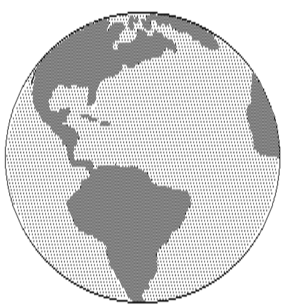
Market Watch
1st Quarter 2008

Summary

- The Dow Jones Industrial Average finished the quarter at 12,262, 7.6% down from its year end close.
- Foreign investments fared even worse. However, the sliding dollar buoyed foreign returns for US investors
- Housing prices fell a record 10.7% from January ‘07 to January ‘08.
- Investors continued to emphasize safety as inflation protected treasury bills (TIPS) had the best returns of the 1st quarter.
- The Federal Reserve continued rate cuts as the Federal Funds rate has dropped 2 points in the past three months to 2.25%.
- Unemployment increased to 5.1%.
- The Dow Jones—AIG Commodity Index gained 9.6% as gold crossed $1000 per ounce and oil saw $100 per barrel.



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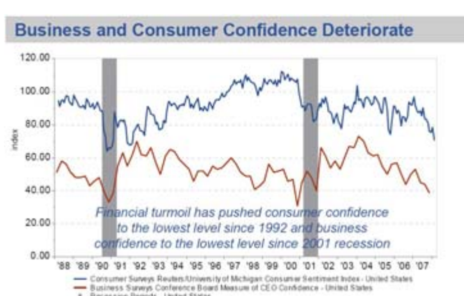
The bad news: investment returns were rotten this quarter.

The good news: While client portfolios experienced negative returns, they were generally much better than the broader market would otherwise suggest.

2008 started out on rocky terrain. The downtrend that began in November 2007 continued throughout the first quarter of 2008. Virtually every sector other than cash, intermediate bonds and commodities fell in the quarter. While some days saw the market rise by 100 points or more, more often than not the market fell back and declined even further the very next day. The Standard & Poor’s 500 index (representing the largest companies in the U.S.) lost 9.4% in the quarter, the Dow Jones Industrial Average declined 7.6%, while the technology-heavy NASDAQ fared worst, losing 14.1%. Overseas results were similar. That being said, most client portfolios at Mosaic did not suffer nearly as badly.

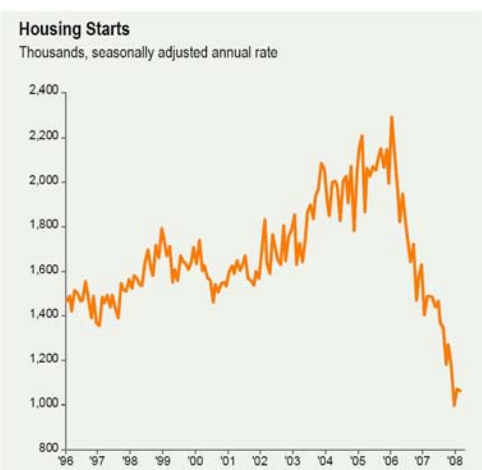
Banks drove business page headlines as bank write-downs and a lack of liquidity affected markets and furthered worries about a pending recession. This 1st quarter saw the wide-ranging auction-rate securities market stumble; Bear Stearns’ near collapse and subsequent rescue at a price just over 2% of its 2007 high; and the discovery of a rogue French trader losing more than $7 billion for the French bank Societe Generale. These stories, combined with broad economic concerns and a general media consensus that the economy is heading into a serious slowdown only helped to exaggerate the negativity that had infected attitudes in the prior quarter.



