



(A SUBSIDIARY OF INSTITUTIONAL INVESTMENT RESEARCH, LLC)

Newsletter Beginning Q2 2008, April 1, 2008

Prepared by Daniel R. Shore, Chief Research Analyst, Publisher, and CEO

Please read the required disclosures and disclaimers at the end of this report. Redistribution or re-production is prohibited without permission. Copyright ©2008 **INSTITUTIONAL INVESTMENT RESEARCH, LLC**.

Introduction:

Welcome back to the Alphareturns Newsletter to open the second quarter of 2008 and close out a very volatile and challenging first quarter. Global equity and credit markets have experienced volatility and unprecedented developments, many of which we have not seen since the Great Depression. While we do not believe the global economy is headed for another Depression, we do think many of the major global economies driving global consumption will experience recession this year.

Executive Summary:

- Q1 2008 ended with the market exhibiting nervous volatility due to continued stress in the financial, consumer, and real estate sectors. Even with this turmoil, the Alphareturns model portfolios beat the S&P500 by more than 6 percentage points on average. Our Conservative, Moderate, and Aggressive Model Portfolios returned 2.33%, -0.42%, and -3.33% respectively for the first quarter of 2008 compared to the S&P500's return of -9.29%. Wise diversification in all of our portfolios created superior performance with considerably less risk and volatility than the broad market (see Q1 2008 performance discussion below).
- Our economic forecast for 2008 calls for a significant slowdown in the US economy with GDP (gross domestic product) growth falling from 2.2% in 2007 to 1.5% in 2008 and a mild recession likely mid-year. We expect GDP growth in the US to drop to -0.5% for the first quarter, -0.3% in the second quarter, and then recover into the 2% to 3% range in the second half of 2008. Euro-zone GDP growth is also forecast to fall from 2.9% to 1.5% in 2008 while Asian economies are expected to slow from 4.8% to 3.9%. When Japan is excluded from the Asian GDP forecast, Asian growth ex-Japan is expected to be a point higher at 4.9%.
- In spite of the slowdown in global GDP, global consumer price inflation is expected to increase into the 3% range during 2008 as consumption weakness in the US and Europe is offset by Asian demand and rising food and energy prices worldwide. When Japan is excluded, global inflation will be north of 3%. Even though cpi inflation is expected to be

moderate during 2008, we expect the dollar to continue its decline against other major currencies. During 2007 the dollar index as reported by the Wall Street Journal declined in excess of 7%. During the first quarter of 2008, we have already experienced a 6% drop in the Wall Street Journal's Dollar Index. This continued dollar weakness is being driven by the excessive liquidity being pumped into the financial system by central banks as financial sector losses and credit crisis fears grow.

- Speaking of the credit crisis, this past quarter we witnessed further write-downs and losses by global banks and a bankruptcy/takeover/bailout of the world's 5th largest bank, Bear Stearns. On March 12th, Bear Stearns executives were on national television telling us that their balance sheet had never been capitalized better and they were in fine shape. Then on Friday morning, March 14th, these same executives announced the bank was bankrupt due to massive losses in their credit derivatives; mortgage/asset backed securities, and leveraged loan holdings! Over the weekend that followed, JP Morgan together with the US Federal Reserve worked out a takeover/bailout plan allowing JP Morgan to buy Bear Stearns for \$2 per share with a special \$30 billion loan from the Federal Reserve. Just 6 months ago, Bear Stearns' stock was over \$125 per share. After a week or so, Bear Stearns shareholders threatened a lawsuit over the special deal offered to JP Morgan. To prevent a messy bidding war and public disclosure of the sordid details of the collapse, JP Morgan agreed to raise the buyout price to just over \$10 per share and the Federal Reserve reduced the special loan to \$29 billion over 10 years at a quarter point over the prevailing Fed Funds rate.
- Also during the first quarter we watched number of economic indicators deteriorate rapidly to levels that we have not seen since past recessions:
 - At the end of March, US durable goods production declined by 2.6%, its 4th decline in the past 5 months.
 - US consumer spending is at its weakest level in 17 months.
 - The US economy lost 63,000 jobs in February and 22,000 in January...the largest consecutive monthly decline since the recession of 2001/2002.
 - Various consumer confidence/sentiment readings are down to levels not seen since 2002.
 - Distressed borrowing from the Federal Reserve's discount window is at inflation-adjusted levels not seen since the Great Depression.
 - The Federal Reserve announced that it has used up over half of its balance sheet in providing capital injections for financial firms caught in the credit crisis.
 - Median residential home prices in the US fell 8.2% in February... the largest monthly decline in history. 2007 marked the first time since the Great Depression that median US home prices declined on a year over year basis.
 - Gold peaked at over \$1,033 an ounce, oil peaked at over \$114 per barrel, and Bonds gained 2.5% as investors flocked to commodities and fixed income for safety.
 - US and global stock markets lost over 9% during the first quarter.
- Currently, major developed stock market valuations appear to be overvalued now that analysts have started factoring in a slowdown in global growth and corporate profits. We calculate that US stock markets are now valued at around 20 to 22 times 2008 earnings which is well above the historical average of 15. European markets are in the range of 15 to

18 times expected 2008 earnings, and Asia (ex-Japan) is at 18 to 20 times earnings. Even though these ranges are not as outrageously high as they were before the last recession/bear market of 2001/2002, we are still very cautious regarding stocks in 2008. We still believe that the global financial credit crisis and GDP slowdown will hurt corporate earnings more than analyst expect in 2008. We continue to believe that Wall Street analysts are chronically too optimistic with regard to corporate earnings growth for 2008 because they are still forecasting double-digit earnings growth in Q3 and Q4. Although we expect this slowdown and recession to be short and shallow, it is not likely that the economy will bounce back as quickly as these optimistic analysts think.

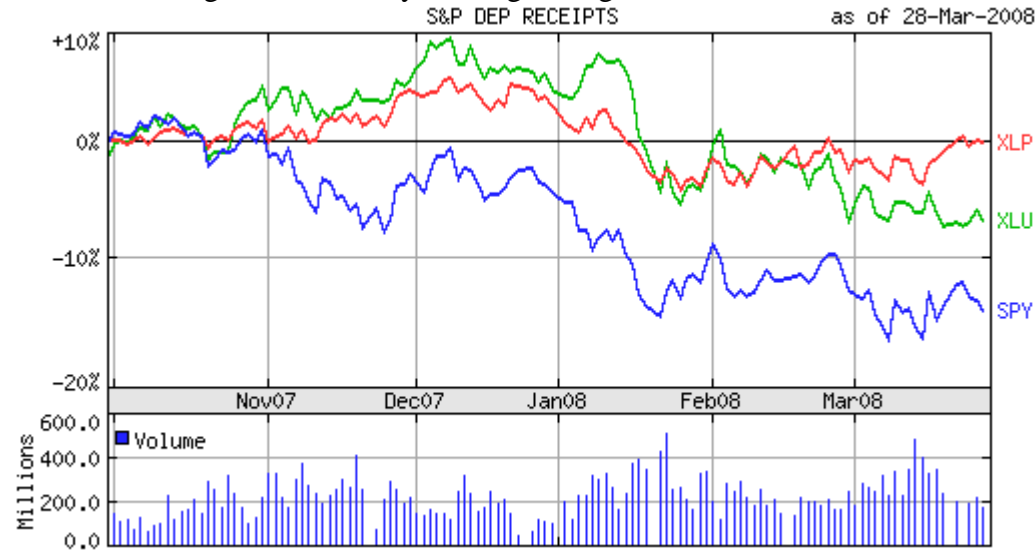
- Therefore, our portfolios will continue to be defensive with even less exposure to stocks and more exposure to global treasury bonds. This limited stock exposure will be concentrated in the large cap consumer staples sector where valuations are still reasonable and sales of food, beverage, hygiene, and other staples are historically more recession-proof. Historically the utility stock and healthcare stock sectors have also held up well during recessions. However, this time around utilities and healthcare are being pummeled along with the broad market, as investors are worried about a possible US Democratic Presidential Victory and the tighter regulatory environment that may ensue. We had expected Asia (ex-Japan) to weather the coming economic storm better than the US, Europe, and Emerging Markets. While economic growth in the Asian region (ex-Japan) has been strong and less affected by the US slowdown, Asian stock markets have nevertheless sold off right along with the US. Asian (ex-Japan) markets are down 12% year to date and Chinese markets are down a whopping 20% so far this year. This bear-market is now going global as investors “shoot first and ask questions later”. The other factor causing an across the board sell-off is the de-leveraging and margin call activity in the hedge fund community. These hedge funds were leveraged up to as much as 20 to 30 times and are now being forced to sell liquid assets across the board to de-leverage because of the credit crisis. As mentioned before, in times of economic distress, large cap consumer staples companies tend to outperform small cap companies and the broad market in general. When the real estate and financial sector troubles subside and economic growth picks up again, we will then move back into the small cap and value sectors.

