



Baldwin Investment Management, LLC

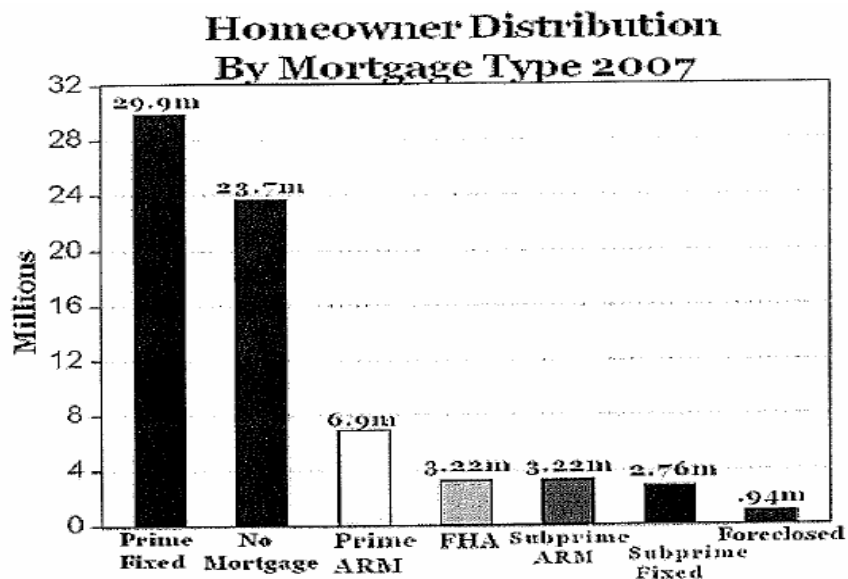
THERE WILL BE BLOOD

Our title was taken from a recently released and highly acclaimed movie starring Daniel Day-Lewis, about an oilman in the early days of the California oil rush and his very complicated and conflicted personal life. Front and center throughout the whole story was his character's drive to succeed – no matter what the cost. “Greed is good” said Gordon Gekko, Michael Douglas' character in “Wall Street”. So it was also for Mr. Day-Lewis' character until there was blood all over the floor. Analogous to the last scene in Daniel's movie, there is blood on Wall Street. Hubris enabled bankers to leverage firms 32 to 1 believing that they had mastered the ebbs and flows of money – that they had considered all possibilities. The bankers thought that they had built the perfectly hedged money spinning machine. But that machine has still not been built. As liquidity evaporated like water on a hot pavement in the summer, the “smart money” has been pounded into that pavement and there is blood from gutted hedge funds and venerable investment banks.

“Psychology has now overwhelmed economics” according to Alan S. Blinder, currently a Professor of Economics at Princeton University and a former vice-chairman of the Federal Reserve. There is little perspective. There is no “blue sky” only grey clouds. It is true that there are problems and some of the problems are severe. A troubling number of hedge funds that have invested in mortgages have “gone pear shaped” as my English friends would say. There was a “run” on the fifth largest investment bank, Bear Stearns. The Fed had to come in at the “eleventh hour” in concert with the Treasury to “bail out” Bear, thereby protecting the U.S. financial system. Home foreclosures continue to rise. Home prices continue to go down. Employment has become a bit soft. Retail sales are also flattish. Inflation has bumped up and the Fed has worried more loudly of recent about it. Bond insurers have been downgraded - so one has to wonder about the value of their insurance product as it is no longer regarded as AAA. The bond market (except for Treasuries) has been beaten down. The stock market has tumbled. In fact, only Treasury bonds have appreciated in value for the past several months, as investors have sought refuge in the ultimate safety of the U.S. government guarantee. The merger and acquisition market amongst the large cap companies has ground to a halt as financing paper from previous deals is still sitting unsold on investment bank inventory shelves. Some large commercial banks, having suffered from big write downs well described in the national media, are now reluctant to lend and instead are licking their wounds from past mistakes instead of conducting business as usual. The dollar has been depreciating

almost on a daily basis and the price of oil and other commodities are appreciating almost on a daily basis – both trends creating a lot of angst. All of this is about what we hear each and every day. But there is other news.

