THE BOSTON COMPANY
ASSET MANAGEMENT, LLC
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Multi-Alpha Market Neutral Equity Management
First Quarter 2008 Investment Commentary

Investment Environment

The first quarter of 2008 dawned with clear indications of some growing stresses in the US financial system as several industry giants announced significant sub-prime-related write-downs and experienced capital shortages. The most notable drama to have evolved from the sub-prime debacle thus far was the implosion of Bear Stearns, which was rescued by a government-backed JP Morgan buyout. In an effort to boost liquidity and buoy the struggling banking sector, the FOMC cut the Fed Funds rate by 2% (to 2.25%) and announced a $200 billion short-term lending facility, which it made available to both commercial and investment banks.

The broader US economy also showed signs of weakness – unemployment numbers increased in pockets and the residential real estate market continued its wide-spread struggles, resulting in flat consumer spending (adjusted for inflation) and falling consumer confidence. In US dollar terms, everything from wheat and oil to gold and the euro rose to new highs, heightening concerns that inflation would hamstring the Fed's attempts to jump-start the economy by lowering interest rates further. With the Fed cutting its outlook for growth and with reported CPI rising at a 4.3% annual rate, the term "stagflation" re-entered the economic lexicon.

All is not doom and gloom, however. As numerous as the negative statistics are, the system is strained, but not broken. The Fed has responded in proportion to the threat, and, in pulling levers beyond standard monetary policy, has targeted the nature of the threat by reinforcing confidence in the system itself. Moreover, some encouraging indicators speak to the resiliency of the economy. While gasoline and crude oil prices have sky-rocketed (up more than 30% and 50% respectively in the last year), and food costs have increased as well, the Core CPI number of 2.3% year over year would indicate that the price levels of many other daily consumer goods and services have held steady or even declined. Unemployment has begun to rise, but it is hovering around a healthy level of 5%. The weak US dollar creates disadvantages, but has helped to boost exports and narrow the current account deficit. While some major deals have gone off-track for lack of financing, attractive valuations continue to drive M&A activity.

Not surprisingly, the conflicting information mentioned above translated into increased equity market volatility during the quarter. In late January and again in mid-March, Fed stimulus reversed the direction of a sharply declining stock market; however, both ensuing rallies were short-lived, and most broad indices up and down the capitalization spectrum ended the quarter with near double-digit losses.

Portfolio Performance Review

The Multi-Alpha Market Neutral Equity strategy slightly lagged its benchmark, the 3-month US T-bill, during the first quarter of 2008 (based on net-of-fees performance). The strategy's underperformance was largely attributable to weak stock selection that generated negative long-short spreads in two of the US-based portfolio slices – Small Cap Growth and Small Cap Value. Strong alpha generation in both the US Large Cap Core and Core Research slices helped to offset much of the negative effects of the small-cap underperformance.

Sector Review

During the first quarter, two slices caused much of the strategy's underperformance, Small Cap Growth and Small Cap Value, while the two larger cap US slices (US Large Cap Core and Core Research) were able to offset much of their negative effect. The disappointing performance within the Small Cap Growth slice can be narrowed down to short positions within Industrials (transportation & building products), general weakness in Financials and several long positions in Information Technology.

The Small Cap Value portfolio actually posted neutral to positive returns on the long side, but gave away much of those gains with some poor stock selection on the short side in the Consumer Discretionary and Financials (commercial banks) sectors.

Counterbalancing the aforementioned detractors were the US Large Cap Core and

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Core Research slices. In the US Large Cap Core slice, stock selection in Information Technology was excellent once again, thanks to shorts in the communications equipment and internet industries. Additionally, the overall long-short spread within the Health Care sector (specifically, equipment & supplies) was very beneficial, as were long positions in the Energy sector (exploration, production & services firms with limited refining exposure).

After posting sub-par performance in the Financials sector last quarter, the Core Research portfolio gained on the back of timely shorts of several capital markets, insurance and commercial banking firms. Furthermore, the Core Research slice benefited from two short positions in Healthcare (pharmaceutical manufacturers).

Looking Forward

As we have witnessed the deeper and broader effects of the mortgage and housing crisis over the past three months, we have come to believe that the most likely scenario for the US economy is a short, shallow, but statistically measurable recession in the first half of 2008. Recovery, however, will take time to play out, with potential for reversals in the early stages. We hope to capitalize on this environment by taking advantage of short-term market volatility to establish long positions in stocks with solid medium and long-term growth prospects, and short those that are poised for failure.

We believe the Fed's aggressive efforts and creative new approaches have helped to prevent the credit markets from seizing up entirely, and accelerated the timing of a turn-around. However, the reluctance of financial institutions to take on additional risk during this period of financial stress will cause a lag in the flow of capital to both commercial and individual end-users. In addition, the negative effects of housing price deflation are likely to act as obstacles to short-term economic growth.

While it is virtually impossible to "call the bottom" in a market such as this, it is precisely times like these that truly hedged market neutral strategies can help insulate investors from the shorter-term volatile swings that can negatively affect many of our long-only and biased long-short peers. Furthermore, during these potential inflection points, both factors and investment styles move in and out of vogue quickly. With our unique multi-slice approach, investors get exposure to a variety of investment styles and return streams, minimizing the effect a downturn in any one slice has on the portfolio.