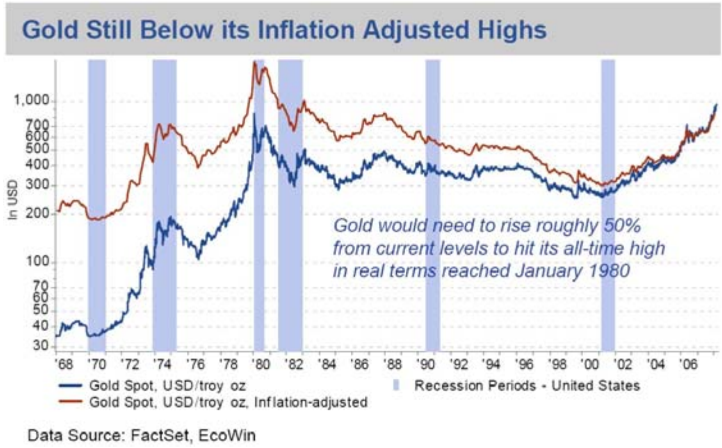
The home mortgage problems that began to show up in mid-2007 were even more pronounced this quarter. Banks, which had lowered their credit standards to offer home loans with no money down or without income verification continued to write down billions of assets in the first quarter of 2008. Despite the Federal Reserve's best efforts to liquefy the banking industry, weak bank balance sheets and more cautious lending attitudes have made it more difficult for growing businesses and many consumers to access the necessary capital to support their financial needs.

To combat illiquidity and avoid a full market meltdown, the Federal Reserve lowered interest rates three times during the first quarter: ¾ of a point on January 22, ½ of a point on January 30, and ¾ of a point on March 18. The Federal Funds rate (now 2.25%) has now fallen 3 percentage points in less than six months. Interest rate futures (often the best indicator of events yet to happen) are betting that the Fed will continue to lower interest rates. To provide additional liquidity, the Federal Reserve also aggressively provided loans to banks using a new approach, offering through loans priced by auction. The Fed also stepped in to help ensure the rescue of Bear Stearns, guaranteeing $29 billion of the first $30 billion of Bear Stearns debt that JP Morgan transferred to their books. To help other investment banks that might need short terms loans, the Fed also opened its discount window to them, an offer previously reserved only for retail banks that directly serviced customers. The Federal Reserve has reassuringly committed in both its words and actions to do whatever is necessary to maintain orderly financial markets and combat economic difficulties.

Subprime concerns lingered around financial markets as housing prices continued to fall. For the year ending January 2008, the Case-Shiller Home Price Index (the real estate industry's standard measure) experienced the largest one year decline in its history, as home prices across the nation fell an average of 10.7%. A separate report from the Office of Federal Housing Enterprise reported a less serious drop of only 3%. The current backlog of unsold homes and the tight mortgage lending market both suggest that the residential real estate market may not yet have reached its floor.



We are only now beginning to see glimmers of bargain hunters entering the market, which usually signals an end to price declines.



The problematic housing market, constrained credit markets and the drop in consumer confidence have all combined to create a general market pessimism that has affected all investors. Each of the ten market sectors that make up the S&P 500 Index showed negative results in the 1st quarter as stocks appeared to lose their appeal for investors. While the financial sector was down 14.0% in the 1st quarter, the technology sector's decline of 15.2% was even worse. Google and Apple each lost more than 25% of their value during the quarter. Once again, the markets remind us that things that go up quickly in price (think the Technology Bubble of the 1990's and the Housing Bubble of this decade) will inevitably eventually fall.

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Inflation has become an important concern as of late. Oil prices crossed the psychological barrier of $100 a barrel. Core inflation in February was reported at 2.3%, which fell just outside of the Federal Reserve's target inflation band of between 1% and 2%. It would have been higher if food and energy prices were included in the calculation. Other commodities also increased at a rate faster than inflation, in particular gold rose above $1,000 an ounce before retreating at the end of the quarter. Many agricultural products, like corn, rice and wheat are also trading at all time highs. All this has helped to make our exposure to commodities in most client portfolios our best performing asset for both the last quarter and the last year.

