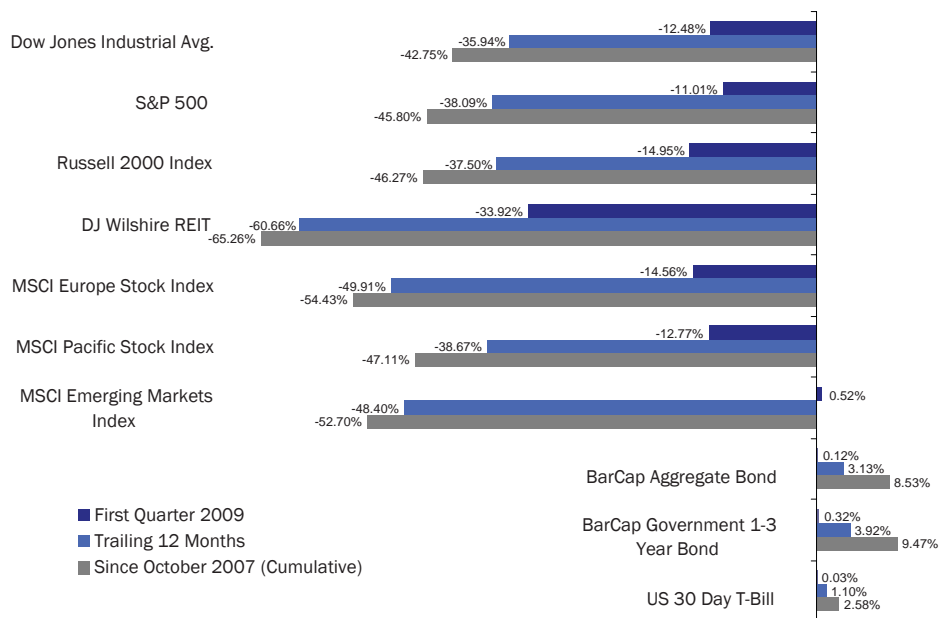


WORLD MARKET SURVEY

As if the steep losses incurred by stock investors in 2008 were not bad enough, the market plunged deeper during the first nine weeks of 2009, only to recover somewhat in the final weeks of the quarter (as of March 26, the Dow Jones Industrial Average had gained 21% in 13 trading days). Even with this late rally, the Dow declined 12.5% for the quarter, the S&P 500 was off 11.0%, and the Russell 2000 Index of smaller US companies fell 14.9%. Using traditional definitions of bull and bear markets — gains or losses greater than 20% — the first quarter included both a bear and a bull market. Of course, the bear market phase represents a continuation of the severe market contraction that began in October 2007. How far has the US stock market dropped from its high point? Between October 15, 2007 and March 9, 2008, the Dow suffered a cumulative loss of 53.2%, the S&P 500 dropped 56.6% and the Russell 2000 plummeted 59.2%. The chart on this page tracks performance between October 1, 2007 and March 31, 2009. Losses reported

(continued on page 6)

Index Returns: First Quarter 2009, Trailing 12 Months, and since October 2007



HEDGE FUNDS AND THE CURRENT BEAR MARKET

The world's equity markets suffered massive losses over the past eighteen months, as a bear market of historic proportions resulted in cumulative declines of 50% to 60% on most broad indices. Certain market sectors, particularly financial services, have dropped much further. And due to various factors, including a dramatic reduction in consumer spending resulting from declining confidence, the global economy has settled into a severe and far-reaching recession.

Declining consumer confidence is rational. Rising unemployment and falling real wages make employment income less predictable, so workers save more as a hedge against unemployment. Falling stock and real estate prices erode the value of consumers' accumulated wealth, encouraging them to save more and spend less. But behavior

that is rational for each individual can be catastrophic for the aggregate economy. Since consumer spending represents 70% of overall US economic activity, less consumer spending means a longer and more severe recession.

Market commentators struggle to explain the cause of the current bear market. Was the blame primarily attributable to banks' lax mortgage lending standards, the resulting unsustainable bubble in real estate prices, and the extent to which the financial services industry found itself exposed to subprime mortgages through derivative financial instruments? Or was it due to lax governmental oversight of financial firms, and a culture of greed that led some companies to adopt imprudent, abusive, or fraudulent practices? Perhaps the bear market was mostly attributable to the current recession,

which is part of the normal business cycle. Or was the bear market caused by some completely different factor?