The Alphareturns Model Portfolios for Q1 2008:

Because of the likelihood of recession and lower corporate earnings in the US economy, we will make adjustments in our model portfolios to take an even more defensive posture going into Q2 2008. In summary, we will substantially reduce our exposure to equities by keeping a conservative allocation to large cap multi-national consumer staples. The table below details the model portfolio allocations we are recommending for the first quarter of 2008. We will briefly touch on the rationale behind the various asset allocation choices:

US Stocks: With our cautious posture regarding the threat of recession in the US, we will continue with the US Consumer Staples ETF fund symbol XLP. However, we will exit our allocation to the US Utility sector due to its uncharacteristic weakness during these times of economic stress. Historically utility stocks have outperformed the broad market during recessions because consumers

still buy utility services even in bad economic times. Unfortunately this time around we see investors selling off their utility holdings along with the broad market.



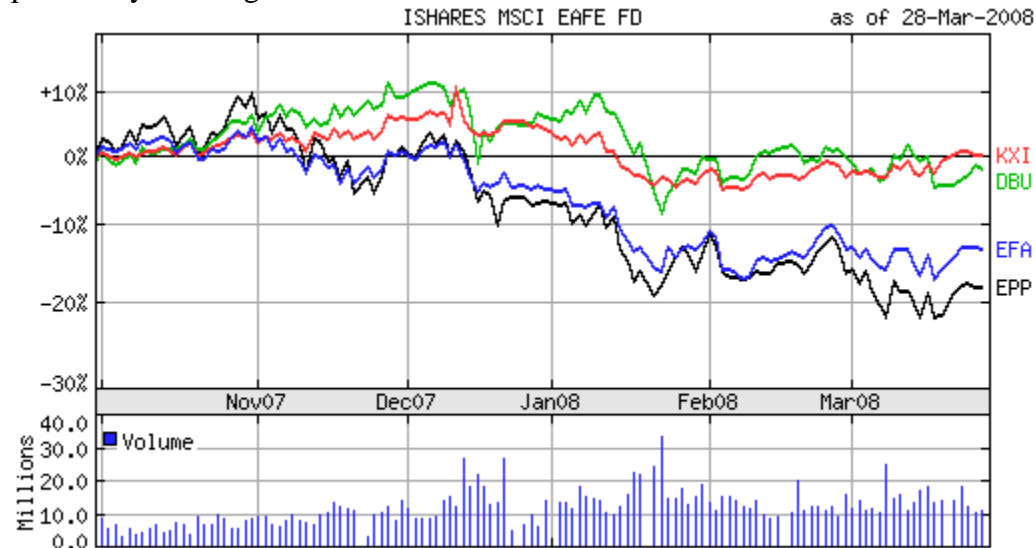
Copyright 2008 Yahoo! Inc.

<http://finance.yahoo.com/>

Consumer Staples (XLP) outperform the S&P500 (SPY) and Utilities (XLU) late in 2007 and during Q108

Source: Yahoo Finance

International Stocks: International stocks in emerging markets, Japan, and Europe are likely to be hurt by the slowdown and possible recession in the US economy during 2008. Asia (ex-Japan) is forecast to have stronger GDP growth than the US during 2008 and should avoid recession even as the US struggles. However, investors are selling off Asian equities along with the US and European markets. Therefore, we will exit our allocation to the Asia (ex-Japan) ETF fund symbol EPP until we have more clarity regarding Asia's economic trajectory relative to the US. We will also exit our allocation to the International Utilities ETF symbol DBU for the same reasons mentioned previously with regard to US utilities.



Copyright 2008 Yahoo! Inc.

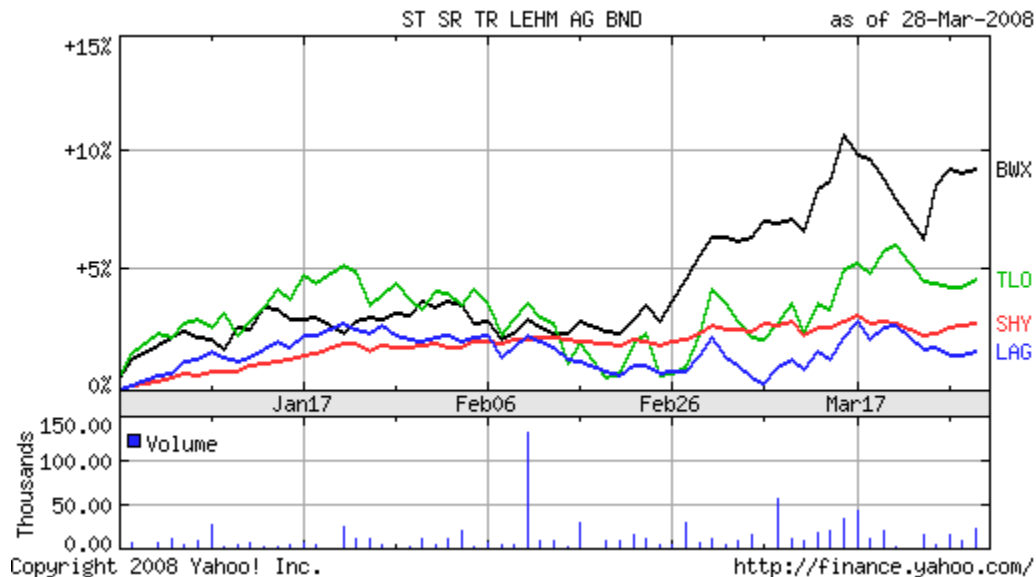
<http://finance.yahoo.com/>

Int'l Consumer Staples (XLP) outperforms Int'l Utilities (DBU), MSCI EAFE (EFA), and Asia ex-Japan (EPP) late in 2007 and during Q108

Source: Yahoo Finance

Emerging Market and Foreign Small Cap Stocks: With the overheated stock market situation in many of the emerging markets, we are maintaining our overvalued call on emerging market stocks. We see most large institutional investors decreasing their exposure to emerging markets and small caps for 2008. As global GDP growth slows, valuations for foreign small/mid cap stocks in developed markets look stretched. Emerging and small cap stocks have historically underperformed during times of economic stress. To this point, Chinese and Indian stocks performed well during the full year 2007, but traded down during the last few months of 2007. As we predicted in our last newsletter, Chinese stocks have now declined by more than 20% during Q1. China's equity markets are down over 40% from their highs in October of 2007.

Fixed Income: As forecasted in our previous newsletters, the credit crunch and re-pricing of risk have caused a steeper yield curve. The steepness has been primarily from reductions in short term maturity rates. Therefore we are still recommending Short Term 1 to 3 Year Duration US Treasuries with the SHY exchange traded fund. We forecast bond rates to fall as US GDP growth slows in 2008. Fed funds futures are forecasting US Fed rate cuts into the 2% range by the summer of 2008. In addition to the SHY short-term treasury allocation, we increased our overall bond allocation by adding two new funds for 2008: the Long Term US Treasury fund symbol TLO, and the International bond symbol BWX. As the US approaches recession and the global economy slows during 2008, central banks should lower rates causing bonds both in the US and abroad to increase in value. Long term US treasuries should increase in principal substantially due to rate cuts and International bonds should increase in value due to rate cuts and the weak dollar.



