

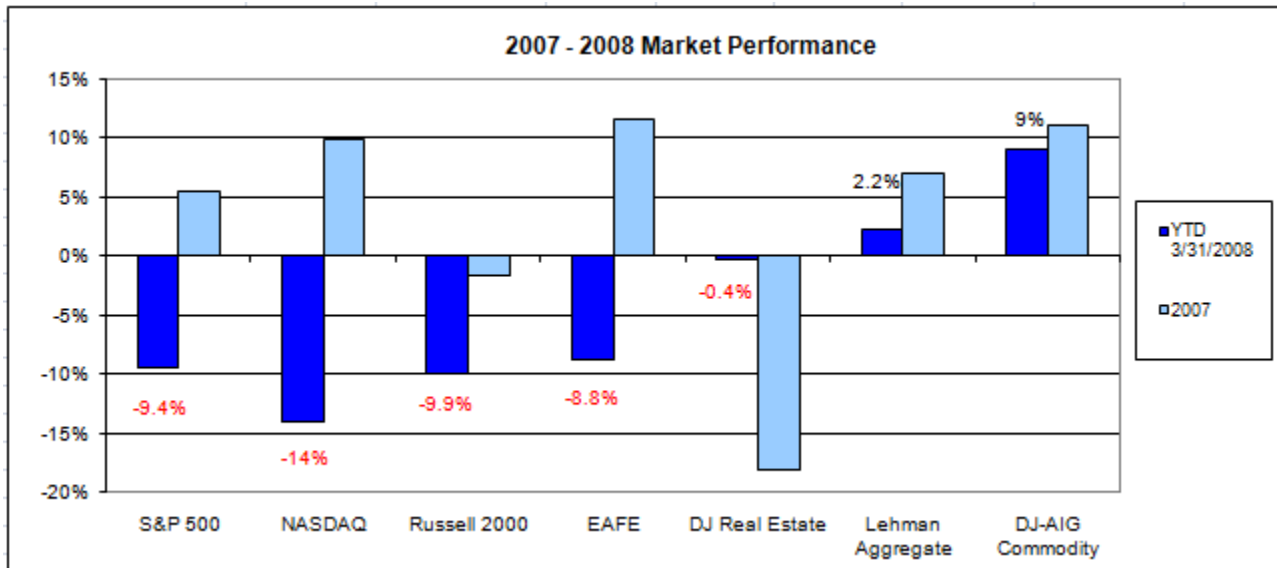


Markets and Economic Summary & Outlook

March 31, 2008

There is no question that the global equity markets were challenged during the quarter as fears of an impending U.S. economic recession intensified. Consumer sentiment, in response to falling home prices and higher energy and food costs, has fallen to a level not seen since the 1990 recession, indicating that we indeed have reached a critical juncture. The most troubling events that affected the quarter were the financial market disruptions that continue to hover over the banking sector. Nevertheless, there were bright spots and pockets of stability, even as most equity market sectors retreated in early 2008. Commodity-related holdings and non-financial, investment-grade bonds have performed very well the last several months. Moreover, investors should not lose sight that even in this environment, there exist many excellent, well-run businesses that will provide astute investors opportunities for very attractive returns in the months and years to come.

The S&P 500, comprised of large and mid-cap U.S. stocks, was down **-9.4%** (total return including dividends) during the first quarter of 2008 (vs. **-3.3%** in Q4 '07), while the NASDAQ Composite erased its 2007 gain, retreating **-14%** (vs. **-1.8%** in Q4 2007). Non-U.S. equities, measured by the MSCI EAFE index, similarly were not immune, dropping **-8.8%** (vs. **-1.7%** in Q4 2007). The primary cause was poor performance by Asian equities, star performers the last three years. One reasonably bright spot during the quarter oddly enough was U.S. commercial real estate (REITs), which was flat during the quarter (vs. **-12.6%** loss in Q4 '07). In any event, we remain extremely wary of most of the commercial real estate market given deteriorating fundamentals and financing issues.