We may never know why global stock markets collapsed in 2008. Economists continue to debate the cause of the Great Depression. But since politicians and regulators continue to propose interventions to restore confidence in the market, and to shorten the recession, understanding why the market collapsed in the first place should help us gauge the likely efficacy of proposed solutions.

What are Stocks Worth?

Let's begin by reviewing some of the basic underlying concepts relating to market valuation. Analysts attempt to calculate a stock's fair value. Although at any point in

HEDGE FUNDS AND THE CURRENT BEAR MARKET

What changed in late September 2008? Why did a relatively benign bear market transform into one of the worst periods for stocks in history?

time, a stock's fair value may differ significantly from its market value, analysts believe that any stock's market value should trend towards its fair value.

Market value represents the balance between supply of and demand for any given stock. For most stocks, market value is easy to determine. You simply review recent trades in the stock. Since stocks trade at the price where there is equal interest in buying and selling, the market determines the price – hence the term “market value.” While there may be instances where trading prices are distorted (e.g., with thinly traded stocks), for most stocks, trading prices are generally an accurate indicator of market value.

Determining fair value is more difficult. Although there are other approaches, analysts typically calculate a stock's fair value by estimating the company's future profits, and then discounting those profits back to a net present value, factoring in both the time value of money and the risk that future estimates will be incorrect. In this net present value calculation, short-term profits are particularly important, since longer term profits, being less certain, are discounted more heavily. This explains why companies manage quarterly earnings reporting so carefully.

During a recession, corporate profits typically contract sharply. This causes analysts to make significant downward revisions in their estimate of a stock's fair value. Not only are short-term profits reduced, but the risk discounting factor on future profits typically increases. In extreme cases, such as automakers and banks in 2008, short-term losses may be so large that the company's longer term viability becomes questionable. This is one reason why stock prices tend to drop significantly during recessions.

Recessions and Feedback Loops

In a recession, stock prices can be subject to two distinct feedback loops, one primarily affecting fair value calculations, and the other affecting market value.

1. The recession triggers a significant drop in stock prices, due to new estimates of fair value. Shareholders cut back on spending, to reflect reductions in wealth. Spending cuts increase the severity of the recession and lead to further drops in stock prices.
2. Falling stock prices cause investors to perceive stocks as increasingly risky. More investors look to sell risky assets, and fewer want to buy. Prices drop to reflect the increased supply and reduced demand. Falling prices reinforce the perception of stock market risk, leading to further reduction in demand.

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Losses over the Past Eighteen Months

As we look back at stock market performance over the past eighteen months, we can break the market collapse into two distinct components. The period roughly between October 2007 and September 2008 was a relatively normal bear market. Markets were choppy, with moderate losses that cumulatively approached the 20% threshold definition of a bear market. There were good weeks and bad weeks, but with more bad than good, the market exhibited a definite downward trend.

Then, beginning September 29, 2008, the market plunged into a virtual freefall. Led by a 16% drop in financial services stocks and an 11% drop in energy stocks, the benchmark S&P 500 Index lost almost 9% of its value on September 29 alone. Between September 29 and November 20, the S&P 500 fell by a third, with massive daily and intraday volatility. Then, between November 20 and the end of the year, the S&P 500 rallied by 12%, taking some of the sting off fourth quarter results. Nonetheless, the S&P 500 lost 22% during the fourth quarter, and 37% for the calendar year, making 2008 the worst year for US stocks since 1931.

What changed in late September 2008? Why did a relatively benign bear market transform into one of the worst periods for stocks in history? While we may never know the true factors underlying the collapse, anecdotal evidence indicates that trading activity by the virtually unregulated hedge fund industry may have played a triggering role in the market disintegration.