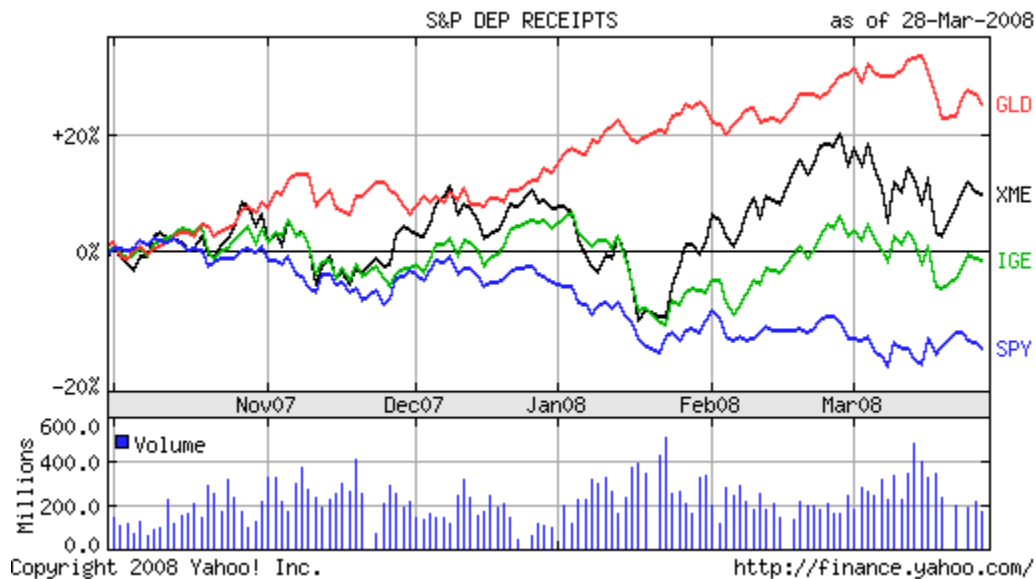
Int'l Bonds (BWX), Long Term Treasuries (TLO), and Short Term Treasuries (SHY) outperform the Lehman Aggregate Bond (LAB) bond market index during q108.

Source: Yahoo Finance

Metals and Mining Stocks: The US dollar index as reported in the Wall Street Journal has declined an astounding 6.6% already in 2008 after posting a decline of over 7.2% in 2007. This helped commodities increase in value since they are denominated in US dollars. We also see increased interest in gold as a reserve asset for central banks in the Middle East, Asia, and Russia.

Gold has now proven to be a better hedge against inflation than Treasury Inflation Protected Treasury Bonds. Over the last few years as energy, food, and commodity inflation have increased; we have witnessed gold vastly outperforming TIPS. We also like gold as a hedge against a bear market in stocks. Historically, gold is negatively correlated with stocks. So far, our predictions have proved correct, as gold and commodities have outperformed during this time of economic and market stress. Our gold exposure is achieved via the Gold Trust Bullion ETF symbol (GLD). In addition to gold, we want to maintain our exposure to metals commodities including steel, aluminum, enriched uranium, copper, titanium, and other metals. We believe the declining US dollar and global GDP growth in the 3% range will continue to favor companies involved in mining precious and industrial metals. Even though metals sold off during the last 2 weeks of March we believe this was primarily due to hedge funds de-leveraging and taking profits to window dress their Q1 portfolio statements. We still see demand strength from Asian, Middle-Eastern, and Russian infrastructure growth. To participate in this sector we are staying with the SPDR S&P Metals and Mining Index exchange traded fund (symbol XME).

Natural Resources: We are standing firm on our allocation to the natural resources sector because we believe the falling US dollar and energy supply issues will continue to favor companies involved in the natural resource sector. Energy companies involved in oil, refining, and natural gas are especially attractive. To achieve a broad diversification in this sector we will continue with an allocation to the Ishares S&P GSSI Natural Resources Index exchange traded fund (symbol IGE).



Copyright 2008 Yahoo! Inc. <http://finance.yahoo.com/>
Gold (GLD), Metals and Mining (XME), and Energy Resources (IGE) outperform the S&P500 (SPY) during late 2007 and Q108.

Source: Yahoo Finance

Please see the table below for our Q2 2008 model portfolio asset allocation percentages.

Alphareturns Model Portfolio Allocations For Q2 Calendar 2008:

Symbol	Asset Class	Conservative Risk 1-3 year horizon	Moderate Risk 4-7 year horizon	Aggressive Risk 7+ year horizon
XLP	US Consumer Staples Stocks ETF	7%	17%	30%
KXI	Global Consumer Staples Stocks ETF	7%	20%	30%
SHY	1 to 3 year US Treasury ETF	30%	20%	10%
TLO	Long Term US Treasury ETF	10%	8%	6%
BWX	Int'l Treasury Bond ETF	30%	20%	10%
GLD	Gold Bullion ETF	10%	7%	4%
IGE	GCSI Natural Resources ETF	3%	4%	5%
XME	Metals and Mining Stocks ETF	3%	4%	5%

Q1 2008 Performance Discussion:

During Q1 2008 our model portfolios outperformed their respective benchmarks and the broad markets during the quarter as well as since inception on January 1, 2007. During Q108, our Conservative Portfolio returned 2.33% vs. its benchmark of 0.68%, our Moderate Portfolio returned -0.42% vs. its benchmark of -4.53 %, and the Aggressive Portfolio returned -3.33% vs. its benchmark of -9.27%. The Moderate and Aggressive Portfolios returned small losses in the 1st quarter due to their higher exposure to stocks. However, as indicated by the data below our portfolios lost less than their respective benchmarks and also lost less than the broad S&P500 index and MSCI EAFE.

Since inception January 1, 2007, our portfolios outperformed their respective benchmarks by a wide margin. The Conservative Model Portfolio returned 10.25% since inception vs. its benchmark of 7.20%, the Moderate Model Portfolio returned 7.24% vs. its benchmark of 3.13%, and the Aggressive Model Portfolio returned 4.00% vs. its benchmark of -1.42% (see performance table below for details).

Alphareturns Model Portfolios →	Conservative Risk 1 to 3 year horizon	Moderate Risk 4 to 7 year horizon	Aggressive Risk 7 + year horizon
Q1 2007	2.47%	2.80%	3.07%
Q2 2007	3.49%	4.57%	5.60%
Q3 2007	1.50%	1.42%	1.28%
Q4 2007	0.10%	-1.23%	-2.41%
Q1 2008	2.33	-0.42	-3.33
Since inception 01/01/07	10.25%	7.24%	4.00%

Dow Jones Benchmarks* →	Dow Jones Relative Risk Conservative Global Portfolio	Dow Jones Relative Risk Moderate Global Portfolio	Dow Jones Relative Risk Aggressive Global Portfolio
Q1 2008	0.68%	-4.53%	-9.27%
Since inception 01/01/07	7.20%	3.13%	-1.42%

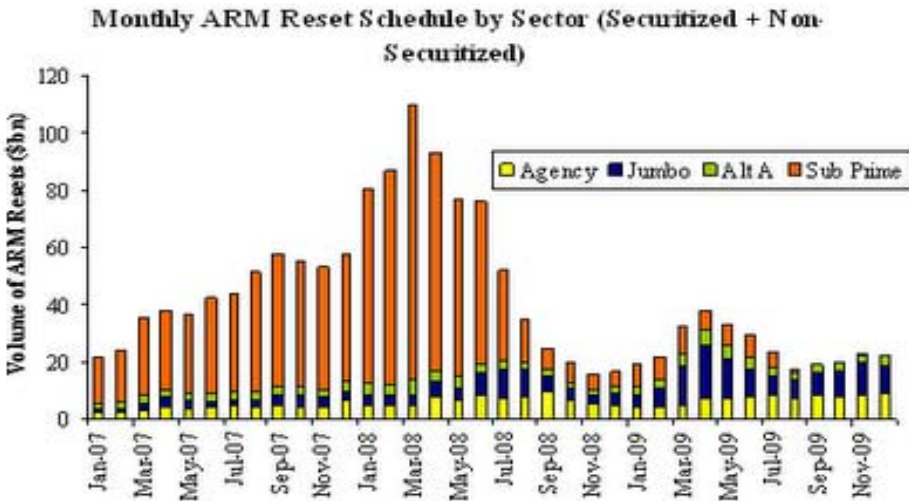
**Note: The Dow Jones Relative Risk Indexes measure the performance of conservative, moderate and aggressive portfolios based on incremental levels of potential risk. The indexes are designed to systematically measure various levels of risk relative to the risk of a global all-stock index. Investors can identify an appropriate benchmark as the index that has the most similar historic risk characteristics. Stock exposure will typically range from 20% in the conservative portfolio up to 100% in the aggressive portfolio. See www.djindexes.com/mdsidx/portfolio/index.cfm?event=showPortfolioGlobalRelativeRisk for more information. Copyright © 2008 Dow Jones & Company. All Rights Reserved*

Detailed Global Economic Technical Analysis and Outlook:

