



Market Commentary

The first quarter of 2008 marked a period of considerable stress, uncertainty, and volatility for the financial markets. Stock indices declined across the board with little regard for investment style, market capitalization or geographical location. The S&P 500 Index lost 9.4% for the quarter and is down 16% from its October high. The Nasdaq fared no better falling 14% for the quarter. Reflecting international equity markets, the EAFE index suffered an 8.8% loss for the quarter.

We are now witnessing rapid de-leveraging of the financial system as the market tries to get a firm handle on the true magnitude of mortgage-related losses. At the same time, the Federal Reserve and Congress have taken decisive steps to defend the economy. The Federal Reserve has continued to aggressively reduce short-term rates. In addition, large lending facilities have been made available to enable banks to increase liquidity. Congress, for its part, pushed through a \$160 billion fiscal stimulus package which provides tax rebates to low and moderate income earners. While the timing is difficult to gauge, both of these actions should have a positive economic impact later in the year.

Treasury securities continue to be the primary beneficiary of the current economic and financial environment. Three month T-bills ended the quarter yielding 1.3% while the 10 year note yielded 2.6%. At current inflation rates, one is accepting a negative real rate of return by purchasing Treasuries securities. We see little value and considerable risk in purchasing longer-dated Treasuries. While government securities have rallied, spreads between other fixed income securities have widened, reflecting the reassessment of risk in the credit markets. For example, municipal bonds have in some cases, been sold down to levels where their yield has exceeded that of taxable Treasuries of comparable maturity.

Looking forward, the Fed appears to be firmly committed to providing adequate liquidity and ensuring that the financial markets are functioning effectively. While we probably have not seen the end to mortgage-related writedowns and headline risk, we believe that the equity markets will be looking for the light at the end of the tunnel. Low interest rates, increased liquidity, and relatively unattractive rates of return in U.S. Government securities should support higher equity valuations. To navigate in the current environment, we believe as strongly as ever in maintaining a well diversified portfolio. Currently depressed sectors such as retail and even financials warrant consideration at today's valuation in our opinion.

While considerable uncertainty and volatility may persist throughout the year, we maintain our commitment to the equity market. History has taught us that despite its volatility and accompanying headaches, as an asset class the equity market has provided solid real returns for patient investors over multiple economic cycles and who have a long-term horizon. In fact, the biggest risk to compounding real, after-tax purchasing power has historically been shown to be the opportunity cost of not participating in the equity market.



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