A Primer on Hedge Funds

Regular INVESTMENT QUARTERLY readers may recall that we reported critically on hedge funds following the first quarter of 2002. Although they have been offered for decades, hedge funds became particularly popular following the 2000-2002 bear market. Hedge funds typically promise solid, reasonably consistent returns, whose source is uncorrelated to the overall stock market. While there are dozens of different hedge fund management approaches, and thousands of different hedge funds, most share the following common characteristics:

- Sold exclusively to institutions and high net worth individuals, thereby mostly skirting the regulatory structure that applies to mass market retail investments.
- Generally focused on relatively esoteric or illiquid investment opportunities that offer the potential for abnormally high profits.
- Permitted to use leverage (borrow money) to increase potential returns (although many hedge funds do not actually use available leverage).

HEDGE FUNDS AND THE CURRENT BEAR MARKET

- Limited public information about portfolio holdings and management strategies.
- Very favorable fee structure for fund managers, particularly if returns exceed a threshold “hurdle” level (managers typically retain 20% of fund profits in excess of the hurdle).
- Contractual restrictions on liquidity/limited availability of redemptions.

Several of these factors, such as the opportunity to invest in esoteric and illiquid markets, limited regulatory oversight, the potential for extremely high manager compensation, and the ability to take longer term views of opportunities, attracted many of the best and brightest investment managers to the hedge fund world. Unfortunately, some factors, such as the limited regulatory oversight and expectations of limited transparency, attracted unethical or outright fraudulent managers to hedge funds. Finally, the compensation structure attracted hordes of managers who are ethical, but not particularly talented. Surveying the landscape, we suggest that most hedge funds fit into one of three categories:

1. Well managed funds that are worth the high management fees.
2. Persuasively marketed funds that don't offer any realistic opportunity for abnormally high profits, after adjusting for risk characteristics and management fees.
3. Scam funds, which are operated by incompetent or fraudulent management teams.

Unfortunately, due to the quality of their management teams, category 1 funds are generally oversubscribed. Consequently, these funds are generally open only to institutional investors with the best connections. While some emerging managers that may eventually join category 1 may be open to investors of more modest means, most individual investors considering hedge fund opportunities are limited to funds from category 2 or category 3. While fraudulent funds have recently created headlines, SCLC believes that most hedge funds belong in category 2 — ethically managed, but overpriced.

To get a sense of how overpriced hedge funds may be, Tuck School of Business finance professor Ken French estimates that costs for equity hedge funds averaged 4.26% per year between 1998 and 2007. Costs related to hedge funds of funds (i.e., funds that invest in two or more hedge funds and which are marketed to less affluent investors) added an extra 2.26% to fees. Cumulative costs of up to 6.52% per year indicate that investors can pay a very high price to access hedge funds.

Growth and Contraction in Hedge Funds

In recent years, hedge funds have been growing very rapidly, both in terms of the number of funds offered, and in assets they manage. Hedge Fund Research, Inc., reports that the number of hedge funds more than tripled between 1998 and 2008, reaching a peak of 10,233 funds as of June 30, 2008. Hedge funds had also been attracting massive flows of new assets. Hennessee Group, a hedge fund advisory firm, reported that net new cash flows into hedge funds in 2007 totaled \$278 billion — roughly 18% of the aggregate value of funds at the start of 2007.

This recent growth trend reversed dramatically in the second half of 2008. Hennessee estimates that total hedge-fund assets declined by 39%, or \$781 billion, during 2008. The decline was roughly evenly split between redemptions of \$399 billion and investment losses of \$382 billion. The 19% reduction attributed to performance is the worst since Hennessee began tracking the industry in 1987.

If hedge funds were able to deliver on their promise of delivering returns that are uncorrelated to the stock market, 2008 should have been a terrific year for the funds. Unfortunately, hedge funds had a dismal year at the same time that markets collapsed. Other factors leading to hedge fund redemptions included:

- Diminished investor confidence in hedge funds, stemming from lack of transparency, constraints on liquidity, and highly publicized frauds.
- Emerging research indicating that most hedge fund returns could be explained by relatively common risk factors. For example, studies from 2004 (Agarwal and Naik) and 2005 (Jaeger and Wagner) determined that more than 50% — and often more than 70% — of the variability in returns from various equity hedge fund styles (equity long/short, equity non-hedge, distressed securities, event driven, and short) could be explained by common risk factors. Similarly, a 2002 study (Fung and Hsieh) found that about two thirds of the return variability in returns from various fixed income hedge fund styles (convertible bonds, high yield, mortgage backed, and arbitrage) could be explained by common fixed income risk factors.
- Greater investor sensitivity to management fees, particularly when hedge fund returns were depressed or negative.

