting, will take some time to discern, it is important to note that one unwelcome side-effect of these reductions is the potential increase in inflationary pressures facing the U.S. economy and U.S. consumers alike from overstimulation. This is a balancing act of which the Fed is keenly aware.

Likewise, the Fed rate cuts have had the effect of exacerbating current weakness of the U.S. dollar's value versus certain foreign currencies abroad. In the Fed's opinion, this is a necessary trade-off to maneuver the U.S. economy through its present state of stress. But when combined with ever-increasing global demand, this devaluation has contributed to soaring commodity costs and the specter of rising inflation down the road.

Yet as with most things economic, nothing is clearly black or white. One consequence of a cheaper U.S. dollar is that U.S. goods and services are increasingly price-attractive to the global marketplace. As a result, domestic manufacturing numbers have remained rather stable recently thanks in part to increased foreign demand and rising export levels. And in the midst of all the gloom and doom surrounding the first quarter results of Detroit's Big 3 automakers, a Wall Street Journal article in early April noted that these car manufacturers were actually ramping up plans to expand sales of U.S. made vehicles to overseas markets.

Spastic day-to-day moves were the norm throughout the first quarter as a general nervousness gripped the markets. No sector was spared but the trepidation focused most squarely on financial-related stocks. From investment banks to brokerage firms and commercial banks to mortgage companies, the underlying health of any financial firm that made, held, bought, sold, or had exposure to subprime mortgage-related securities was suspect. Even aggressive markdowns (overly aggressive, we suspect) of the securities in question did little to assuage the sense of uncertainty. The 'foxhole' mentality that large money institutions adopted regarding cash/securities transfer nearly seized up the liquidity-dependent financial machinery.

The government-prodded sale of beleaguered Bear Stearns to J.P. Morgan in mid-March was a critical turning point in this potential crisis and returned some sense of stability to the markets. With Bear Stearns literally teetering on the edge of bankruptcy, the Federal Reserve financially backstopped some of the riskier assets involved in the transaction and helped to successfully broker the deal. Though debate will continue as to whether this was a proper move for the Fed to make, their timely actions very likely prevented the calamitous fallout that would have resulted from the inevitable Bear Stearns implosion. Combined with their expansion of discount window lending to additionally ease liquidity constraints, Bernanke & crew did the best they could with a very difficult situation and sent the message that it was time to do business again.

Finally, it is impossible to fully capture the economic tenor of the first four months of 2008 without giving the politicos their due. Not only were the presidential hopefuls crisscrossing the country luring potential voters with promises of unparalleled generosity via extensive new federal spending, those politicians already entrenched on Capitol Hill were not to be outdone at buying favor and responded with a speed henceforth unseen to legislate that almost every man, woman, and child receive a sizable 'tax rebate' with the admonition to go forth and spend. However, the 'tax rebate' moniker for the package was quickly switched to 'economic stimulus' when it soon became apparent that actually paying any taxes was certainly no prerequisite for receiving the 'rebate' check from Uncle Sam. A minor definitional detail to be sure.

Also missing from the brief thought that went into this quickly crafted political giveaway was any acknowledgement whatsoever that maybe, just maybe, over-reaching consumer spending contributed to the whole housing bubble/mortgage debt/foreclosure mess that is currently gumming up the works. Or perhaps that these dollars might be better used to help jump start our nation's abysmal individual saving rate and perhaps that just might be useful in offsetting the ever-escalating costs of Social Security and Medicare. But advocating fiscal common sense doesn't seem to win votes these days - at the national, state, or city level.

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Our Tactical Investment Stance

Roof Advisory Group's disciplined investment approach emphasizes adding value to client portfolios while controlling downside risk. Strategies include clearly defining investment policy ranges based on each client's specific investment objectives/risk tolerance, monitoring portfolio adherence to established benchmark parameters, and the ongoing evaluation of relative portfolio return.

Within this strategic context, the firm makes tactical shifts in response to changing market conditions to optimize client portfolio performance. While every client situation is unique, outlined below are a few of the tactics being used in the current market.

- For the majority of clientele, the firm has returned to a ***mid-point equity allocation***, as defined by each client's individual investment policy. This formal change was made in early April as asset appreciation and selective equity additions raised our overall targeted equity exposure. This is the first upward shift in allocation since our target equity weighting was dropped to *one-step below mid-point* in early January 2008.

  Selective stock buying opportunities continue to be pursued where appropriate. At present, our overall ***allocation bias is slightly positive*** towards equities, primarily due to much lower fixed income interest rates, but we are patiently maintaining a 'wait and see' approach until the economic picture becomes a bit clearer.

- Diversification is always a priority in the firm's equity and fixed income portfolios, with that strategy again demonstrating even more value in unstable market conditions. While the firm does not make significant sector bets, we do add portfolio management value by slightly overweighting those areas in favor and underweighting those that are not. In our opinion, ***avoiding untimely sectors and poor performing stocks is essential*** to long-term portfolio growth and risk control.

  It was noted in the January's *Investment Update* that many Financial Service sector stocks, particularly commercial banks, brokerage firms and investment banks, had been either eliminated or significantly underweighted since mid-summer 2007. However, our current portfolio position is a ***slight overweighting versus benchmark in Financial and Energy*** sector stocks across all portfolios, combined with a ***slight overweighting in Utilities for income-oriented portfolios*** and a ***slight overweighting in Industrial Materials for growth-oriented portfolios***.

- Positions in stocks of companies with ***significantly lowered earnings expectations remain pared***. The firm ***holds no individual Home Building or Sub-Prime Lending*** stocks and has not done so throughout the entire credit crunch/mortgage crisis.

  Some individual equities that were ***deemed vulnerable to negative market moves*** and ***previously sold/reduced*** have now been ***repurchased/enhanced in a timely manner at significantly lower prices***. Specific examples include J.P. Morgan, Citigroup, Bank of America, General Electric and several others.

- ***International and global exposure remains higher than norm*** as a hedge against weakness in the U.S. economy and dollar currency. Part of this exposure is through ***direct investment in stable foreign economies*** via exchange traded funds or specialized managers, while another part comes via stock ownership of ***multinational firms that maintain noteworthy overseas operations*** and are ***dependent on successful foreign revenue/growth.***

- We have continued ***increasing the average duration of all fixed income portfolios*** as short-term interest rates have continued to fall, creating additional ***return premium for lengthening bond maturity***. Individual bonds are always used for larger fixed income portfolios to control quality, maturity, and yield. Holdings with ***downgraded credit standing/negative credit watch*** receive ***additional scrutiny.*** Junk-rated bonds are never purchased by the firm.

  Short-term fixed income investment levels have been ***reduced because of lower interest rates.*** Likewise, holdings/parameters of the money market/ultra-short term bond funds used by the firm were reviewed for potential sub-prime exposure and vulnerability.

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