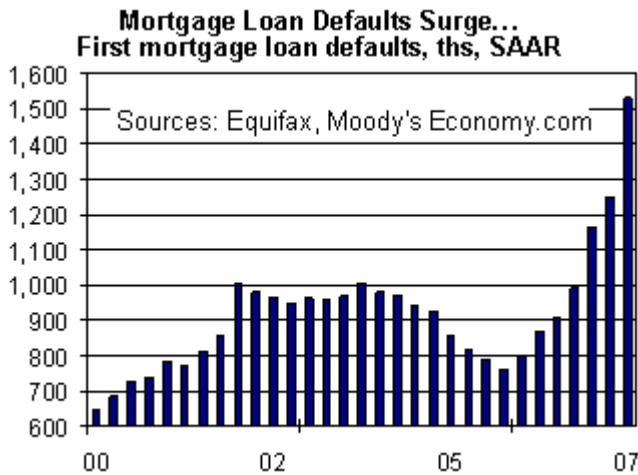
During Q1 2008, the world's financial markets continued their volatile gyrations. Problems continued to grow in the battered real estate and financial sectors of the US market and then spread to consumer markets. During the 1st quarter, credit problems in the US financial sector also started to spillover to markets in Europe and Asia. The US Treasury and Federal Reserve continued to make "diving catches" to rescue the market. This created a "tug-of-war" during the quarter as bad economic news sent the market down and the Treasury and Fed's actions propped the market up. Even with the temporary optimism of this government action, the markets remained nervous and skeptical as the quarter ended. Many economists increased their forecasts for a US recession in 2008 due to the increased risk that the financial sector's credit problems will impact consumer spending and cause the US and Global economies to slow and possibly contract. We now have Goldman Sachs, Morgan Stanley, Merrill Lynch, Moody's, and many others calling for recession this year in the US. At Institutional Investment Research and Alphareturns, we believe a mild US recession is likely to occur in 2008. We see stress in the world's banking system that rivals the savings/loan crisis and the Japanese economic implosion of the late 80's and early 90's.

US Real Estate Sector Continues To Weaken:

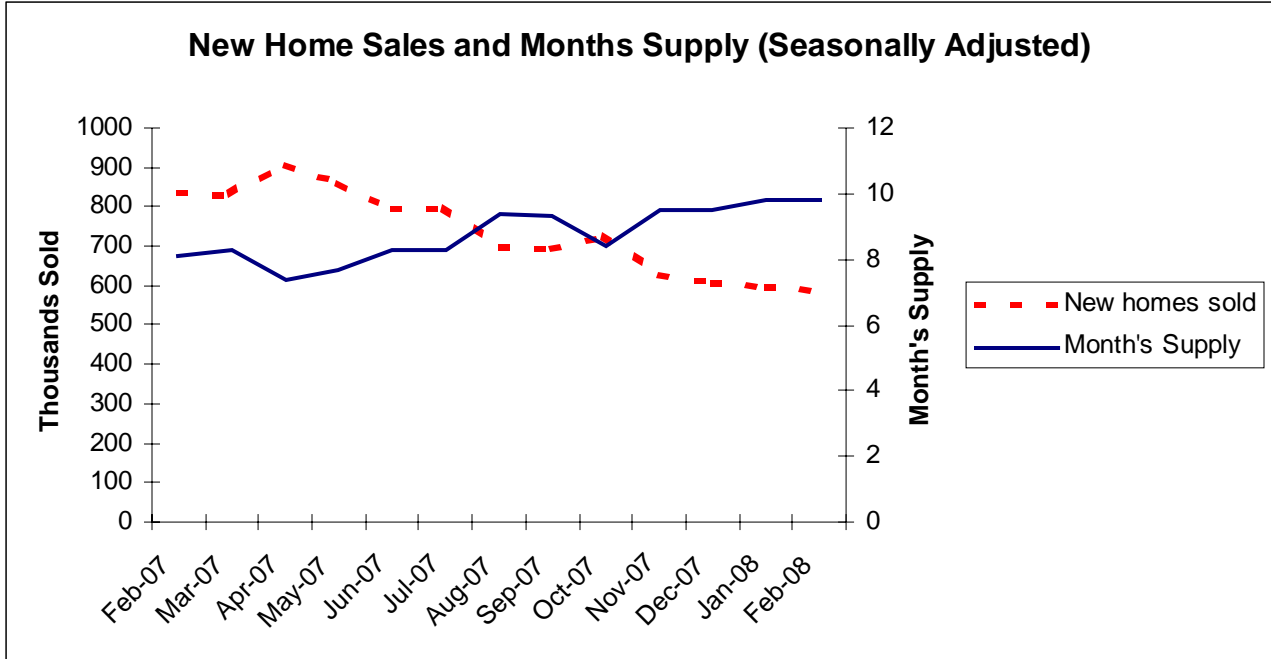
The re-pricing of risk in the financial sector and weakness in the real estate sector continue to get worse in 2008. Financial institutions continue to announce stunning losses associated with residential mortgage portfolios, leveraged buyout loans, and now we are even seeing weakness in commercial mortgage backed securities. Even with these announced losses, our research shows that there may be an additional \$100 billion to \$200 billion in losses yet to come. These losses have not been realized yet because the peak in adjustable rate mortgage resets is actually occurring now. The peak in mortgage defaults and foreclosures will therefore occur in mid to late 2008 following this peak in resets. CNN reported today that there are over 2 million homes in foreclosure now and over 8 million homeowners who owe more than their home is currently worth in value.



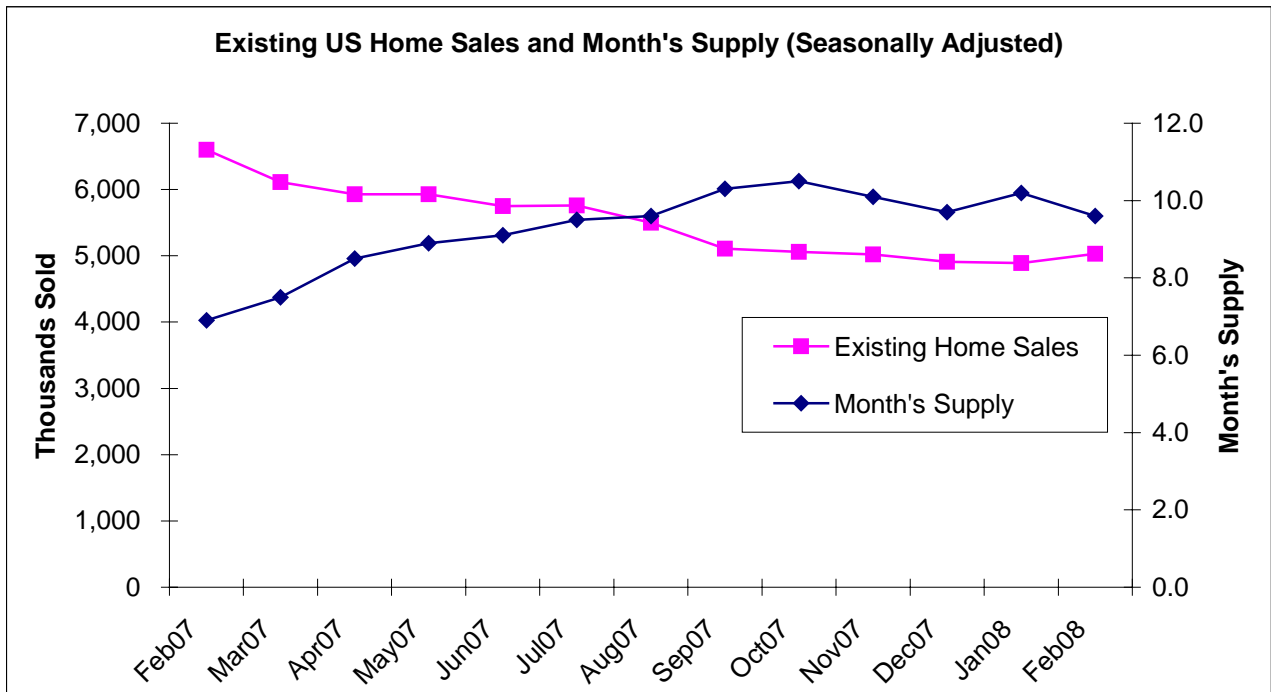
Source: Bank of America, Orange County Register