Market pressures have led many industry observers to predict increased consolidation in the hedge fund industry. IGS Group, a company that advises hedge funds on raising money, predicts that

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HEDGE FUNDS AND THE CURRENT BEAR MARKET

Barclays Capital strategist Robert McAdie has predicted that 70% to 80% percent of hedge funds could shut down in 2009.

almost a third of hedge funds will shut or merge in 2009. "The failure rate is going to go up, the closure rate is going up, and the merger rate is going up," IGS Chief Executive Officer John Godden said. "It's going to be a 30 percent wipe out."

Godden cites pressure from prime brokers, the banks that provide loans and handle fund administration, as one of the reasons behind the consolidation. He indicates that prime brokers are cutting ties with firms they don't expect to be profitable clients. To stay in business, a hedge fund will need to manage at least \$300 million in assets, up from \$100 million a year ago.

Other observers are even more pessimistic. Barclays Capital strategist Robert McAdie predicts that 70% to 80% percent of hedge funds could shut down in 2009.

Funds of Funds

Evaluating and investing in hedge funds is clearly a difficult challenge. With limited useful information available about fund strategies and performance, and the massive risk inherent in selecting an incompetent or fraudulent fund manager, many prospective clients seek help prior to investing in hedge funds. This demand for help led to the rise of funds of hedge funds. A fund of hedge funds promises investors one-stop access to numerous hedge funds. For an incremental fee, a fund of hedge funds offers:

- Diversification among multiple hedge fund managers and various hedge fund investment styles and approaches.
- Fund selection expertise, to help investors identify the truly skilful managers.
- Rigorous due diligence, to help investors avoid fraudulent managers.

Over the past few years, funds of funds have become increasingly prevalent. Hedge Fund Research reports that in 2008, there was roughly one fund of funds for every three hedge funds, up from one to seven in 2001.

Funds of funds do not appear to have been successful in identifying skilful managers, or in avoiding fraudulent managers. In particular, Bernie Madoff attracted many of his clients through funds of funds. For example, Tremont Group Holdings Inc., had \$3.3 billion in total exposure to Madoff. David Swensen, chief investment officer for Yale's \$17 billion endowment, has been particularly critical of funds of funds, arguing that the arrangements "facilitate the flow of ignorant capital." Swensen continues: "Fund[s] of funds are a cancer on the institutional investor world. The best [hedge fund] managers don't want fund of funds money because it is unreliable." We'll return to Swensen's arguments later.

In this environment, the number of funds of funds has already started to drop. At the end of 2008, there were 3,660 funds of funds listed in Morningstar's database, a drop of about 12% percent from 2007.

Liquidity, Gates and Funds of Funds

Another problem with hedge funds is their limited liquidity. Most hedge fund contracts provide that an investor can redeem assets from the fund only at the close of a calendar quarter, and must provide 45 days written notice of the intent to redeem. The contracts also permit the manager to freeze redemptions — to put a "gate" on the fund — if the manager believes that permitting redemptions would force the fund to incur losses by mandating asset sales in unfavorable market conditions. Hedge fund managers argue that liquidity constraints are necessary in the context of their esoteric and long-term investment strategies. So long as fund returns and cash flows were consistently positive, liquidity constraints were rarely problematic for either managers or investors. But when returns and cash flows turned negative in 2008, liquidity constraints became increasingly onerous. Investor redemption requests stepped up significantly during the year. In response, hedge fund managers erected liquidity gates, permitting investors only fractional or staged withdrawals.

In this environment, the redemption notice requirement introduced unexpected complexities. Burned by unexpectedly negative fund performance, investors began placing preemptive redemption requests with fund managers, thus preserving their options. If they perceived problems with the fund, filing the redemption notice was needed in order to cash out. However, if they believed the fund was doing well, the notice could be rescinded a few days prior to the end of the quarter.

