



## Quarterly Report – March 31, 2008

### ***Discussion and Analysis of Markets***

One of the challenges with writing this newsletter is that by the time you receive it the markets may have moved, perhaps considerably, and we may have since made transactions in your account. For example, as I write this newsletter on April 1, 2008, we remain 100% invested in money markets in our allocations. However, we are getting close to re-entering both the equity and high yield markets, so please always check your account for the actual, current investments.

### ***Equity Markets***

In mid-December of last year Hanlon Investment Management (HIM) moved to an all cash position in our allocations as our research and analysis saw the coming market meltdown. We have been defensively invested in money markets since then. So far in 2008 the major domestic and international indices have experienced considerable drops, but not so for Hanlon Investment Management clients.

Index	YTD as of 3/31/08
<b>HIM Allocations Gross Approx.</b>	<b>0.50%</b>
Dow Jones Industrials Average	-7.55%
S&P 500 Index w/ Dividends	-9.47%
NASDAQ Composite Index	-14.07%
Russell 2000 Index	-10.19%
MSCI EAFE iShares	-8.41%
MSCI Emerging Markets iShares	-10.59%

Source: Yahoo Finance

Table 1 – Major Equity Indices YTD 2008

The current financial market troubles are rooted primarily in lax lending standards. Money became easily available at too low a cost. Builders kept building homes with no end in sight and investors, primarily the large institutional types and hedge funds, kept borrowing and leveraging their portfolios. The easy money and associated purchases resulted in price appreciations that became a bit parabolic, which sooner or later leads to a correction (drop) in those prices. As the correction in prices gets significant enough, this leads to reduced value associated with the collateral protecting the loans. This prompts the lenders to require more collateral to be posted or they begin to call the loans. Of course this then leads to either the original borrowers seeking to borrow more from riskier lenders, or they must liquidate their assets to pay down their loans. That is what we are seeing now; the reduction in asset values due to normal economic cycles, the “bursting” of the

parabolic bubbles in real estate and associated investments, and the liquidation of these assets which causes even further price reductions, collateral deterioration and loan calls.

This then typically leads to banks and finance companies shutting their doors to new business while they firm up their balance sheets and capital ratios. The problem with that behavior by the bankers and finance companies is that businesses that may need the capital to grow can no longer obtain it. This can then lead to company expansion plans, new equipment purchases, research and development, and new hiring's to slow down and even stop in certain sectors of the economy and regions of the country. No worry, this is all a part of the normal - perhaps a little worse than normal - cycle and correction that capitalist economies must go through every now and then to correct the excesses. The key is to not get hurt when this is happening and to protect your principal, preparing for the next up-leg in the markets, which has always occurred sooner or later.

I am going to get a little bit technical here and describe some of our core science, so please bear with me. Below please find a three-month chart of the NASDAQ Composite – it is the **Red Line** and it is the index that is down about 14% this year so far. This chart also shows three of the important market breadth indicators that we follow. These are:

**Advance decline line** - this is a 20-day moving average of the advance decline line – this measures the number of stocks that are advancing versus the number of stocks that are declining. **Up is good. During this year there has been no “up”.**

**Up volume vs. down volume line** – this is a normalized, moving average of up-volume minus down volume – this compares the volume of those stocks that are going up versus the volume of those stocks going down. **Up is good. During this year there has been no “up”.**

**New 52-week highs vs. new 52-week lows Line** – this is a summation of new highs versus new lows – this compares the number of stocks making a new 52-week high versus the number of stocks making a new 52-week low. **Up is good. During this year there has been no “up”.**