With inflationary pressures rising and domestic interest rates falling, the dollar has become less attractive to foreign investors. In fact, the most recent interest rate cut by the Federal Reserve made the U.S. dollar the second lowest yielding currency in the developed world. The dollar hit a record low against the Euro on the last day of the quarter — when exchanging $1 would get you only €0.6333. While few people want their domestic currency to be “cheap,” a weaker dollar may provide an economic boost to multi-national US-based companies. As foreign currencies become more costly, US exports should rise. The US job market may also benefit should the weaker dollar make outsourcing more expensive. While the trade deficit was still negative for February at $63.2 billion, exports rose 2%, a positive economic sign. The increase in exports reflected in part, strong gains in American-made heavy machinery.

Returns by Category

1Q08

Small Value	-6.5%
Mid Value	-8.6%
Large Value	-8.7%
Large Growth	-10.2%
Mid Growth	-10.9%
Small Growth	-12.8%

Finally, the quarter closed with negative employment news. The unemployment rate rose .3% in March to 5.1%. After adjusting the February numbers, the economy experienced a total loss of 27,000 jobs. While 5.1% unemployment is still low in historical terms, a loss of jobs is always viewed as a negative market indicator.

US Markets: The first quarter’s investment results were nearly universally difficult, with only bear funds producing positive returns among domestic fund strategies, according to Morningstar. Bear market funds (those that bet the market will fall) averaged a return of 11.0%. Long-short funds (funds that hold some stocks expecting a rise in price while selling others “short” betting the stock price will fall) lost only 2.9%.

Last year, for one of the few times this decade, growth style investing beat value investing. This was short-lived as this quarter value investments once again had “better” returns (or more truthfully, “less negative”) than growth in all size categories. Because our portfolios tilt in favor of the value investing style, our clients’ results were generally better than the broader markets (though still down for the quarter). Small, value companies were the relative winners among U.S. equities with a return of negative 6.5%. Small, growth companies had the worst “style returns” falling 12.8%. Large value also fell less than large growth, returning -8.6% versus growth’s -10.2%.

In our portfolios, the primary holding in each asset class (e.g., U.S. large companies) is a “core” or “blend” fund that holds roughly equal proportions of value and growth. We often hold a secondary fund in the asset class that follows a value strategy. In combination, we try to maintain each asset class with a 60% exposure to value and 40% to growth, thus tilted slighted towards value. Historically, value has slightly outperformed growth, but as importantly, it has also tended to be less volatile.

You will recall that real estate started out this decade as one of our very best performing asset classes before experiencing a downturn in 2007. In this year’s first quarter, real estate achieved a modest increase with the NAREIT index rising 1.4%, making it once again the best performing domestic equity sector. While residential housing was hit particularly hard this last quarter, the real estate securities that we use in clients’ portfolios are influenced by very different factors. Office space, shopping malls, industrial property, apartment complexes and hotels are all valued based on the level of income they generate. While economic concerns and liquidity for further development may have slowed these investment vehicles, flat returns during a generally difficult quarter illustrates the benefits of diversification .

World Markets: Virtually every international stock market fell this quarter; there were few places to hide. Most international indices posted double-digit declines in the quarter. Japan and Europe (excluding the UK) fared better than most but still experienced declines of more than 7% (for comparison, the S&P 500 Index fell 9.4%). The first quarter saw the MSCI Pacific Index (excluding Japan) lose 12.8%, making it the worst performing regional index. The MSCI Emerging Markets Index, which includes many countries from Asia, the Pacific Rim, Latin America, the Middle East and Africa, declined 10.9% in the quarter. Canada as represented by the TSX 60 (their version of the S&P 500) was down 2.5% in Canadian Dollars.

Emerging markets have been an outstanding investment sector over the last 3, 5 and 10 years. Recently investors have taken particular notice of India and China, which both gained more than 50% just in 2007. That trend reversed itself in the first quarter of 2008 as Indian markets lost 27.0% and China lost 23.7%. After their 2007 run ups, India and China together represented 3% of the global marketplace of securities. While this percentage is still fairly small, it also shows the significant growth that these countries have experienced in the last decade.

As in the U.S., international small companies tended to do better than larger ones in the first quarter. They lost 6.2% of their value while the large companies in the non-U.S. developed world (the EAFE index) lost 8.8% of their value.