These redemption notices proved particularly problematic for funds of funds. Many funds of funds promised quarterly liquidity without a notice requirement, or imposed the same 45 day notice rule as the underlying hedge funds. Historically, there had never been problems with this approach — most redemption requests could be satisfied from new cash flows, and in the rare event that a fund of funds had insufficient cash to satisfy a redemption request, an underlying hedge fund would cover the need.

But many funds of funds were caught short during the third quarter of 2008. Cash flows dried up, eliminating one primary source of liquidity, and the underlying hedge funds were unwilling or unable to cover redemption requests. Consequently, many fund of funds investors, seeking liquidity following the third quarter of 2008, found that their requests for cash were not honored.

"Fund[s] of funds are a cancer on the institutional-investor world. The best [hedge fund] managers don't want fund of funds money because it is unreliable."
David Swensen, Yale University

HEDGE FUNDS AND THE CURRENT BEAR MARKET

Liquidity issues at the close of the third quarter led to a potential doomsday scenario during the fourth quarter. Fund of funds managers knew about the Q3 liquidity problems and the dismal stock market performance in October and early November, but had no idea what liquidity issues they would face at the end of the year. Some fund of funds investors had begun filing preemptive redemption requests. Many fund of funds managers decided that the only rational response would be to file their own preemptive redemption requests with the underlying hedge fund managers. By filing redemption requests early, the fund of funds managers hoped to have access to year end liquidity if they needed it. If not, the managers would simply rescind their requests. Of course, in forcing the underlying hedge fund managers to prepare for possible massive redemptions, the fund of funds managers exacerbated the liquidity pressures on the industry. It is this very “hot money” phenomenon that forces hedge funds to jettison their longer term investment approaches, and led David Swensen to refer to funds of funds as unreliable funding sources, and a “cancer on the on the institutional investor world.”

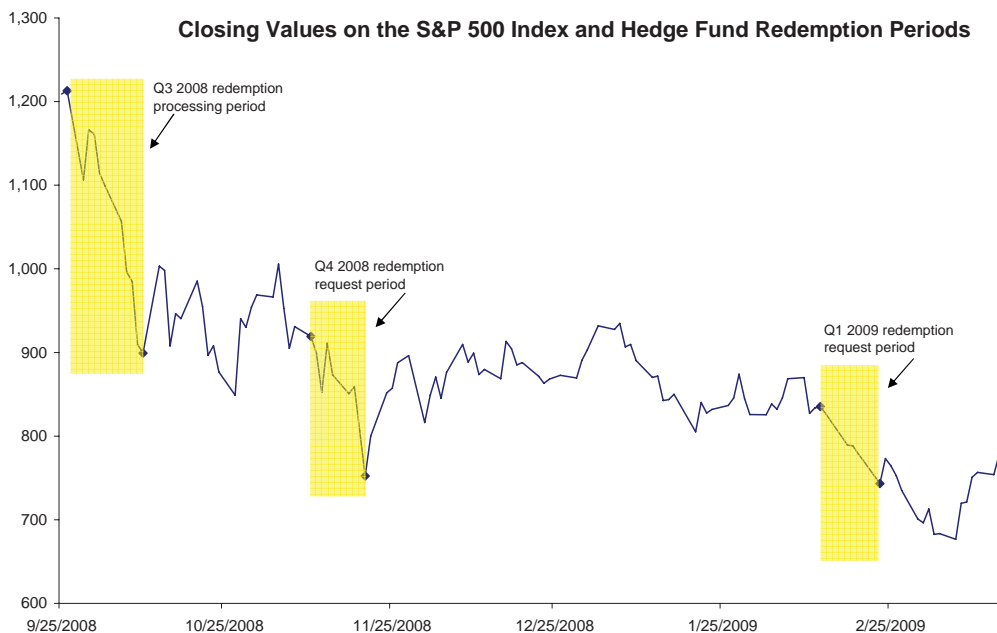
Matching Redemption Request Dates to Market Activity

One plausible explanation for both increasing market volatility and the increased severity of the bear market during the fourth quarter of 2008 is that hedge fund managers, saddled with excessive leverage and operating in relatively illiquid securities markets, were forced to sell stocks to meet redemption requests. While the overall hedge fund market is large, such

forced sales would not normally trigger a broad market collapse. However, given the weakness in the overall economy and the financial services sector in particular, hedge fund managers sold stocks into a market already experiencing muted demand. If hedge fund managers were selling stocks to meet redemptions, selling more stocks relating to diminished leverage on a reduced asset base, and selling even more stocks to reduce overall leverage in an increasingly risky market environment, cumulative selling pressure could be significant.