NEWS ITEM #1: NOT ALL HOMEOWNERS ARE IN FORECLOSURE



In fact, according to the Mortgage Bankers Association from whom we get the above chart, 34% of the 69.7 million American homeowners own their homes free and clear. Forty-three percent (29.9 million) of homeowners have prime fixed mortgages. Ten percent of homeowners have an adjustable prime mortgage. Only 8.58% of all homeowners are rated as sub prime and roughly half of that population has an adjustable rate mortgage, which makes up almost half of the foreclosures to date. As of Q4 2007 only 1.35% of all homes were in foreclosure and 98.65% were not.

NEWS ITEM #2: U.S. EXPORTS ARE GROWING



Exports have helped to counteract the deteriorating housing market problems. Over the past six quarters, exports have on average contributed nearly one percentage point to economic growth, while the housing market has subtracted about the same amount. Exports in January, according to the U.S. Commerce Department grew 16.6% vs. a year earlier. Why have exports done so well? Simply it is because of the dollar. From 2004 (the onset of the dollar's decline against other world currencies) to 2007, U.S. exports grew 8.3% a year, on average. In the four years prior to that period, a time of a relatively strong dollar, exports grew only 0.6%. While a declining dollar is not in all cases an elixir for our nation's health, in this instance, i.e. foreign trade, a cheaper currency has been a boon for businesses which sell goods or services abroad. Recently, David Rosenberg, an economist for Merrill Lynch, forecasted a longer term "manufacturing renaissance" in the U.S.

NEWS ITEM #3: FOREIGN INVESTORS STILL BUYING

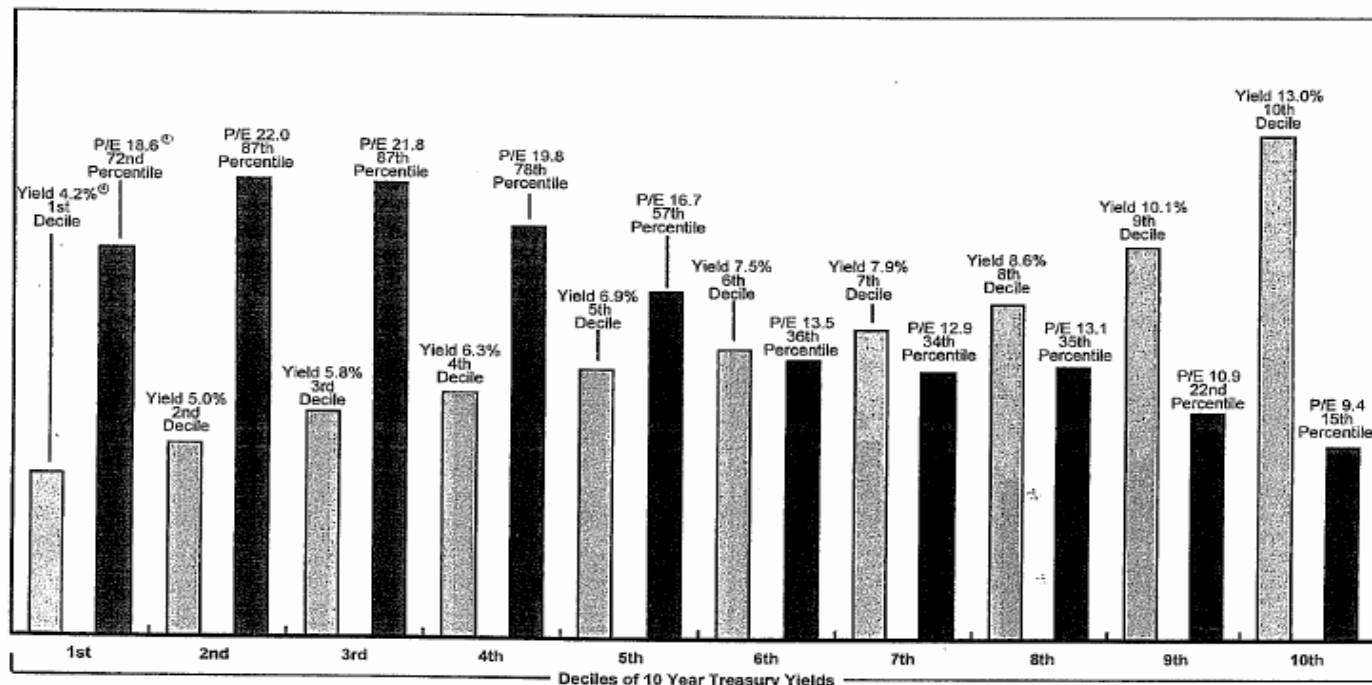
Despite the gut wrenching volatility and the seemingly endless downward trend to markets, international investors have come to the fore and invested in the U.S. Various sovereign funds have taken up billions of dollars of securities in Citigroup, Blackstone, Och-Ziff and Merrill Lynch. They have tried to buy port operations and have bought hotels and office buildings. In fact, according to the Department of the Treasury, foreign central banks bought a net \$36.1 billion of Treasury bonds and notes in January – a record, despite a falling dollar.

