ALTER ASSET MANAGEMENT, INC.

March 31, 2008

"The stock market is a no-called-strike game. You don't have to swing at everything; you can wait for your pitch. The problem when you're a money manager is that your fans keep yelling, 'Swing, you bum!"

- Warren Buffett - 1999 Berkshire Hathaway Annual Report

Dear Friends and Family,

We hope this finds you well. The major equity averages generated positive, albeit, below average returns in 2007 with the S&P 500 appreciating by 3.5%. Longer term, the first decade of the new millennium generated little overall price movement for common stocks. The S&P 500 began the decade at 1469 and eight years later was one point lower at 1468! Your Advisor has successfully navigated the "lost decade for U.S. equities" by combining bottom up security selection, a long-term investment horizon, and an emphasis on a margin of safety to substantiate value for our clients.

During the first quarter of 2008, the S&P 500 experienced a price decline of more than 9%. We believe the United States entered a recession in late 2007 that is likely to continue for several more quarters. The culprit is largely the inappropriate pricing of risk in the credit markets coupled with extreme levels of leverage. The impact has been felt in all sectors of the economy. Your portfolio currently has cash balances in excess of normative levels. This combination of liquidity and asset price weakness allows your Advisor to buy great businesses at discounted valuations for the long-term.

Current economic conditions and recent swings in stocks have resulted in a field day of negativity. It all appears to be "different this time" in a very uncomfortable way. While we do not wish to underestimate the characteristics that comprise the current downturn, history demonstrates that markets tend to bottom approximately half way through a recession. If this is a severe recession, it could extend eighteen to twenty four months from its origin in the fall of 2007. Accordingly, the current headwinds impacting the major averages are likely to recede over the next several quarters and we believe a set-up for an upswing for common stocks is in place based on valuation, investor psychology, and government intervention.

Valuation – U.S. stocks are inexpensive on an absolute and relative basis. The S&P 500 trades at fourteen times reduced estimates for 2008 earnings. Utilizing the Fed Model and examining the historical relationship between stocks and corporate credits, stocks are undervalued by between 10% and 20%.

Investor Psychology – Measures of bearishness among retail investors are at extremes and levels of cash in money market type accounts are at record levels. When sentiment shifts, large gains can occur over relatively short periods of time.

Don't Fight the Fed – The Federal Reserve is committed to cushioning the blow associated with the deleveraging of the economy. We believe the Fed's position on interest rates and the unprecedented availability of liquidity for financial institutions is extremely supportive of higher asset prices. As an example, the combination of investors "trading down" the risk spectrum, attractive valuations, and global consumerism are likely to benefit well-capitalized multinational businesses.

U.S. common stocks look attractive relative to other asset classes. By way of example, over the last decade residential real estate represented a major use of the marginal investment dollar. This market has turned, and investors are seeking alternative "homes" for their capital. The decline in the status of residential real estate as an asset class is likely in the early innings.

The body of this letter highlights our view of residential real estate. Similar to the recession caused in 2001 by the bursting of the internet bubble, the current downturn can be directly tied to weakness in residential real estate — the largest single asset for most Americans. In fact, net housing wealth as a share of GDP rose from 60% in 1997 to about 85% in 2006. We fear it may make the "lost decade in common stocks" appear tame. The body of this letter is not for the kids.

GETTING REAL WITH RESIDENTIAL REAL ESTATE

"The future ain't what it used to be."

-Yogi Berra-

We believe that residential real estate peaked in 2006, and that prices achieved during this period will not be seen until the Cubs win the World Series (we are giving them a decade). As we noted in our 2005 mid-year letter:

"It appears that many U.S. housing markets have gotten ahead of themselves. These prices may be justified if long-term interest rates continue to fall dramatically in tandem with a strong economic backdrop. In our view, this is the lowest probability scenario. When will the music stop? As in every speculative period, it will only be clear in retrospect."