As the chart below indicates, the worst days for the market clustered around September 30 and November 15. The period around September 30 was when hedge funds were attempting to meet Q3 redemption requests. The period around November 15 was when hedge funds were beginning to position themselves for redemption requests following the end of the year. Shortly after November 15, the S&P 500 rallied through the end of the year, indicating a period of diminished selling pressure on stocks. Then, the S&P 500 slid again as the Q1 2009 redemption request period approached.

We should be careful to not read too much into this apparent correlation between market performance and hedge fund redemption request processing periods. There is no direct proof that hedge fund sales triggered the market collapse, or, even if they did, that a similar correlation pattern will continue into the future. Nonetheless, the confluence of events should be of significant interest to regulators and legislators as they consider future approaches to market regulation.



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HEDGE FUNDS AND THE CURRENT BEAR MARKET

What to Expect Next

Successful funds are also likely to offer greater transparency to investors, more liquidity, and lower fee structures. In other words, hedge funds are likely to look more like mainstream investments.

Given the recent spate of fraud linked to hedge funds and offshore investments, public outrage related to the fraud, to the bailout of the financial services sector, and to the collapse of markets in general, we can reasonably expect to see greater federal oversight of financial services companies. Hedge funds in particular are likely to be subject to much greater regulation and oversight.

In this environment, we can expect surviving hedge funds to adopt a more conservative investment approach. Successful funds are also likely to offer greater transparency to investors, more liquidity, and lower fee structures. In other words, hedge funds are likely to look more like mainstream investments.

The number of hedge funds is likely to decline, due to increasing public skepticism regarding unconventional investment approaches, higher costs relating to increased regulation, and limited access to credit and fund servicing functions through prime brokers. Fewer funds of funds will also make it more difficult for new hedge funds to amass sufficient assets to make operations economical.

The mainstreaming of hedge funds is likely to make it increasingly difficult for them to fulfill their implied promise of solid, consistent returns that are uncorrelated to the markets. However, with fewer hedge funds seeking to exploit market inefficiencies, the remaining funds may face less competition for certain market opportunities. Eventually, hedge funds may find a comfortable level of market equilibrium, with steady, consistent demand for their services, reasonable compensation, and the possibility of competitive returns, after adjusting for risk and fees.

We may never know one way or another about our hypothesis that hedge fund selling might have triggered the stock market collapse during the fourth quarter of

2008. However, we are encouraged by a report in the March 20, 2009 edition of Hedge Fund Daily, indicating that in March, US hedge funds became net purchasers of stocks for the first time since October 2008. Whether or not hedge funds triggered the collapse, it appears that their massive selling is coming to a close, and that in the future, the market will respond to more traditional supply and demand dynamics.

Finally, without meaning to appear overly prescient, SCLC observes that INVESTMENT QUARTERLY readers who paid attention to our 2002 hedge fund article probably managed to stay clear of the hedge fund collapse. Here are some highlights:

"... hedge fund characteristics make them uniquely "stealthy" with respect to traditional measures of investment risk The investor ... must dig deeply into the investment strategies of the manager to determine the types and magnitudes of risks which have not yet manifested themselves ... During periods of market crisis (for example, the 1998 Asian Financial Flu), asset correlations often "phase lock." This means that correlations quickly go from zero to perfect unity ... Asymmetries in factor exposures may quickly turn compelling performance track records into investment disasters ... Although hedge funds may be appropriate complements to large institutional portfolios commanding significant resources and leverage within the financial services community, hedge funds may be unsuitable for more modest pensions, trusts and endowments."

For these reasons, SCLC has never recommended hedge funds to any clients. Madoff investors and many others, who invested in hedge funds based on marketing claims and reported performance, would have been wise to have considered our cautionary advice.