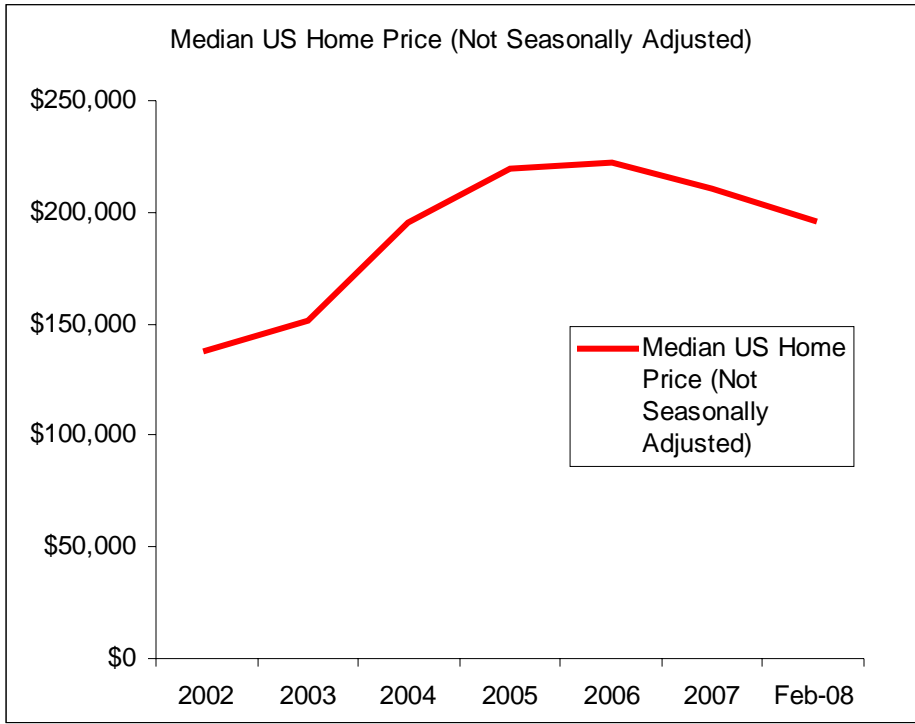
These resets will trigger further losses in the financial sector that are yet to be accounted for in stock prices. This second-wave of bad news will create substantial headwinds for global stock markets in 2008. The government's program to reduce foreclosures is also likely to be too little too late in that it will only help around 200,000 homeowners in a market that now has 2 million foreclosures. The other issue with the program offered by the Treasury is that this program is not mandatory. The program so far requires the mortgage servicers and investors to voluntarily modify sub-prime loan terms to prevent and/or delay foreclosure. Each loan has to be reviewed and modified on its own terms, creating a mountain of administrative work for a mortgage industry that is currently shedding employees by the thousands. On the construction front, housing starts are falling sharply but inventories of unsold new and existing homes continue to rise.



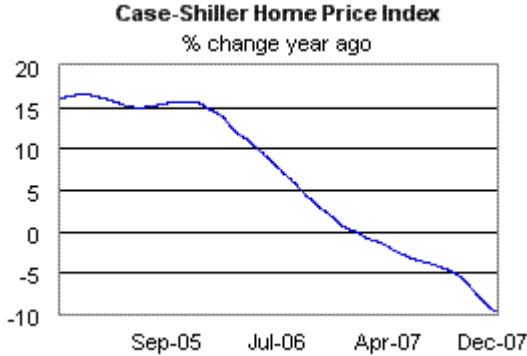
Source: US Census Bureau



Source: National Association of Realtors

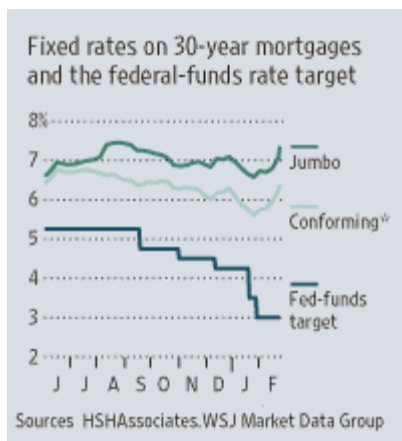


Source: National Association of Realtors



Source: Moody's

As we can see from the charts above, high inventory supply and weak demand are causing median home prices to fall year over year. This has not happened since the Great Depression.

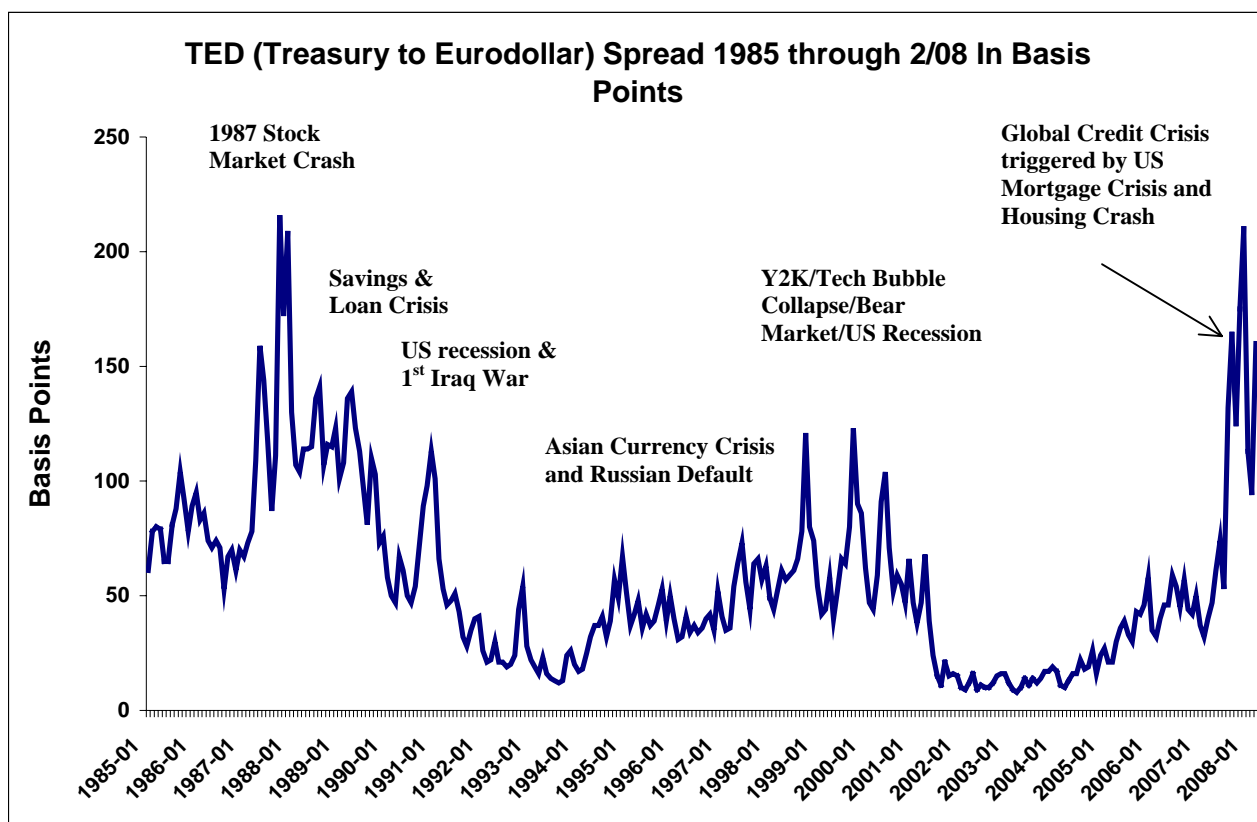


Fed Funds vs Mortgage Rates (June 2007 to February 2008)

As the Federal Reserve lowered the Fed Funds rate, banks and mortgage firms have not lowered mortgage rates. This is evidence that these financial institutions are hoarding cash and using the lower Fed Funds rate to cover and refinance bad debt still held on their books instead of encouraging new loans. This hoarding and extreme risk averse behavior will continue to make it difficult for homeowners to refinance and purchase homes going forward. In summary, we believe the housing downturn will get worse through the remainder of 2008. History tells us that US housing prices and demand can stagnate and go sideways for long periods of time. The last housing boom/bust we experienced was in the late 1980's, after which we experienced a decade of stagnant inflation adjusted housing prices from 1988 to 1998. This most recent housing bubble was the "mother of all housing bubbles", so we expect there to be a long (possibly decade-long) trough as this bubble unwinds.

Global Credit and Financial Crisis Continues to Get Worse in 2008:

The global credit bubble we have been talking about since January of last year has finally turned into the global credit crunch. As we discussed in previous newsletters, the lowest interest rates in a generation, liquidity created by derivatives, deficit spending worldwide, poor mortgage and corporate lending standards, and a global housing boom caused a bubble in credit and debt issuance. This bubble is now officially deflating as debt markets re-price risk and the financial sector starts dealing with credit defaults and foreclosures. Credit spreads are finally starting to widen back to historical levels as credit risk gets priced more accurately.