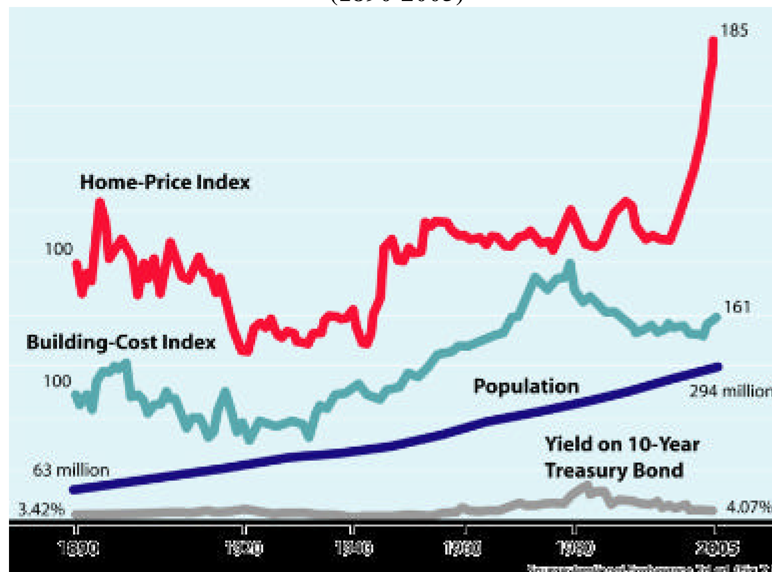
A weak housing market is now working through the economy in dramatic fashion. Of particular interest to your Advisor is how valuation, demographics (supply & demand), and taxes (the carrying cost of a home) will likely keep prices under pressure for an extended period. But before we can examine the future, let's turn to the past for context.

HISTORY OF RESIDENTIAL REAL ESTATE

Residential real estate appreciation from 1998-2006 was unprecedented. Professor Robert Shiller of Yale University has conducted the most detailed historical analysis of U.S. home prices. He examined inflation-adjusted prices from 1890 to 2005 and compared them with building costs, population growth, and long-term interest rates.

Shiller put together the first, long, true index of home prices by looking at repeated sales of the same or very similar houses over time. Conventional indices confuse changes in size and quality with changes in the price of housing. What the index demonstrates is that inflation-adjusted home prices were relatively unchanged for 100 years until 1998. It was only after 1998, when the Fed made money cheap and banks came up with easy ways to get it to unqualified borrowers, that the bubble in residential real estate took hold of the U. S. economy. Chart 1 highlights this phenomenon:

<u>Chart 1</u>
Inflation-adjusted U.S. home prices, Population, Building Costs, and Bond Yields (1890-2005)



Here are two of Shiller's conclusions:

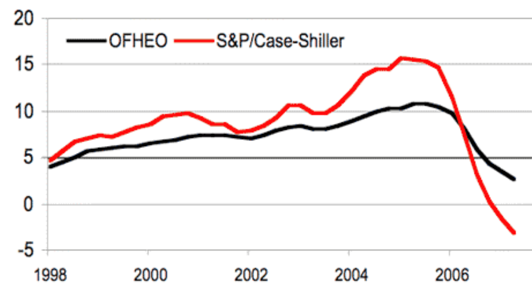
- There has not been a continuous uptrend in real home prices. Adjusted for inflation, residential real estate has increased 0.4% per year from 1890 to 2005. There have been two booms in the past 115 years — one just after World War II and the recent one we witnessed from 1998-2006. Why then do so many people believe that homes have done well over time as investments? Homes are relatively infrequent purchases so people remember the price from many years ago. For example, some may be amazed to see that a house now worth $190,000 could be purchased in 1948 to $16,000. It appears this investment did very well. During this period, however, inflation rose eightfold so the inflation-adjusted increase in value was only 48% — an increase of less than 1% per annum.