One painful investment truism is that diversification tends to be least effective when it is needed the most.

WORLD MARKET SURVEY

(continued from page 1)

on the graph are modestly smaller than the actual peak to trough drop, since the graph includes both the March 2009 rally and gains earned in the first half of October, 2007.

Share price volatility and market distress go hand in hand. According to the *Wall Street Journal*, last quarter the Dow finished at least 2% higher or lower on one third of trading days. One year ago, such large price changes occurred only 15% of the time. Still, the market has stabilized somewhat since last year's fourth quarter, when 2% or greater swings occurred two thirds of the time. As one market observer quipped: "maybe it is indicative that we are out of the acute phase of the crisis and into a more chronic phase."

International Stocks

One painful investment truism is that diversification tends to be least effective when it is needed the most. Capital markets that normally move independently tend to move in lockstep during times of crisis. We saw this effect in 2008, as global equity markets declined in near perfect unison. The pattern was particularly evident during the fourth quarter's seemingly indiscriminate sell-off. In early 2009 this lockstep trend has given way to a more normal pattern of differentiation in the market performance of individual countries. Recent winners include several emerging market economies, such as Brazil (up 10.8% for the quarter) and China (up 3.6%). Conversely, several larger developed foreign markets suffered greater declines than the US, with

(continued on page 8)

SURVEY OF INDICES & FUND AVERAGES
PERIOD AND ANNUALIZED COMPOUND RETURNS IN PERCENT

	First Quarter 2009	Trailing 12 Months	3 Years Ending 3/31/2009	5 Years Ending 3/31/2009	10 Years Ending 3/31/2009
Inflation Index & Risk Free Rate					
Consumer Price Index	-0.12	0.07	2.21	2.67	2.61
US 3-Month Treasury Bills	0.05	1.13	3.42	3.06	3.19
US Stock Market (Large Companies)					
Standard & Poor's (S&P) 500 Index	-11.01	-38.09	-13.06	-4.76	-3.00
S&P/Citigroup Large Cap Growth Index	-6.18	-32.22	-10.34	-4.53	-4.64
S&P/Citigroup Large Cap Value Index	-16.11	-44.00	-15.97	-5.18	-1.96
Average Large Cap Blend Fund ‡	-10.01	-38.13	-13.61	-4.92	-2.24
US Stock Market (Small Companies)					
Russell 2000 Index	-14.95	-37.50	-16.80	-5.24	1.93
Dimensional US Micro Cap Fund	-16.13	-40.86	-20.06	-7.24	5.45
Russell 2000 Growth Index	-9.74	-36.36	-16.20	-5.37	-1.61
Russell 2000 Value Index	-19.64	-38.89	-17.54	-5.30	4.87
Average Small Cap Blend Fund ‡	-13.05	-39.07	-17.56	-5.24	3.81
Real Estate					
DJ Wilshire REIT Index	-33.82	-60.66	-27.00	-9.44	3.72
Fixed Income (Bond) Markets					
BarCap Government Bond Index	-0.99	6.95	8.09	5.24	6.21
Avg. Intermediate Gov't Bond Fund ‡	1.37	4.01	5.42	3.72	4.87
BarCap Municipal Bond Index	4.22	2.27	3.19	3.21	4.60
Average California Intermed/Short Muni Bond ‡	3.47	0.06	1.87	1.93	3.46
Credit Suisse High Yield Bond Index	5.81	-19.55	-4.52	0.02	3.28
Average High Yield Bond ‡	3.58	-20.97	-6.20	-1.42	0.99
Citigroup World Gov't Bond Index	-4.81	-3.75	7.66	4.63	5.79
Average World Bond Fund ‡	-2.78	-9.45	2.44	2.31	4.66
International Stocks					
MSCI EAFE Foreign Stock Index	-13.94	-46.51	-14.47	-2.18	-0.84
Average Foreign Large Blend Stock Fund ‡	-13.30	-46.46	-14.74	-2.48	-0.77
MSCI Europe Stock Index	-14.56	-49.91	-14.31	-1.79	-0.99
MSCI Pacific Stock Index	-12.77	-38.67	-15.00	-3.24	-0.59
MSCI Emerging Mkt Index (excl. dividends)	0.52	-48.40	-10.23	3.41	5.47
Average Emerging Markets Fund ‡	-1.50	-49.59	-10.41	4.05	7.78