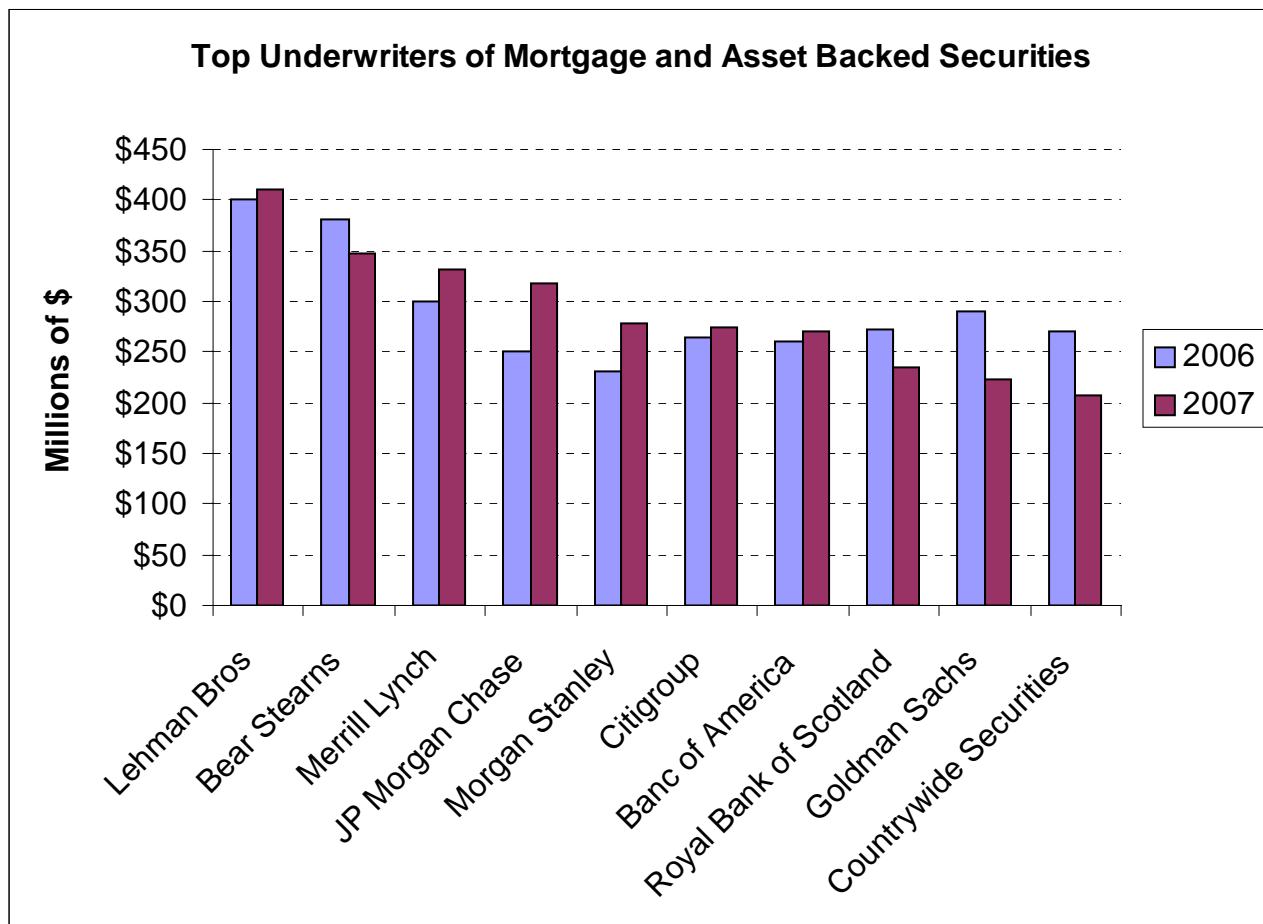
US Treasury to Eurodollar Libor Rate “TED” Spread Differential As An Indicator of World’s Financial System Stress - TED Spread is now at levels we haven’t seen since the ’87 Crash
 Source: BBA (British Banker’s Association) and US Federal Reserve Bank

From the chart above, we see the TED spread is still warning of extreme stress in the world’s financial system...stress unlike anything we have seen since the October 1987 stock market crash. After countless interventions by central banks and governments, the TED spread is still elevated at an alarming level. This elevated spread indicates an extreme reluctance of banks to lend to each other and to clients as well. This is why mortgage, leveraged buyout, and commercial loan rates have stayed the same or gone higher even as the Federal Reserve has dramatically lowered its Federal Funds and Discount rates. The conclusion we draw from this is that the banking system must still be sitting on large pools of non-performing debt and swap/derivatives contract losses to the point that they are still not willing to increase credit availability at any price. They simply do not have the capital structure and liquidity to do so given the losses on their books.

Is There Another Bear Stearns Out There? We Think Possibly So:

In addition to more mortgage related write-downs expected in 2008, we expect to see further bailouts required for investment banks. As mentioned earlier in the executive summary, Bear Stearns had to be bailed out by the Federal Reserve and JP Morgan over the weekend of March 15th due to bankruptcy. This sudden bankruptcy resulted from Bear Stearns’ heavy losses in mortgage-backed securities, credit derivatives, and leveraged loans. This begs the question: will there be others who become insolvent and require a rescue? One only needs to look at the chart below to see

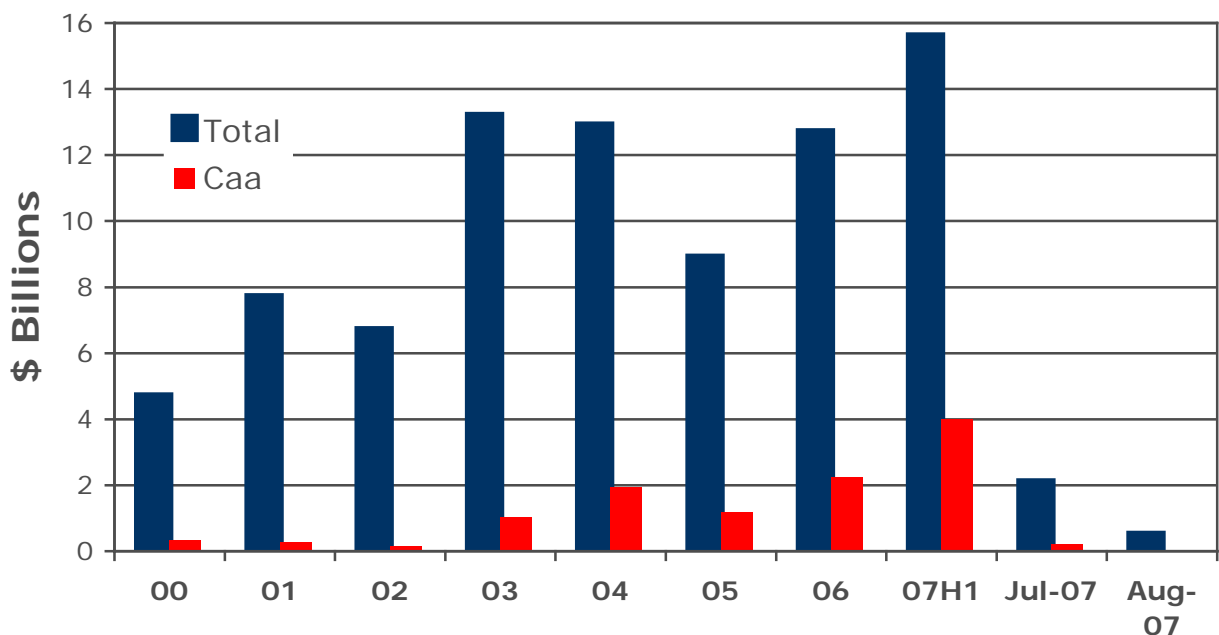
that a number of major banks look suspect due to their heavy involvement in the mortgage backed security market:



Source: Institutional Investor Magazine

We also expect to see further write-downs and litigation as banks back out of merger and acquisition related leveraged loan financing contracts. The chart below shows how high yield bond issuance has practically come to a halt as banks try to get out of contracts to finance leveraged buyouts and acquisitions. These leveraged loan high yield bonds have plummeted in value as yields spiked due to concerns over recession and rising defaults within the high yield bond sector. We are even seeing trouble in the once quiet municipal bond market as auction rate security municipal bonds have failed to secure new auctions. This latest credit market crisis has resulted in muni-bond yields that are at parity with taxable yields, and massive litigation against UBS, Citigroup, Merrill Lynch and others who sold these “auction rate” municipal bonds as safe haven cash alternatives. To those who believe the financial sector has bottomed and there is no way from here but up, we offer the following history lesson: During the savings and loan crisis of the late 1980’s, US financial sector stocks traded below book value. Currently the US financial sector is trading at 1.3 times book value, down from the 1.5 times book we reported in last quarter’s newsletter. We would not be surprised to see financial stocks trade below book value again before this credit crisis is over.