- Those who justify rapid real estate appreciation from 1998 to 2006 by referencing population growth, increased building costs, and low interest rates do not have history to support their argument. While all three factors contribute to price appreciation, they cannot explain most of the increase. U.S. population growth has been steady and gradual. Building costs — labor, lumber, concrete, and steel are also not out of line with long-term trends despite the recent spike in commodity prices. Central banks have cut interest rates many times in history, and such actions have never produced such concerted price appreciation.

Housing's role as a leading economic indicator has been demonstrated by research conducted by the Federal Reserve Bank of St. Louis and data from the U.S. Bureau of Economic Analysis. On average, housing peaks about three quarters before a recession starts. Housing also has historically made the largest negative contribution to growth during a recession.

While appreciation in home prices over the past decade has been unprecedented, the engine has been thrust in to reverse over the last eighteen months as highlighted in the chart two below.

Chart 2
U.S. House Price Indexes – Percent change from four-quarters earlier



Source: Office of Federal Housing Enterprise Oversight (OFHEO) and S&P/Case-Shiller.

Now that we have an historical framework, let's look at the key variables that are likely to drive real estate prices: valuation, demographics, and taxes.

VALUATION

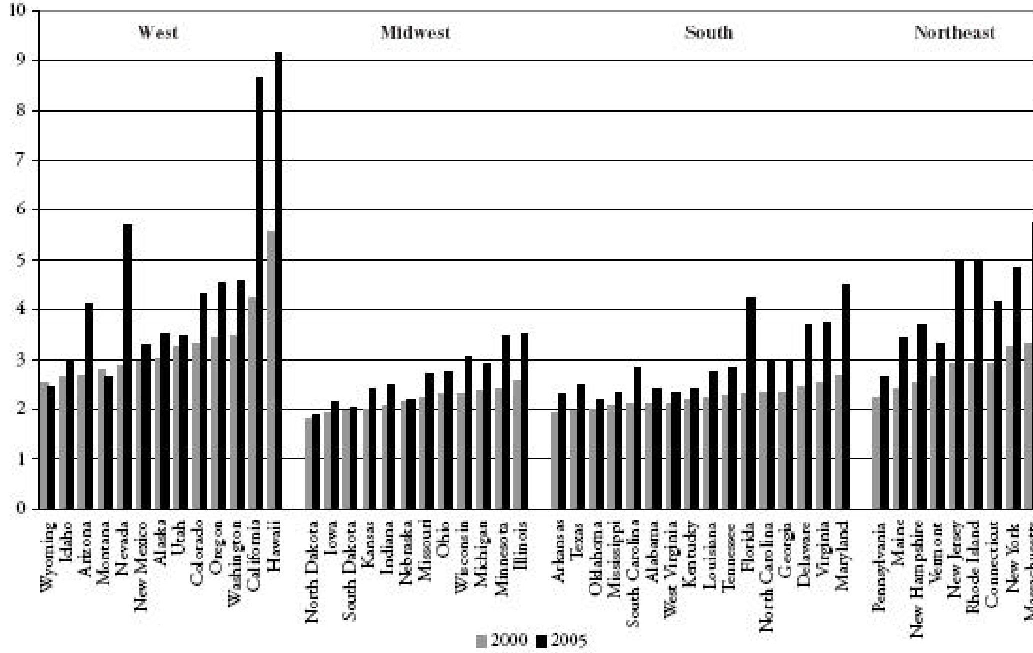
Over time, housing prices have been highly correlated with metrics like household income and rents. These relationships broke down as the U.S. housing market gained 86% in inflation-adjusted value from 1998 to the peak in early 2006.

A. Household Income

The chart below shows the ratio of median home value to median household income of buyers between the age of 30 to 34 in 2000 and 2005. The cost of housing in states like California, for instance, nearly doubled during this 5-year period. The fourteen states with the highest ratios and most dramatic price increases

contribute disproportionately to the economic well-being of the nation as they comprise 45% of the U.S. Gross Domestic Product.

