WINFIELD
ASSOCIATES

Winfield Quarterly

April 2008

Customized Investment Portfolios and Private Wealth Advisory Services

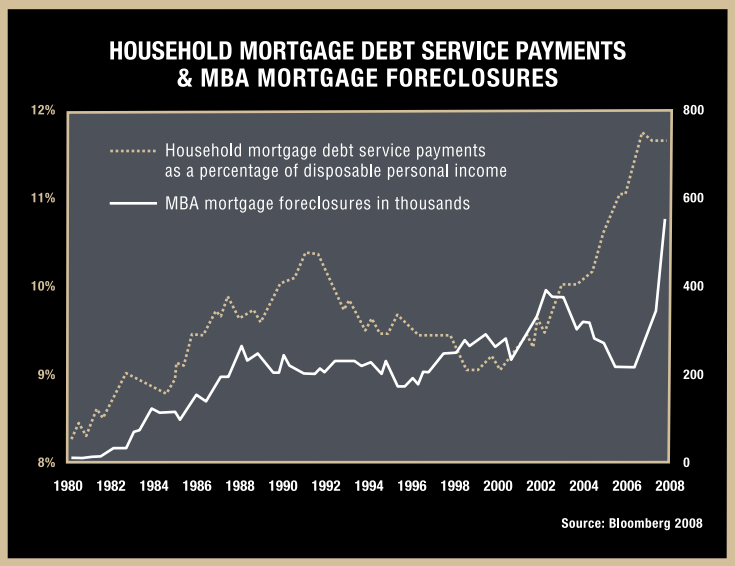
MARKET COMMENTARY

The first quarter of 2008 was one of the most volatile periods of investing in years. Daily swings of 2-3% roiled equity investors as the market reacted to the increased likelihood of a US recession. The unemployment rate rose to 5.1% in March, and weekly jobless claims remained above 350,000 for most of the quarter. The employment component of the Chicago Purchasing Managers Index fell 13.5 points to 33.5 in February, the largest one-month decline since the data series began in 1946. Consumer confidence, consumer spending as well as industrial output all fell during the quarter. Preliminary estimates showed that US GDP slowed to .6% growth in the fourth quarter of 2007, down from 4.9% in the third quarter. At the center of investors' concern, financial institutions continued their massive write-downs of subprime debt and related credit vehicles, reaching a total of $250 billion through the middle of March with the likelihood of more to come.

The crescendo of the credit crisis occurred at the end of the first quarter. On Sunday, March 16, JP Morgan announced a buyout of investment banking giant Bear Stearns & Co. for less than $300 million. Bear Stearns shareholders saw their equity value fall from $57 a share on Thursday, March 13 to just $2 on Monday, March 17. Yet, despite the rapid decline of one of Wall Street's largest brokers, the S&P 500 drifted down a mere -.8% on March 17 to close at 1,277. Interestingly, the S&P held to a -19% decline from its 52 week high of 1,576 in the fall of 2007, avoiding the critical -20% decline that marks the technical definition of a bear market. US equity investors apparently felt the combined efforts of JP Morgan and the Federal Reserve Bank that weekend staved off a financial catastrophe. The S&P 500 which was down -13% year-to-date through March 17, finished the quarter down -10%. And, as of April 18, the S&P 500 was down only -5% for all of 2008.

The Federal Reserve's actions during the quarter involved remarkable ingenuity and historic rapidity. As we mentioned in our January 2008 newsletter, the Fed appeared to be behind the curve at the end of 2007 and needed to move immediately to address a liquidity crisis. During the first quarter, the Fed cut rates three times, dropping the federal funds rate from 4.25% to 2.25% (down from 5.25% in June 2006). Additionally, the Fed established the Primary Dealer Credit Facility, providing investment banks with a $200 billion backstop for a wide variety of investment grade assets. The $164 billion tax stimulus package along with the Fed's actions returned investors' confidence that both Congress and the central bank would actively pursue solutions to the economic downturn.