High Yield Bond Issuance in \$ Billions



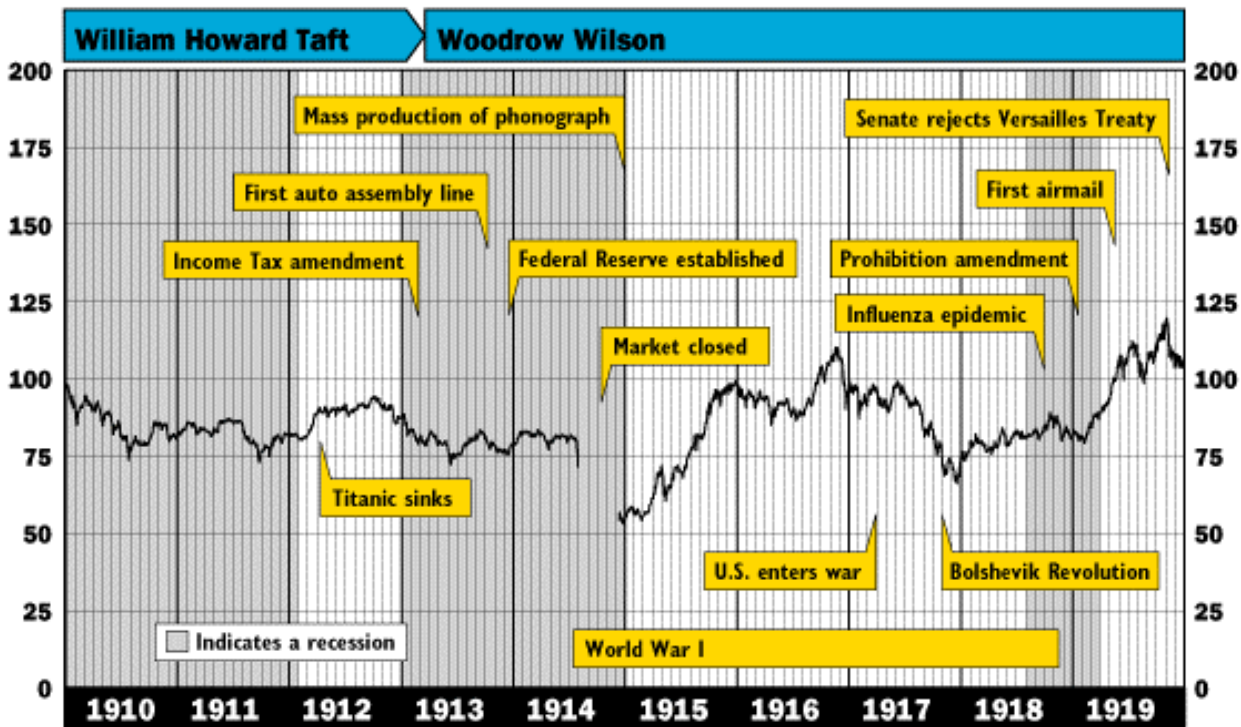
Source: Lehman Brothers, Moody's Economy.com

When the banking system is in crisis, there is usually a substantial reduction in lending as banks lend less to shore up their capital base. The financial sector derived over half of its profits from mortgage backed securities, leveraged high yield bond issuance, and credit derivatives during the boom times of the past couple of years. One must ask the question, do we really expect those areas to bounce back soon to the levels we had a few years ago? WE THINK NOT! Why would anyone expect sub-prime mortgage issuance, leveraged buyout activity, and high yield bond issuance to snap back to 2006 levels? We don't understand such logic, but this type of thinking is pervasive among the bulls on Wall Street at the moment. The financial sector comprises 18% of the S&P500 and therefore is the single largest industry component of the US market by capitalization. We expect the continuing deterioration in this sector along with real estate (housing, construction, durable goods) to create substantial headwinds for US and global markets in 2008.

But Isn't All This Bad Economic News Already Factored In To Stock Market Valuations and Aren't Valuations Reasonable?

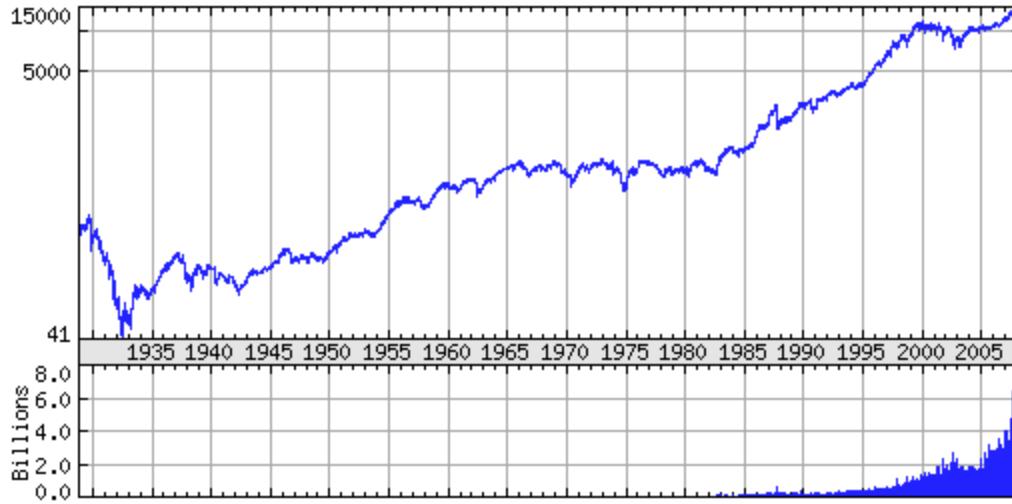
So by now, our readers are probably asking the question: "*But Isn't All This Bad Economic News Already Factored In To Stock Market Valuations and Aren't Valuations Reasonable?*" Well, we continue to be bearish on the broad markets and only bullish on the consumer staples sector. The reason for our bearish posture is our forecast for corporate profit deterioration during the remainder of this year. Even though the S&P500 trades at around 16 times forward 12 month earnings and this sounds like a reasonable valuation, we have to understand that this is based on a forecast of 16% positive earnings growth in 2008! Historical earnings performance during recessions suggests that corporate profit growth drops to -5% when GDP growth is around 1 to 2% and profit growth drops to -10% on average when GDP growth slows to zero. With total US GDP growth in 2008 forecasted to be in the 1.5% range, we expect corporate profit growth to be in the -5% range. This is a far cry from the 2008 S&P500 earnings forecast of +16% reported by Reuters. If we apply our -5% forecast to the actual 2007 S&P500 earnings of \$71.56 per share, we have the S&P500 trading at around 20 times forward earnings instead of 16. The Wall Street Journal has been reporting on this mismatch of 2008 earnings forecast relative to historical recession-era earnings. The Journal

recently reported that 27 of the 30 Dow Jones Industrial Average stocks are actually overvalued when measured on a PEG (price to projected earnings growth) basis. Only Alcoa, Home Depot, and Boeing were fairly valued. But what about the old buy and hold strategy of staying in the market and riding it up and down through market cycles? While we do not believe in frequent market timing, we do believe that there are a few times during decade long market cycles where extreme caution is required with regard to stock exposure in your investment portfolio. Wall Street will never tell you this, but during the past 100 years there have actually been 4 lengthy periods where the US market had flat or negative inflation adjusted returns: 1910 to 1919, 1929 to 1954, 1968 to 1981, and 1999 to the present.



Yes, that's right... 1999 to the present. All of those buy and hold investors out there need to recognize that a dollar invested in the S&P500 in 1999 is actually worth less than \$1 today, and a dollar invested in the DOW 30 Industrials in 1999 is worth less than \$1 today on an inflation adjusted basis. If you study the following historical market charts closely, you will see that prolonged periods of market under-performance usually happened after a period of extreme market out-performance (*read BUBBLE!*). The long market downturn of the 30's and 40's was preceded by the roaring 20's. The bull market of the 50's and 60's preceded the downturn of the 70's. And last but not least, the past 9 years of market stagnation have been preceded by the bull market of the 80's and 90's... which was the mother of all bull markets in terms of euphoric price gains. In summary, we think the market is not yet factoring in the likelihood of recession and the hit to corporate profits.