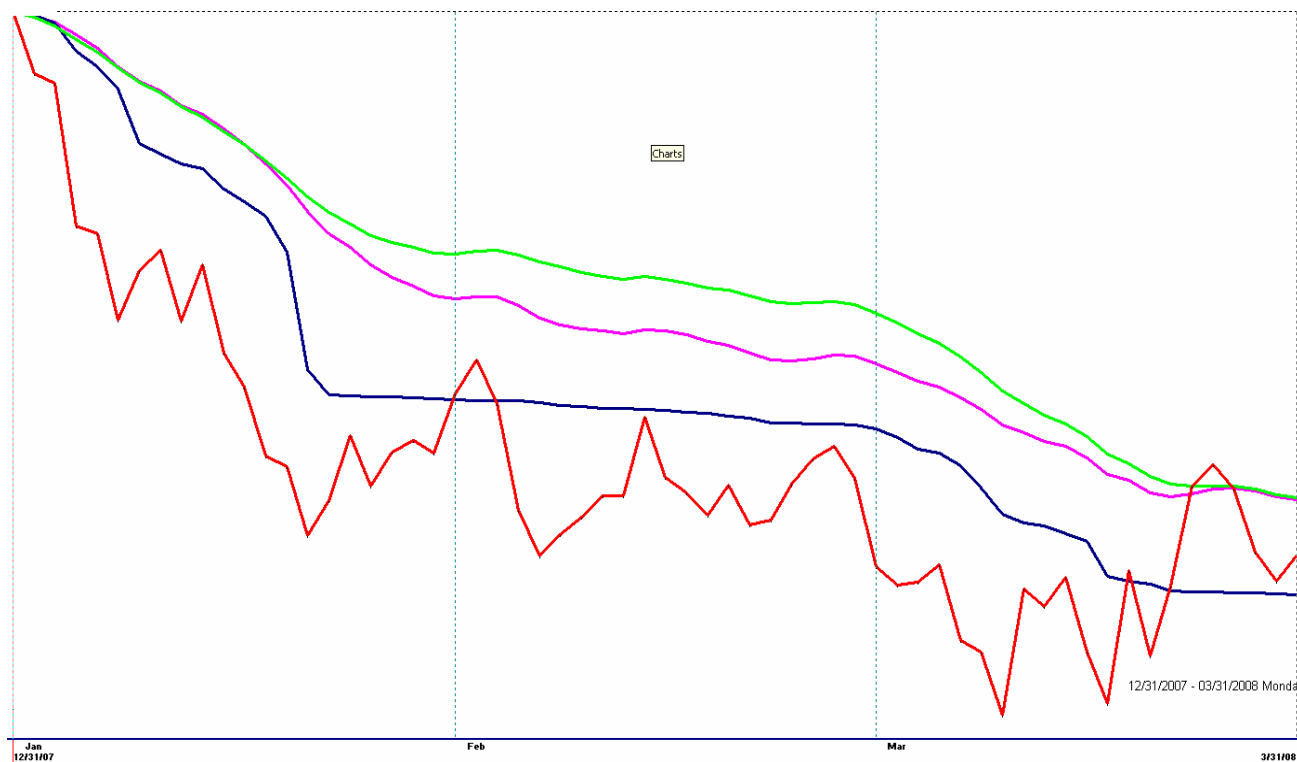


Chart 1 - NASDAQ Composite (**Red Line**) and Breadth Indicators YTD 2008

You can see from Chart 1 that the breadth indicators have done their job, keeping us out of the market even during the rally in late January that ultimately proved to be a false breakout. Our research pays very close attention to the movement of the major indices, such as the NASDAQ Composite, which you can clearly see has started to attempt to form a bottom and possible new uptrend. However, the breadth indicators must also corroborate that new trend, and so far they are not quite there yet. They are getting closer, however, at the time of this writing.

### **Fixed Income Markets**

High yield bonds, one of the types of securities that we use for the fixed income component of our allocations, have clearly been in a downtrend. **This is why we have been in cash and not invested in the high yield bond market since mid-December.** Our investment strategy in this area is to attempt to be invested during periods of positive trend, when the bonds are appreciating in value. When they are appreciating in value they provide a very nice return due to the handsome interest that they pay as well as the price appreciation – sort of a double benefit. The interest rate on these bonds is now above 10% and so when we get reinvested into them, which could be soon, they could produce a very attractive potential return. Long time clients of HIM are aware of the valuable benefits that our investment management in this area has provided over the years. We will attempt to have another very good experience when we re-enter the high yield bonds, hopefully soon.