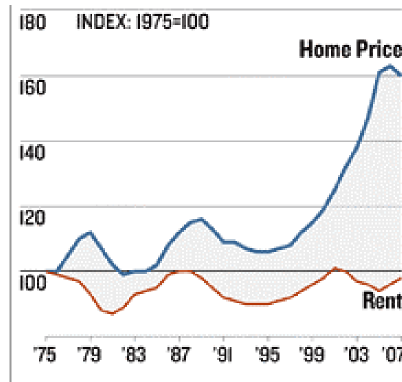
<u>Chart 3</u>
Ratio of Median Home Prices to Median Household Incomes 2000 & 2005



B. Rents

Similar to household income, the ratio of real estate values to rents tells a story of home prices gone wild without a clear economic link. Some combination of rising rents and falling home prices are required to reestablish equilibrium in the residential real estate market. The chart below highlights the significance of recent divergence.

<u>Chart 4</u>
Ratio of Median Home Price to Rent 1975 – 2007



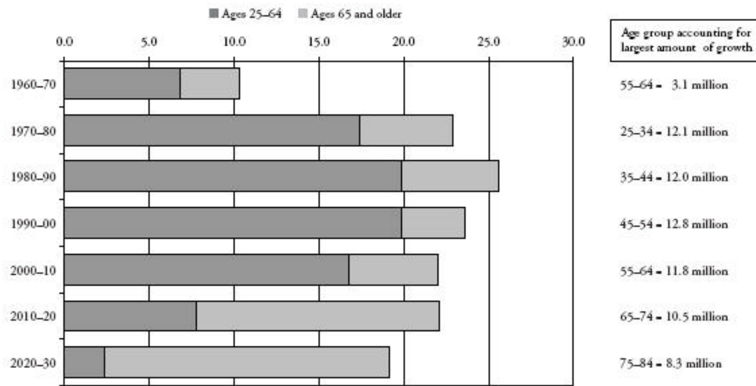
DEMOGRAPHICS

Professor Dowell Myers and SungHo Ryu of the University of Southern California have produced one of the most insightful research papers on the impact of the baby boomers and the demand for housing. Here are the facts:

A. Sellers of existing homes provide 85% of the annual supply of homes.

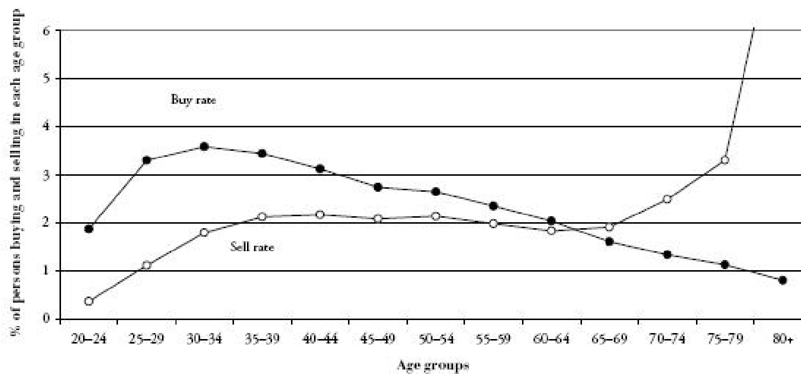
B. According to the U.S. Census, over the next two decades, the ratio of seniors to working adults will surge over 67% to unprecedented levels.

Chart 5
Ratio of Seniors to Working Adults 1960 – 2030



C. Age is highly correlated with the increased selling of homes. For most of an Americans' lifespan, the rates of buying and selling are balanced. The tide starts to shift when individuals reach their mid-60s.

