

INVESTING WITH DISCIPLINE

NEWSLETTER

MARCH 31, 2008

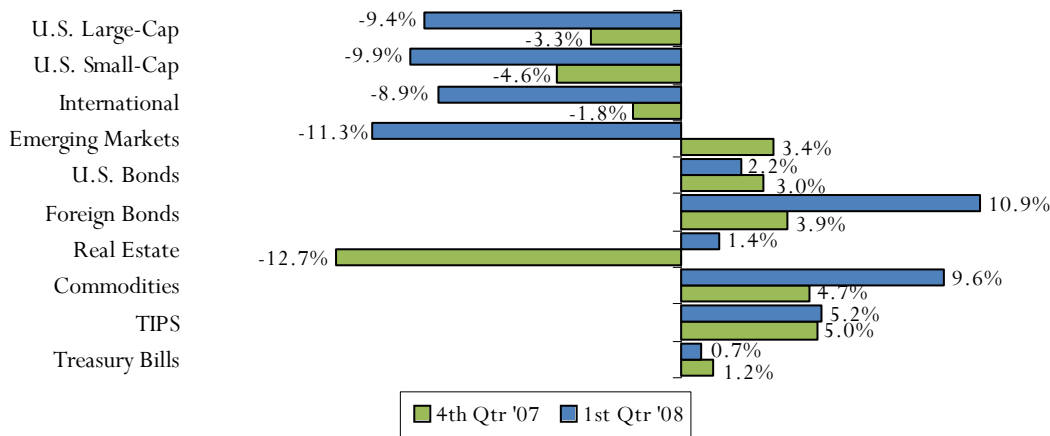
MARKET UP-DATE

The first quarter of 2008 was marked by turmoil. As highlighted in the chart below, equities took a beating while fixed income, commodities and TIPS provided some counter-balance in the volatile markets. We expect uncertainty in the financial markets to persist throughout 2008.

The U.S. and global economies grew in Q1, albeit slowly. External factors, such as continued economic progress in China and other emerging markets, will play a role in our recovery. In our quarterly topic, we discuss some of the other hurdles our country must overcome before the economy will strengthen.

Please visit the Archive section of our website to see additional charts and information about the previous quarter in our Quarterly Review & Outlook and to read articles about Municipal Bonds and a January 2008 Market Update.

Asset Class Performance Comparison



INDEX SCORE-CARD

QUARTERLY RETURNS

US Large Cap:	-9.44%
US Small Cap:	-9.90%
International Stocks:	-8.91%
Emerging Markets:	-11.32%
US Bonds:	2.17%
Foreign Bonds:	10.93%
REITs:	1.40%
Commodities:	9.60%
TIPS:	5.18%
Treasury Bills:	0.72%

All data as of the period ending
03/31/08

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QUARTERLY TOPIC: "IN-DEBT-GESTION"

Fallout from stalled credit markets continues to ripple through our economy and sets the stage for an interesting, if not difficult, 2008. What started as trouble in a small segment of the mortgage industry has quickly snowballed and exposed problems in other areas, weaknesses that had been slowly building but remained masked by extraordinarily easy access to money/credit. The situation prompts a number of thoughts and observations.

The world is suffering from a case of "in-debt-gestion" following a global binge on all types of debt, the most unsavory being related to sub-prime mortgages. Low interest rates and declining lending standards made debt available for virtually anyone who wanted it. Want to buy a house for \$0 down, with bad credit, and no documentation of income? No problem! This kind of faulty

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QUARTERLY TOPIC: "IN-DEBT-GESTION" (CONTINUED)

thinking and gross misjudgment of risk has percolated through the economy in the last 3-5 years. As a result, many Americans have a savings rate very near zero and less than 50% equity in their homes for the first time in history. Mortgage debt, credit card debt, auto debt, corporate buy-out debt – these took years to build up and our case of "in-debt-gestion" will not go away overnight.