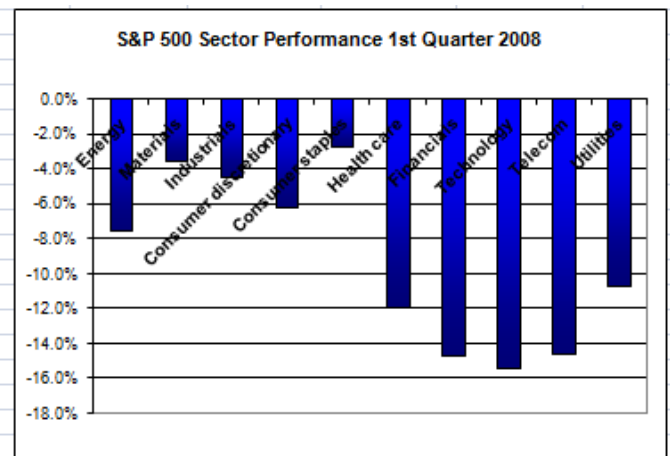
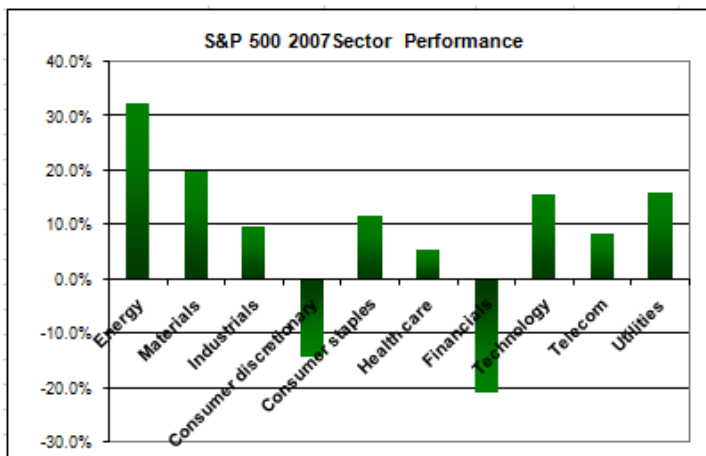


Total returns include capital gains and losses plus dividend and interest payments received and reinvested over the periods described. S&P 500 is an index of U.S. large and mid cap stocks; NASDAQ is the NASDAQ Composite Index; Russell 2000 is an index of U.S. small cap stocks; EAFE is an index of stocks from Europe, Australia, and Far East; DJ Real Estate is an index of traded U.S. REITs (real estate investment trusts); Lehman Aggregate is an index of U.S. Treasury, agency, and investment grade corporate bonds; DJ-AIG Commodity is a total return index of futures contracts on metal, agricultural, and energy commodities.



Investment grade bonds, **+2.3%**, and balanced commodities, **+9%**, outpaced equities during the first quarter. The Fed's rate cuts, a flood of government money into the banking system, and a flight to quality have driven short-term Treasury yields down into the 1.5% to 2% range, which is far lower than current annual inflation, which is running around 4%. Other segments of the fixed income market, for example state and municipal and high-rated non-financial bonds, have thus far not experienced a similar decline in rates as spreads have widened to Treasuries. These securities present interesting near-term opportunities for the income-oriented or defensive investor in search of more stable returns and regular cash flow.

Commodities, by contrast, have been a very hot area, so much so that there's some concern whether this represents a speculative bubble. Clearly, global economic expansion and the resulting strain on resources have been the primary factors behind the run up in commodity prices, but there is a significant speculative component at play as well that has contributed to higher volatility. Several key commodities had large price swings during the quarter, most notably natural gas (+33%), corn (+21%), copper (+26%), and gold (+9%), which were partly offset by declines in live cattle (-13%), lean hogs (-19%), and soybeans (-3%).