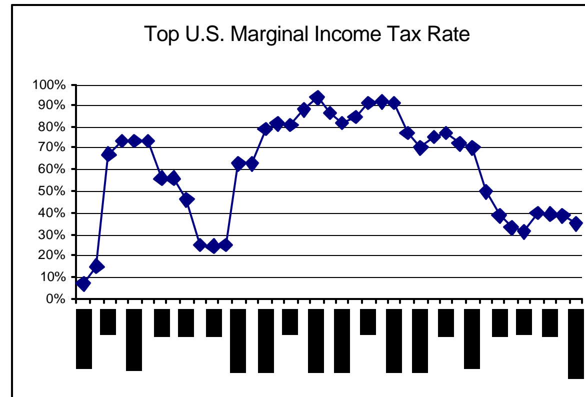
Chart 6
Percentage of People Buying and Selling Homes By Age Group



TAXES – WHAT GOES DOWN WILL GO UP

Buckle up. Either government spending and entitlement programs are coming down or taxes have to go up. The solution will likely be somewhere in between. In 1980, the top U.S. marginal income tax rate was 70% — double today's 35%. A family earning $100,000 in today's dollars fell into the 49% bracket compared with a current rate of 28%.

Chart 7
Top U.S. Marginal Income Tax Rate



U.S. Census and Internal Revenue System

Tax cuts under President Reagan successfully lifted economic growth, but tax receipts did not offset the enormous expansion in federal spending. The oldest boomers have already become eligible for Social Security and they will be become entitled to Medicare in three years. If today's tax rates remain in place, 76% of all federal tax revenue in 2050 will be soaked up by these two entitlement programs alone.

The same government mismanagement is visible at state and locals levels of government, and both political parties share the blame. New Jersey, for example, now faces about a $60 billion shortfall in a fund earmarked to pay for its retired government employee healthcare costs. This amount is nearly twice the state budget and nearly twice the amount of its outstanding debt. Local municipalities in the state have an additional $10 billion that they owe.

What is amazing is that New Jersey's predicament is not unique. The total liability for state and local governments for funding just the pension and healthcare costs for its retirees may be as large as $2.5 trillion according to Mercer Human Resources Consulting.

CONCLUSION

Don't run out and sell your primary residence. Instead, consider owning a home which you can afford with a margin of safety, think twice about the appreciation potential of a second home, and forget about flipping residential real estate for fun and easy profit. We see meaningful parallels between the recent past and the present. Just as our economy absorbed trillions in losses from the bursting of the internet bubble, so too will the speculative characteristics of the residential real estate market place be absorbed by an increasingly global economy.

What can improve the outlook for residential real estate? Here are some possible catalysts:

- Growth in Income and Rents – This will help bring historical valuations back into balance.

- Immigration – As a nation, if we attract and retain significantly more young and upwardly mobile immigrants then this can offset the U.S. Census demographic projections.

- Government Policies – The government can ease the cost of home ownership by providing tax incentives. Currently, momentum is growing in Washington, D.C. for legislation that would directly help struggling mortgage holders. Current proposals include up to $300 billion in subsidized government guaranteed loans that would replace high interest mortgages. This would aid those who are unable to refinance because they have negative equity in their homes.

As we approach our eighteenth year as investment advisors, the current environment harkens back to the early 1990's. At the time, we were advised with great vigor, that a recession was not the right time to begin a financial services company. It turned out to be one of the best times, as great businesses were selling at reasonable prices.

Eighteen is a significant number. It reflects the transformation to adulthood in America, and "Chai" or life in the Jewish faith. As assets under management reached a record level in 2007, your Advisor is taking this period to build a strategic plan for the next eighteen years. Highlights include:

1) Exploring opportunities to invest in additional asset classes using an approach that has been successfully employed by the world's largest University endowments.

2) Creating an equity ownership link for all current and future employees.

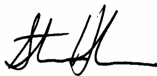
3) Building a financial institution with a foundation that will be here for you and your children.

4) Developing a company culture that reflects who we are and what makes us unique.

We have always created the greatest amount of value during periods of uncertainty. As we often say, protect the downside and the upside will take care of itself. We aim to be your family's personal CFO, aligning ourselves with your needs as we integrate all aspects of your financial life into a sound financial foundation for your lifetime and the generations that follow. We look forward to speaking with you and visiting together in the coming weeks and months. Have a happy and safe spring season.

In addition, a copy of the Firm's ADV Part II, is included for your review.

Sincerely,



Howard Steve George Janet Janice