DJ INDU AVERAGE (DOW JONES & CO
as of 31-Mar-2008

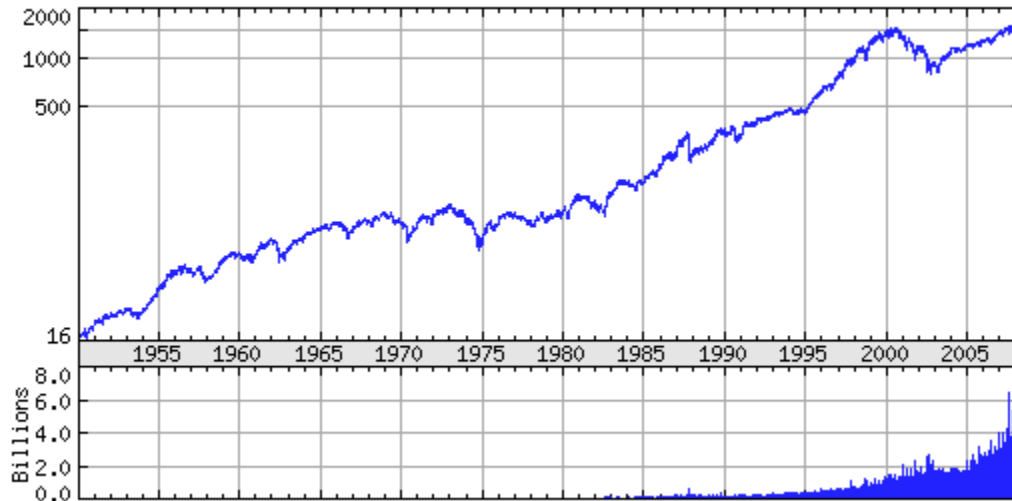


Copyright 2008 Yahoo! Inc.

<http://finance.yahoo.com/>

Historical Dow Jones Industrial Average Chart 1929 to Present (on a log format basis)

S&P 500 INDEX (STANDARD & POOR'S
as of 31-Mar-2008



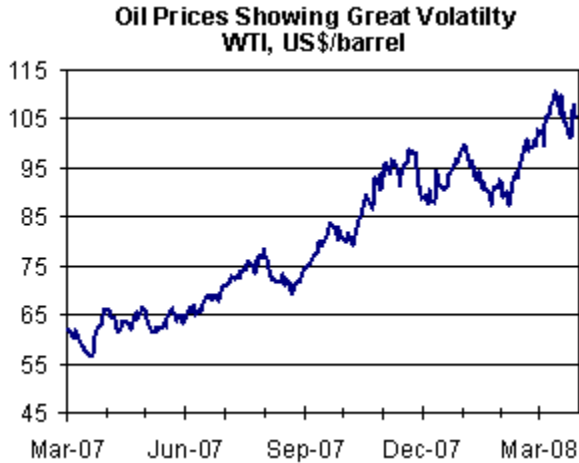
Copyright 2008 Yahoo! Inc.

<http://finance.yahoo.com/>

Historical S&P500 Chart 1945 to Present (on a log format basis)

Oil and Energy:

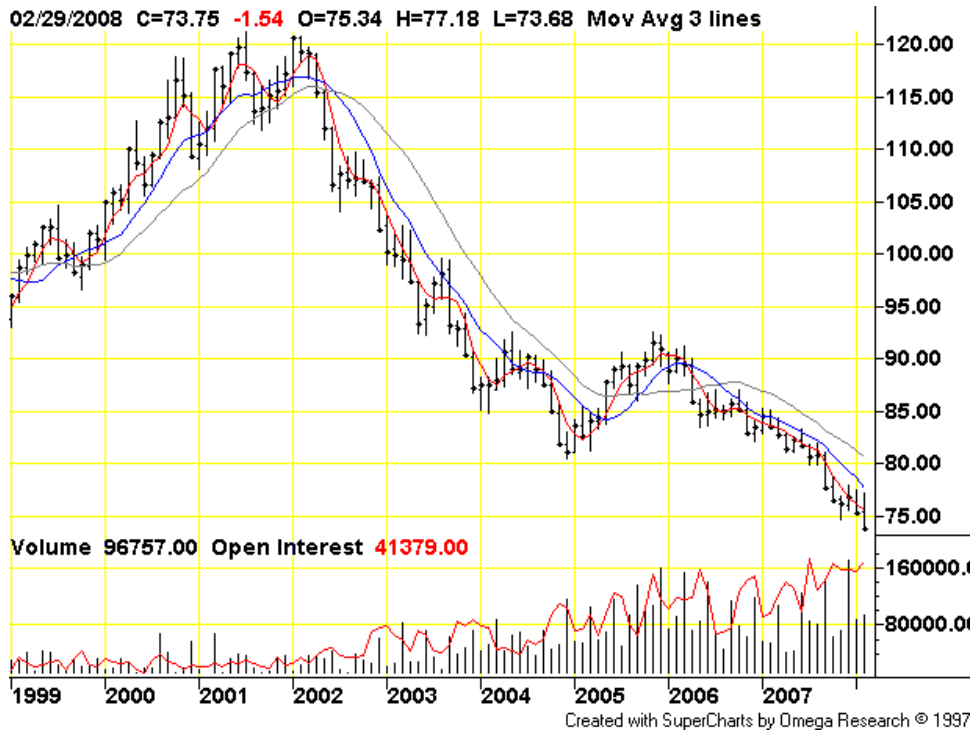
As we have predicted for two years now, crude oil continues to rise in price as a result of the falling dollar, increasing global demand, OPEC supply constraints, and investor speculation in the future's market. At this point we believe the new floor for crude is around \$80 per barrel and expect oil to trade between \$80 and \$120 per barrel during 2008. If recession in the US spreads globally and proves to be deeper than we are forecasting, perhaps oil could fall back into the \$50 to \$80 range. However, at this time we do not see the global slowdown being deep enough or long enough to force oil lower for very long.



Source: EIA (Energy Information Association)

US Dollar in Decline:

As discussed in our previous newsletters, the US Dollar continues to lose its value relative to other currencies with the US Dollar Index (as reported in the Wall Street Journal) losing just over 7% during 2007 and close to 6% already this year. Dollar weakness and global demand for commodities are causing price increases in most commodity sectors. Gold gained 31% during 2007 and has already gained another 10% during the first quarter of 2008. As the US economy stalls in 2008, rate cuts by the US Federal Reserve should cause the dollar to weaken further as it decreases the yield advantage of the dollar relative to foreign yields.



US Dollar Index Values from 1999 to Present
Source: TradingCharts.com

Inflation Outlook:

Regarding consumer price (cpi) inflation, our research position has not changed significantly since the last newsletter. Global money supply growth is leveling off and we have inflation in the world's major economies comfortably below 3%: US= 2.2%, Eurozone= 1.9%, Australia 2.5%, Canada 2%, UK=2.5%, Japan=0%. As global GDP growth slows from an estimate of 3.4% in 2007 to an expected 2.7% in 2008, consumer price inflation should remain calm. Many economists are discussing the possible inflationary effects of the central bank actions and the US Federal Reserve's recent rate cut. As discussed earlier, these central bank actions were taken to stabilize the global credit markets in the wake of the recent credit market turmoil. We do believe that more rate cuts are coming and these cuts have the potential to cause increased inflation. However, it is more likely that rate cut induced inflation will be offset by housing and financial asset deflation. Our benign consumer price inflation forecast is not at odds with our investment allocation to commodities because we believe commodity prices are now driven more by dollar devaluation than by consumer price inflation.

Conclusion:

As previously discussed, 2008 is likely to be a year for caution and defensive investing. At Institutional Investment Research, we see many of the world's best institutional investment professionals making defensive moves to protect their clients' portfolios. Through the Alpha returns model portfolios we hope to provide timely research and ideas to help the individual investor make wise institutional level portfolio decisions. Our performance (since inception and so far this year) is proving the merit of our investment philosophy. As we continue in 2008, we hope our research will give you peace of mind in this otherwise turbulent and challenging investment environment.

Disclaimers and Disclosures:

This Institutional Investment Research LLC newsletter is published quarterly and is not an offer or endorsement for the purchase or sale of any security or financial instrument. The securities mentioned in Institutional Investment Research LLC reports may not be suitable for all investors. Institutional Investment Research LLC is a financial research newsletter publisher and is not a Registered Investment Advisor and therefore does not provide specific investment advice as specified by the Investment Advisors Act of 1940. Employees of Institutional Investment Research may and in some cases do own the securities covered in these newsletter research reports. The information in this newsletter research report is based upon information that we consider to be reliable, but Institutional Investment Research LLC does not warrant its accuracy, adequacy, or completeness and should not be relied upon as such. Before acting on any recommendations in this material, you should consider whether it is suitable for your particular circumstances and, if necessary seek other professional advice. Past performance does not guarantee future results. This report was prepared with information from the following sources: Moody's Economy.com, Reuters, Standard & Poor's, The Financial Times, The Wall Street Journal, and the OECD.