Critical to the recovery of the markets is the leveling off of mortgage write-downs and home foreclosures. The graph below illustrates household mortgage debt service payments as a percentage of disposable personal income versus the Mortgage Bankers Association Home Foreclosure Index from 1980 to 2008.



From the 1980s to the late 1990s, foreclosures held below 400,000 per quarter as the percentage of consumers' disposable income for mortgages stayed between 8% and 10%. Increased access to debt and lower lending standards from 2001 to the present raised the percentage of disposable income used to pay mortgages to nearly 12%. Despite this increase, the number of foreclosures actually *fell* between 2002 and 2006. As the graph illustrates, the recent jump in the number of foreclosures closes the gap.

There are other signs the credit crisis may be easing. High yield credit spreads, the difference between the interest rate on US Treasury securities and riskier corporate bonds, narrowed over 150 basis points from March 17 to the middle of April. During the week of April 14, the Fed's daily average lending to banks fell -23% from $10.1 billion to $7.8 billion, and lending to primary dealers dropped -24% from $32.6 billion to $24.8 billion. First quarter write-downs from Citigroup and Merrill Lynch were less than feared. While most economists believe the crisis has yet to run its course, the market appears to view that the worst is over.

MACROECONOMIC OUTLOOK

	January 2008	April 2008
US GDP	Neutral	Neutral
Inflation	Neutral	Neutral
Employment	Neutral	Neutral
Productivity	Positive	Positive
Corporate Profits	Neutral	Neutral
Consumer Debt	Negative	Negative
International Growth	Positive	Positive

We are maintaining our outlook on macroeconomic indicators from our January newsletter. Despite turmoil in the financial and consumer sectors, businesses with globally-skewed end markets continue to outperform expectations. The depreciating US dollar and the structural resilience of emerging market demand benefit technology, industrial and materials companies that export products worldwide. While US credit market losses have been in the hundreds of billions of dollars, the global value of assets is in the hundreds of trillions of dollars. Global GDP is expected to top $53 trillion in 2008. The US's portion of GDP is projected to be 27% ($13 trillion), down from 41% in 1970. We continue to believe that the effects of a US slowdown should be relatively smaller on the global economy.

In addition, we believe the Federal Reserve's stimulus will have a meaningful impact on the US economy from now until the end of the year. Already, the Fed has pushed real interest rates down to a level normally reached in or after the end of a recession. In the floating exchange rate era, the economy has never entered a recession with the federal funds rate this low (2.25%in April 2008).

RECESSIONS AND FEDERAL FUNDS RATES

Recession began	Fed funds rate
December 1973	10.5%
February 1980	13.4%
August 1981	18.8%
August 1990	8.0%
April 1995 (slowdown)	6.0%
April 2001	5.0%
April 2008?	2.25%

MARKET PERFORMANCE

	2007	2008 YTD
Dow Jones	8.96%	-6.92%
S&P 500	5.48%	-9.47%
Nasdaq	9.81%	-14.07%
Russell 2000	-2.75%	-10.19%
MSCI EAFE	11.73%	-8.75%
Lehman Agg	6.97%	2.17%

WHEN TO WORK WITH WINFIELD

PRIVATE INDIVIDUAL INVESTORS

- Manage accumulated wealth, inheritances and settlements to meet investment objectives

ENDOWMENTS AND FOUNDATIONS

- Manage assets with a long-term growth strategy while meeting investment policy requirements

BUSINESS OWNERS

- Customize investment portfolios to meet investment objectives and lessen risk of concentrated assets
- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to meet investment objectives and lessen risk of concentrated assets

RETIREES

- Customize investment portfolios to meet investment objectives with the option of drawing income
- Management of IRAs, trusts and taxable accounts

www.winfieldinc.com

700 West St. Clair Avenue, Suite 404 • Cleveland, OH 44113

(216) 241-2575 • (888)322-2575 • fax: (216)241-4774