Losses among the international sectors would have been worse except for the falling dollar. For example, the Europe Australia Far East Index lost 14.9% in local currency terms but only 8.8% when computed in dollars. This has been a continuing trend over the last two years. The dollar has fallen against most world currencies. During the first quarter, it fared particularly poorly against other developed countries' currencies such as the Yen (-11.2%), the Australian Dollar (-4.3%) and the Swiss Franc (-12.0%).

Bonds: With inflation rising, inflation protected securities (often called "TIPS") did especially well in the first quarter — up 5.2%. In a similar vein, as economic worries increased, investors gravitated towards higher quality bonds. This benefited US government-issued bonds with treasuries gaining 4.4% this quarter.

Short-term bonds essentially broke even this last quarter, after producing over 4% last year. In many of our client portfolios, one of the funds we held in this group was the Schwab Yield Plus Select Fund. We sent you an earlier communication about this fund, which got caught in a cross-fire of sub-prime concerns, the flight to credit quality, and investors confusion about the nature of the fund, causing the fund to drop somewhat more than 10% this quarter. We sold all positions in this fund before the end of March to avoid further deterioration.

Intermediate term bonds fared well this quarter with the Lehman Brothers Intermediate Bond Index rising 3.0%. As interest rates fall, the price of bonds rise. As a result, intermediate bonds benefited this quarter from the Fed's interest rate reductions. Higher quality bonds, like the treasuries and TIPS discussed above, performed especially well. For the quarter, the Lehman Brothers Aggregate Bond Market, an index of the bond market in its entirety, returned 2.2%.

Municipal bonds fell 0.6% this quarter as concerns about MBIA and AMBAC (the companies that insure municipal bonds) created worries in this market. However, municipal yields have not fallen as much as treasury yields, allowing for some value to be found in the municipal market.

Alternative investments: The Dow Jones-AIG Commodity Index rose 9.6% in the first quarter, continuing its strong performance in 2007. Highlighted by record prices in gold (7.2% of the index) and oil (12.8% of the index) the index was one of the few bright spots for investors in this otherwise dreary quarter. Gold briefly climbed above the $1000 an ounce mark before giving way to finish the quarter at $918. Oil crossed $100, finishing the quarter at just over $101 a barrel.

Commodity prices have jumped as global demand has continued to increase. The weakening dollar has also contributed to the significant rise in commodity prices. Some analysts believe that speculative investors have driven commodity prices up. The Mosaic view is that these assets represent an effective portfolio diversifier that moves independently of the financial markets. While it will not always be so, holding this asset class certainly helped our portfolios over the last few years.

Among the other alternative investments in our clients' portfolios, timber, as represented by the Plum Creek Timber Company, had an off quarter losing 11.9% as worries around housing slowed the use of lumber. Merger arbitrage was flat. The Merger Fund was down 0.2% , as tight credit markets constrained the financing of large mergers. Another alternative investment that many Mosaic clients hold is Pimco's Developing Local Markets Fund, a fund that invests in emerging market's money market funds. This fund returned 3.4% this quarter.

Conclusion: This was a tough quarter all around. Still, your portfolio did not suffer as badly as the broader markets. Diversified portfolios holding commodities, cash, bonds and real estate were much more balanced in their results. While international stocks fell back from their recent successes, these too were mitigated by favorable exchange rates (for U.S. investors). Once again, diversification has worked in your favor.

We can't tell the future, but if the past is any guide, the markets will identify positive opportunities while the news headlines are still scaring people — in much the same way that the market's difficulties began well before people were heard talking about recession. There are a number of difficult factors about today's economy and the markets that reflect them, but we expect that many of these will ease in the not too distant future, allowing the markets to normalize. Our best guess is that we'll see this start to happen by the end of the summer, if not before.

Sources: JP Morgan Quarterly Review, The Federal Reserve, Reuters, Forbes, Bloomberg, Morningstar Standard & Poors, Google Finance