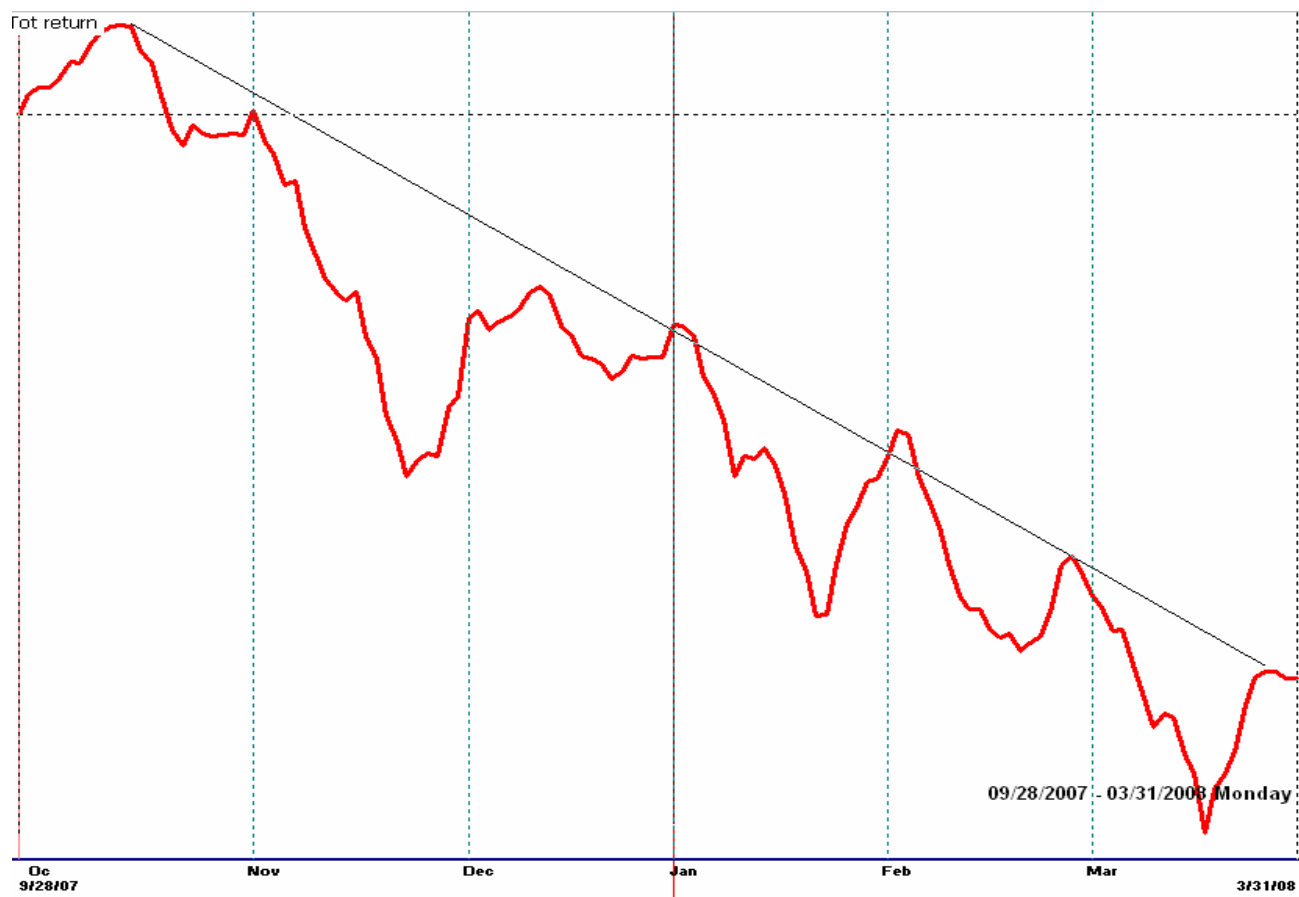


Chart 2 – High Yield Bond Index (Red Line) with trend line

## **Final Thoughts**

In the doom and gloom there are some positive signs emerging. Here are a few:

- Home builder stocks are beginning to show some strength. These stocks led the market down and they will probably need to recover some for the market to get going again, although their overall market impact is quite small.
- Bank stocks are beginning to show some strength. These stocks are typically early stage recovery stocks, as the market begins to see diminished expectations for further write-offs as well as negative earnings revisions start to slow.
- Small cap stocks are beginning to show some strength. These stocks are good proxies for the overall health of the market and US economy.
- Interest rates are low and expected to go lower. This will make access to capital for the large institutions less costly and provide an opportunity for the institutions to recapitalize their balance sheets and prepare for the next economic expansion.
- Unfortunately, there must be a sacrifice. The necessary major catastrophe and collapse, potentially signaling the end of the financial challenges, has occurred – Bear Stearns.

As the CEO and Chief Investment Officer (CIO) at Hanlon Investment Management your overall portfolio returns are very important to me and the rest of the team at HIM. Our investment discipline is one that attempts to identify “productive” periods in the equity and bond markets and then invest during those periods. Alternatively, when the markets are displaying “unproductive” periods we seek the shelter of conservative investments such as money markets. This year, so far, so good. Hopefully the markets find their footing soon, we re-enter the markets and proceed to have a profitable year.

Thank you,



Sean Hanlon, CFP®  
CEO and CIO

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