Turning our attention to first quarter performance by industry, we see that no sector was left unscathed (right chart above). However, this masks some positives from the quarter. Energy, materials, industrials, and consumer staples were the best performing groups. Reasons vary by industry. For example, the commodities boom has benefited most energy and materials producers, the consumer staples sector generally does well during a slowdown as investors shift to more defensive holdings, and export-oriented industrials have performed well partly due to the competitive benefit of a weaker dollar. Performance within a sector can also be deceiving. For example, the major integrated oil and gas companies such as Exxon Mobil and Conoco were down 5% to 10% during the first quarter, in contrast to more nimble and focused, yet still very large, exploration and production companies like Apache and Devon, both of which had +10% returns.

Some sectors long thought of as "defensive" plays based on past slowdowns behaved quite badly this quarter, most notably health care and utilities. Health care illustrates the risk of extrapolating too much from past convention when forming today's investment decisions. The health care sector is faced with a set of unique afflictions unrelated to the state of the economy that include significant regulatory issues and hurdles, patent expirations and generic drug competition, and the



potential for a changed landscape following the presidential election. Utilities have pulled back partly due to rising fuel costs, most of which can be recaptured in rate hikes, and the potential for reduced electricity and gas demand should the slowdown linger longer than expected.

Turning to the rest of the world, global equities in general did not perform well during the first quarter. The only observable trend, not surprisingly, was that commodity-rich countries and sectors tended to perform better. Chile, Brazil, and Canada fall into this category, and the latter two countries are very well positioned for many years to come with ample oil reserves and other natural resources necessary to feed future global growth.

Name	Return ▲
Single Country	
MSCI Chile Investable Market Index	+10.76% 
MSCI Mexico IMI Index	+7.84% 
MSCI Taiwan Index(SM)	+6.34% 
MSCI Thailand Investable Market Index	+4.04% 
MSCI Brazil Index(SM)	+3.57% 
MSCI Switzerland Index	+0.15%
MSCI Sweden Index	-0.55% 
MSCI Belgium IMI Index	-0.62% 
MSCI Canada Index	-2.09% 
MSCI Spain Index	-2.53% 
MSCI Netherlands IMI	-2.55% 
MSCI Japan Small Cap Index	-3.73% 

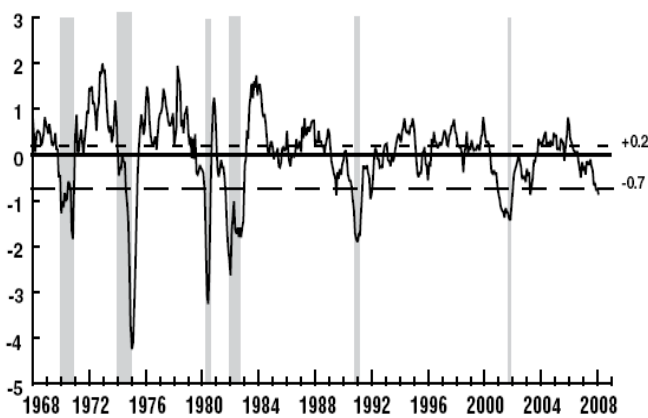
Source: Barclay's Global Investors (2008 through April 8)

April 2008 Outlook

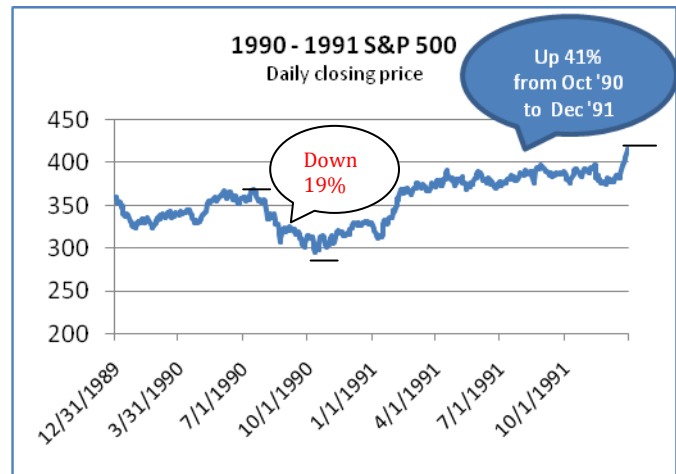
There is no sugarcoating the fact that the U.S. economy has slowed. The question is, "How long, and how deep?" A slowdown does not mean all business activity grinds to a halt. Autos, clothing, tonight's dinner and lots of other goods and services will continue to be purchased, but in aggregate we expect at a moderately lower rate than the previous year. The overriding issue facing the economy is how much further home prices are going to fall, and when will price stability resurface. It is conceivable that home prices could fall another 10% to 20% given the current inventory backlog and rising tide of foreclosure sales, which would push the recovery for housing well into 2009 or even 2010. This diminishes the wealth effect consumers feel from what is often their largest asset, and that, along with higher energy bills no doubt has negatively impacted consumer sentiment and spending.

