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### First Quarter, 2008

In many ways, this was a quarter that would be best forgotten. Although there were two fitful, brief rallies that trailed actions by the Federal Reserve, the market overall moved relentlessly lower. The S&P 500 managed to decline 9.5% on a total return basis and was one of the stronger market indices, with only the Dow Jones index doing better. Small- and mid-capitalization indices fell by 9.9% and the NASDAQ was off by 14%. The International markets which had survived the US weakness in the fourth quarter were also weak with the EAFE (developed markets) down by 9.5% and Emerging Markets off by 11.3%. Even worse were the developed markets measured in their local currencies, with a drop of 15.5%. The bond market was better, but remained hostile to anything but the finest credits. Treasury securities rallied across all maturities with the three-month Treasury bill reaching a low yield of 0.5% near the end of the quarter. Returns on lesser credits and longer maturities were weaker as investors fled risk.

The culprit in the market chaos of the quarter is well known, the sub-prime mortgage loans and the bonds that were created to fund them. What has been remarkable has been the extent of the damage done to different parts of the financial markets by these securities. The periodic sale of auction rate preferreds and bonds, previously a simple security used by closed-end funds and municipalities to fund short-term needs, were halted as investors became concerned about the quality of longer dated bonds owned by the closed end funds and the access to credit of the municipalities. All of this came about due to the impaired credit of bond insurance companies. The impaired credit of the insurance companies was due to their guarantee of bonds backed by sub-prime mortgage loans. The reach of the sub-prime problem into such esoteric areas of the financial market is the reason for the general fear of extending credit to anyone. Any company or fund needing short-term funds to support illiquid assets has been at risk.

The various steps taken by the Federal Reserve over the quarter have been targeted not just to stimulate economic activity, but increasingly to insure a functioning financial system. This culminated during the quarter with the rescue of Bear Stearns. The actions involved not only providing credit assurances to the market for a portion of Bear's assets, but also gave other primary brokers access to the Federal Reserve. The Fed also agreed to take as collateral for borrowing a variety of assets including well-rated mortgage-backed bonds in the hope of stabilizing their value in the broader market.

What the markets appear to be wrestling with today, and the volatility in both the stock and bond markets is supportive of the wrestling analogy, is the effectiveness of the actions by the Fed and the Administration to return the financial system and economy to some normalcy. Because of the breadth of the problem, there will likely be no one event or action that will turn attitudes of investors and put us on a path to market and economic recovery. We feel that it is going to be a combination of actions that gradually improves the markets. We are of the opinion that what has taken place so far, as well as interest rate and policy changes that seem to lie ahead, will turn attitudes and the markets. As a consequence, we likely have seen the lows for this market cycle. However, risk will not be easily re-assumed by investors. Quality will remain a must in both stocks and bonds and we believe our portfolios are well prepared for this environment.