‡ Source: Morningstar Principia 3/31/2009

WORLD MARKET SURVEY

(continued from page 6)

France off 15.9% and Germany down 19.4%. Foreign returns are reported in US dollar terms. The dollar has generally strengthened with each new shock to the global financial system. However, as a modicum of confidence drove the March rally, the value of the dollar receded commensurately.

Credit Markets

The ability and willingness of institutions to loan money to individuals and corporations continues to be the central issue underlying the current economic malaise. While some credit markets have improved, others remain stalled, and the difference has everything to do with stimulus and intervention by the Federal Government. The US Treasury and the Federal Reserve launched several programs last quarter in an effort to stimulate both demand for and availability of credit.

Government purchases of mortgage securities that adhere to Fannie Mae and Freddie Mac standards helped to keep the average rate on conforming 30 year mortgages below 5%, a number low enough to induce a wave of refinancing. The Fed also purchased Treasury bonds to keep interest rates relatively low. Other programs included incentives for private investors to purchase securitized debt to strengthen bank balance sheets, and initiatives designed to promote lending to consumers and businesses. At the end of the quarter, the yield on the 30-year Treasury bond was 3.6%, and the 10-year bond paid 2.7%. While

the yield on government debt is low, the spread between rates on US Treasuries and investment grade corporate bonds remains relatively high, at about 6%. For less creditworthy corporations, the cost of borrowing averages 17 points higher than the rate on comparable Treasuries.

Gold, Oil and other Commodities

Lately, commodities have been an interesting gauge of investor sentiment, as prices adjust to reconcile two conflicting views of the future. During the second half of 2008 the Dow Jones-AIG Commodities Index fell by more than 50%, as the sudden onset of the global recession curtailed demand for the various energy, metal, timber and food items that comprise the index. The drum beat of negative economic news early in the first quarter pushed the index down another 13%, as of March 2. Commodities investors then shifted their focus to future inflation threats. The Commodities Index rallied with the stock market in March, and ended down for the quarter by 6.4%.

Some observers forecast the 2009 trend in commodities will look like a mirror image of 2008, with historically low prices through early 2009, followed by a steep spike upward as the global recession shows signs of abating. Others point out that the International Monetary Fund cut its estimate of global economic growth from 2.2% last fall, to just 0.5% for this year, a rate not seen since World War II. Ongoing weakness in the global economy could keep a lid on commodity prices for the foreseeable future.

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QUALIFIED RETIREMENT PLANS,
PRIVATE INVESTORS, TRUSTS, ENDOWMENTS & FOUNDATIONS

Individual Country Returns First Quarter 2009

	US Dollar	Local Currency
North America		
United States	-11.2	-11.2
Canada	-3.8	-2.0
Latin America		
Brazil	10.8	9.4
Chile	14.7	4.8
Mexico	-14.1	-12.5
Africa		
South Africa	-5.5	-2.7
Europe		
Austria	-5.2	-0.8
Belgium	-6.4	-2.0
Denmark	-11.2	-7.0
Finland	-20.9	-17.2
France	-15.9	-12.0
Germany	-19.4	-15.6
Great Britain	-10.8	-10.5
Ireland	-10.5	-6.3
Italy	-20.3	-16.5
Netherlands	-15.5	-11.5
Norway	3.7	0.0
Portugal	-8.4	-4.1
Spain	-19.8	-16.0
Sweden	-5.8	-1.5
Switzerland	-15.5	-9.2
Asia		
Australia	-3.5	-3.2
Hong Kong	-0.1	-0.1
Indonesia	2.3	8.5
Japan	-17.1	-9.7
New Zealand	-7.3	-5.1
Philippines	5.8	7.5
Singapore	-9.0	-4.0
South Korea	-1.6	8.1
Taiwan	9.7	13.3
Thailand	-6.6	-4.8

Source: Dow Jones Global Indexes