The conventional definition of a recession is two consecutive quarters of negative GDP growth (contraction), but the trouble is that we usually don't find this out until the recession has already ended because of the large time lag in processing the data. The Chicago Federal Reserve Bank issues a monthly index that's a composite of over 80 national economic indicators (CFNAI) that presents a more real-time feel for the state of the economy, and as of February and March, it's showing we're in the middle of a recessionary contraction based on the direction and level of the index (lower left chart). The troughs on the graph correspond to past recessions (shaded areas), and if there's any solace to take away from our experience over the last 20 years, it's that the more recent recessions have been fairly brief, averaging only 11 months with a 2.2% contraction in GDP. The more muted effect is attributable to earlier and more aggressive policy actions by the Federal Reserve and government. The Fed has been even more aggressive in its actions in the current downturn.

CFNAI-MA3 and Business Cycles



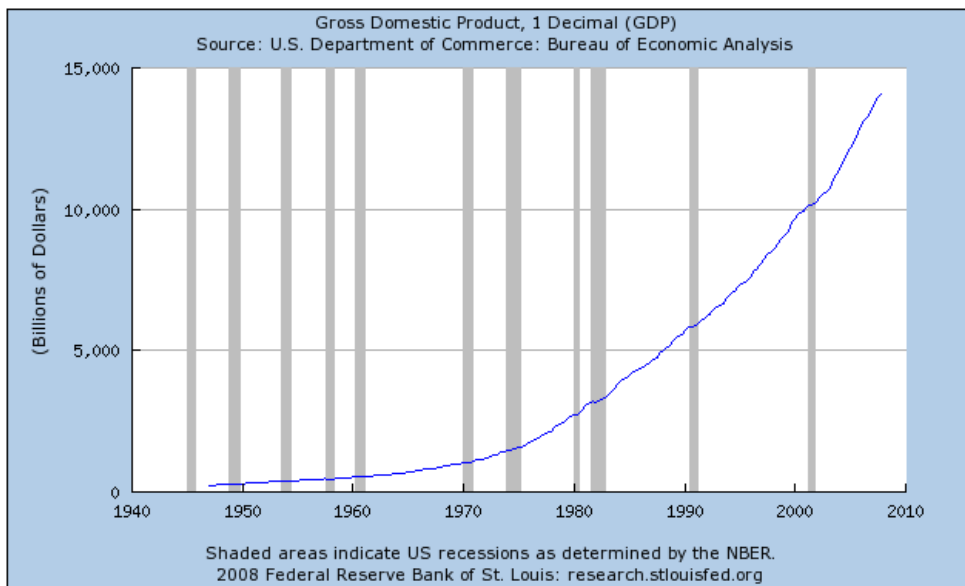
Source: Chicago Federal Reserve Bank



Some of you have already seen the comparisons we have made to the 1990 recession, which bears some similarity to the current situation. Then, as today, there was a fairly large drop in home sales and prices in tandem with a sharp decline in consumer sentiment and spending. There are key differences between the two periods, for example, the scope and complexity of the financial markets is vastly different and the current housing downturn is much more severe, but it is useful to review how the stock market performed in 1990-91. The S&P 500 declined 19% from July 1990 through October 1990, leading the way into a recession the second half of the year and into 1991.

Like the past few months, banks and cyclical stocks were by far the worst performers in 1990. The market then rose 41% from October 1990 through December 1991 as the recognition grew that the banks and housing market would stabilize and recover. It's also worth noting that banks were among the best performing stocks in 1991, some were up as much as 75% to 80% as the economy got back on its feet.