To a large degree the accumulation of debt was made easy by financial innovation and the misjudgment of risk. Banks were willing to lend on looser terms because they were not going to be responsible for collecting the debt payments. Financial engineers devised a way for commercial banks and mortgage companies to sell loans to investment banks—they package the loans together, get them stamped with a AAA rating by a credit agency, and sell interests in this mortgage backed security to hedge funds, banks, municipalities, and anyone else who was interested. The actual owners of risk became so far removed from the underlying investment they had difficulty evaluating its quality.

Banks did not have an incentive to worry about the risky loans they were making, as long as they could turn around and sell the loans to someone else. However, when sub-prime home buyers began to default, banks and other mortgage lenders could no longer sell the toxic loans they were making. That's when the wheels really came off the cart. Mortgage backed securities by this point had been spread far and wide. As they defaulted at higher than expected rates, their AAA credit ratings became meaningless and determining who owned them difficult. For those reasons, trading of the bonds locked up. Banks and brokerages began hoarding money to cover rising defaults. Off balance sheet investment vehicles, à la Enron, were exposed and led to further capital hoarding and write-offs for bad loans. These trends are still in play and confidence in the financial system is severely shaken.

The system is not broken; however, there is no quick fix. The federal government is providing some economic stimulus and extra money for financial institutions, but the true healing of our system will take time. Banks need to replenish the capital reserves that back their loans. Foreign investors have contributed billions of dollars in this regard. Consumers need to rebuild savings and pay off debt. A small tax rebate is nice, but only secure jobs will truly facilitate this change.

As the market and people are drawing lessons from our current situation, we need to remember that financial innovation can be great. It has given us the mutual fund concept, online banking, and exchange traded funds. Furthermore, economic crisis is a regular occurrence. In fact, financial history is littered with examples, from speculation over tulip bulbs to internet stocks. Financial crises and speculation are inherent risks to an open market system.

The economy will continue to ebb and flow. Although it could take awhile for the economy to get back to the growth rate we expect, we have confidence that it will grow again. The U.S. is a dynamic and innovative country and economy. The best way to move forward is to look at the decision making from the recent speculative era and try to avoid future mistakes. The current situation is a startling demonstration of risk being misunderstood or ignored. Even boring bonds have risk. That's why we diversify.

Regards,

Brian J Lawrence, CFA

WIT & WISDOM

*"Obstacles are those frightful things you see
when you take your eyes off your goal."*

- Henry Ford (1863-1947)

Index Definitions

US Large Cap: A U.S. large company stock index measured by the S&P 500. A group of 500 of the most widely traded stocks in the U.S., as chosen by Standard & Poor's.

US Small Cap: Measured by the Russell 2000. The index is comprised of the smallest 2000 stocks in the Russell 3000 Market Index.

International Stock: An international stock index measured by the MSCI EAFE. It is comprised of stocks from developed markets in Europe, Australia, Asia, and the Far East.

Emerging Markets: An international stock index that tracks non-developed markets throughout the world. It is measured by the MSCI Emerging Markets Index.

US Bonds: A measure of the Total U.S. Bond Market by the Lehman Aggregate Bond Index. It takes into account corporate, government, mortgage and asset backed securities.

Foreign Bonds: Measured by the Citi World Gov't Bond Index. The fund is comprised of primarily investment grade bonds from around the world.

REITs: Measured by the FTSE NAREIT Index which is a composite of Real Estate Investment Trusts traded on U.S. exchanges.

Commodities: Performance is represented by the PIMCO Commodity Real Return Strategy Fund, which uses the DJ AIG Commodity Index as a benchmark.

TIPS: Performance is represented by the Lehman Brothers US Treasury Inflation Protected Securities Index. TIPS are government bonds that have adjustable coupon payments based on the rate of inflation (as measured by the CPI).

Treasury Bills: Short-term government issued securities with maturities less than 90 days. Because they are government issued, T-Bills are free from default risk.

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