NEWS ITEM #4: THERE IS A SEA OF MONEY WAITING TO INVEST

Six trillion dollars is waiting in U.S. investor accounts to buy stocks, bonds and even real estate when “the flag is dropped”. This money is in addition to an approximate one trillion dollars sitting on corporate balance sheets, which are under levered. In Miami, a distressed real estate conference was recently held in the midst of troubled condominium projects throughout Miami and Miami Beach. Some 700 potential buyers showed up. Attendees had to park at a nearby mall, because the lot was filled quickly and the conference halls were overwhelmed forcing many to watch the proceedings on screens in adjoining rooms. Not everyone has run out of cash.

NEWS ITEM #5: RELATIVE TO INTEREST RATES STOCKS ARE CHEAP

Price/Earnings Perspective 1970 Through September 2007

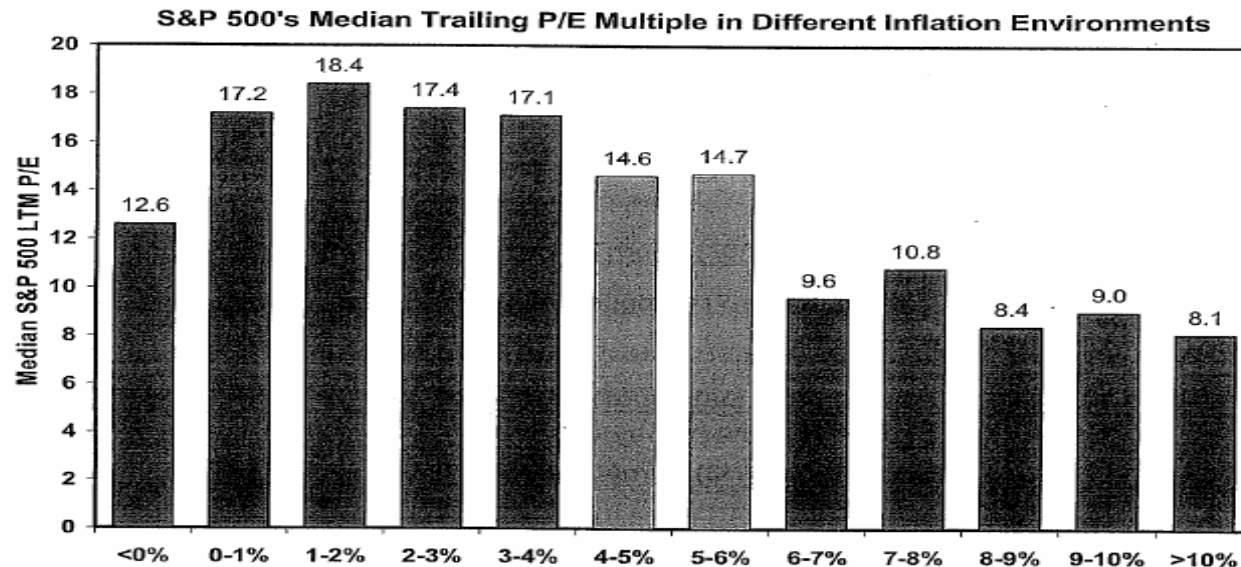


Source: Federal Reserve Board & Standard and Poor's Corp

This chart shows the traditional relationship between the Standard and Poor's 500 price earnings multiple and the yield of the 10-year Treasury bond. The current 10-year U.S. Treasury yields approximately 3.30%. At this rate, Treasuries are priced expensively- the yield is historically low - in their 1st decile. The corresponding P/E (price/earnings) ratio for the S&P 500 should be 18.6x. Now the trailing twelve months P/E ratio is 15.60x and the P/E (estimated) for 2008 is 13.7x –suggesting that equities are cheap according to historical measures. Some pundits have declared that earnings estimates for 2008 are too high. Even if corporate America were to register earnings down 15% from 2007's level, the resulting P/E would still only be 16.1x – still cheap by historical standards.

NEWS ITEM #6: RELATIVE TO INFLATION STOCKS ARE CHEAP

A 17-18x Multiple is Also Consistent With Inflation Between 0-4%



Source: Haver, Thomson Financial, S&P, Robert Schiller, Standard & Poor's, BLS, Factset, Morgan Stanley Research

The most recent read on consumer prices would suggest an inflation rate in the 2 – 3% range. This would correspond to a P/E ratio for the S&P 500 of approximately 17.4X – also suggesting some upside here.

It is always hard to know where the “bottom” is in any market – especially when a market has become very volatile. There has been a lot of financial “blood” spilled. Firms and some people’s lives have been ruined. Each day is recorded another disaster. Few want to mention any glimmers of hope for fear of being labeled Pollyannaish. Certainly no one wants to ignore reality. When it is bad an