Again, each time period's situation and problems differ, but one shouldn't be too surprised should the equity markets return to a sharply positive track the latter half of 2008 or early 2009. There's a lot of noise in today's economic data, but the facts are, the U.S. still has a relatively young, growing, highly productive population, excellent education and infrastructure, and the economy will continue to grow (next chart). Sentiment is a fleeting thing, and can change very quickly despite the current doom and gloom. One last thought – the S&P 500 closed at 417 in 1991, today it stands at 1360.



Portfolio implications for the next 6 to 12 months

Corporate earnings will most likely retreat the next quarter or two, led by numbing losses from the financial sector, but most of this news has already been factored into stock prices. The talk in the press that we're in a severe recession or even a depression seems to be utter nonsense. We're faced with a rise in unemployment of 1% to 2%, meaning 93% to 94% of the working population continues to work full-time. This is a far cry from the 30%-35% unemployment rates in the '30's. Could the market retreat further? Sure it's possible, but the odds appear slim for swaying too far from the current trading range. It is expected that in the not too distant future there will be a recovery. As for timing, it's best to prepare for what's to come based on what we think is most probable. What follows is a summary outlook of advice for getting through the next few months:

- The financial sector should remain highly stressed as it pays the price for wishful thinking and overly optimistic modeling assumptions. Straight-line 10% plus annual increases in asset prices, like houses, are never sustainable, and certainly shouldn't be the basis for lending huge sums to individuals who may or may not be thinking very clearly at the time of purchase.



Banks will most likely hemorrhage bad debt the next several quarters, and a rise in bank failures and forced sales should result. These will probably be relatively few in number, thus potentially leaving thousands of other banks still open for business as usual. The steeper yield curve the Fed has facilitated will allow most banks to "earn" their way out of the mess. Out of the rubble will surface numerous profitable investment opportunities, but we think it best to avoid the sector until mid-summer at the earliest or until more light has been shed on how much further housing prices will fall.

- Common sense informs us that discretionary spending by consumers should be impaired for the foreseeable future. Large mortgage debt service and higher energy bills are the prime culprits. However, a decline in the value of a home is the present owner's loss and a future buyer's gain, so consumer spending on other goods will likely increase a few quarters out. Again, we think it is best to avoid consideration of the consumer discretionary sector (e.g., autos and retail) until mid-2008 at the earliest.
- High oil prices and the need to import 2/3 of our oil contribute to the U.S.'s massive trade deficit, and that, along with low interest rates means a weaker dollar. This helps U.S. companies with large export-driven businesses. U.S. goods and services are now extremely competitive in the global markets. Beneficiaries include U.S. industrial and consumer companies that have a high percentage of revenue and income from non-U.S. markets. Many of these stocks have held up well or are up since year-end, and we would expect this trend to continue.
- Our past commentaries have maintained a very favorable outlook on energy and commodities in general, and we're not going to change our tune here. The fundamentals on these sectors remain extremely compelling, particularly for oil and gas, and we see nothing that would change this view even if global energy demand were to slow given the state of the current economy. The slowdown is a temporary phenomenon, but the core energy problems remain on a global scale. Oil is increasingly expensive to produce and is past peak production in key regions, demand should continue to grow, and there exist very few meaningful options for substitution from other energy sources.
- It is in most investors' interests to consider fixed income securities given the state of the equity markets, and the proven benefit bonds have in reducing portfolio price volatility. Spreads for investment-grade corporate debt have widened significantly relative to Treasuries. We're not talking about beaten-down, non-transparent financial institutions, but companies with relatively low debt and prodigious cash flow. Yields to maturity from 5.5% to even 7% for relatively short maturities are not uncommon. This compares to 2.5% money market rates, which will likely descend even further in the coming weeks. The last few weeks has also seen a large increase in attractively priced tax-exempt state and municipal debt. High investment grade state and muni debt now fetches 5.5% to 6.5% on a taxable equivalent basis for the highest tax bracket, although this should dry up as the credit markets recover.

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