investor has to realize the seriousness of the situation, if one wants to survive financially. But to fearfully retreat to one's personal "bunker" would probably mean missing out on recovery. Each day there is news – some bad and some good. We do not believe that the world will come to an end and we do believe that over a reasonable time horizon prices of stocks and bonds (except for Treasuries which we think are expensive) will appreciate handsomely.

PREDICTIONS FOR 2008

COMMENTS

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| 1. Late in 2008, the Fed will begin to raise interest rates | Still believe |
| 2. The dollar will appreciate in value vs. the Euro and Yen | Off to a "rough start" –but still believe |
| 3. Housing will stabilize in the second half of 2008 | Sales are picking up as prices decline |
| 4. Financial stocks will outperform in 2008 | Still believe, although Q1 has been "scary" |
| 5. There will be Middle East progress in Palestine and in Iraq | The "surge" has helped in Iraq & talks in Palestine
continue SLOWLY |
| 6. Oil prices will come down | Hedge funds may be sellers |
| 7. Inflation will be a little worrisome in the first half of 2008;
but not in the second | So far |
| 8. Hillary Clinton will not be elected President; and Michael
Bloomberg will run if the Republican field is "muddled"
coming out of South Carolina | With McCain in, Bloomberg is out – Obama may
derail Hillary |
| 9. International equity markets will continue to distance themselves
from U.S. markets | Has not happened yet – but still believe |
| 10. The U.S. stock market will do better in 2008 than it did in 2007 | Still believe |

A FINAL THOUGHT



A FINAL, FINAL THOUGHT



The opinions expressed in this Commentary are those of Baldwin Investment Management, LLC. These views are subject to change at any time based on market and other conditions, and no forecasts can be guaranteed.

The reported numbers enclosed are derived from sources believed to be reliable. However, we cannot guarantee their accuracy. Past performance does not guarantee future results.

A list of our Proxy voting procedures is available upon request.

A current copy of our ADV Part II is available upon request or at www.baldwinim.com/disclosure.htm

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