



HANLON

INVESTMENT MANAGEMENT, INC.

Quarterly Report – June 30, 2008

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. I am writing on July 1, 2008, and at this time we remain 100% invested in money markets in our allocations. Please check your account for the most up-to-date information. Also, in your enclosed performance report we have revised the reporting period to show the YTD period only. We hope that this more focused reporting period makes it easier for you to measure your portfolio performance.

Equity Markets

In early May Hanlon Investment Management (HIM) moved back into the equity market. This was a temporary move as the uptrend that started to emerge in April gave way to weaker equity prices by early June. 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 our defensive investment strategy has preserved portfolio capital for HIM client accounts.

Index	YTD as of 6/30/08
All HIM NW 401k Allocations Approx.*	Range of +3.00% to -1.00%
Dow Jones Industrials Average	-14.44%
S&P 500 Index	-12.83%
NASDAQ Composite Index	-13.55%
Russell 2000 Index	-9.97%
MSCI EAFE iShares	-10.88%
MSCI Emerging Markets iShares	-8.69%

Source: Yahoo Finance

Table 1 – Major Equity Indices YTD 2008

The weakness of the financial markets continues to be a function of the large unwinding of the incredible amount of systemic leverage. Many institutions were permitted to borrow too much money at extremely low interest rates. With these borrowings they made investments that are now depreciating in value, some significantly. Furthermore, now these institutions must liquidate their investments to free up capital to pay back that debt and reduce their leverage. This simultaneous mass liquidation in concentrated areas exacerbates the downward pressure on stock, corporate debt and mortgage debt prices. This downward pressure in prices can cause a further need to liquidate as the equity protecting all that debt drops in value.

I recently attended a conference meeting chaired by former Federal Reserve Chairman Alan Greenspan, where he spoke extensively on the subject of leverage. What I found rather disturbing was that the Federal Reserve permitted the financial system, and therefore some of our largest investment institutions, to engage in such high amounts of debt. For example, Bear Stearns was leveraged 33 to 1. When an institution is

leveraged 33 to 1, to me there is no room for error. If the equity value of the holdings protecting that debt (the portfolio) drops in value by just 3% then you have essentially lost all of your equity. That's too risky in my mind; way too risky. This past weekend I read a Barron's article about a "conservative" finance company that is leveraged "only" 8 to 1. I thought conservative leverage was more like two to one, similar to when you buy stocks on margin and the Federal Reserve has a margin requirement of investing 50% of your own capital for the initial purchase. Many of the world's largest financial institutions are still leveraged over 20 to 1, including Merrill Lynch, JP Morgan, Goldman Sachs, Morgan Stanley and more. Until this debt unwinding begins to slow down and a bottom is established, we are in for more rocky times in the investment markets.

Inflation is on the minds of investors these days. During the past twelve months inflation, notably the indicators CPI and PPI, are both running way above the comfort zone for the Federal Reserve target, to as high as 5-6% year over year. Unfortunately the Federal Reserve now has itself "hemmed in" as it deals with the counter forces of higher inflation and lower economic output. Many of us remember the stagflation of the 1970's, where there was considerable inflation and a muted business output. The difference back then as compared to now is then there was also a wage inflation, which so far does not exist. This is most likely due to the fact that we are now in a global economy where we do not need to rely on only our domestic workforce to produce all our goods and services. Inflation remains a problem and will continue to be a headwind for the Federal Reserve and the markets.

In the December Newsletter I wrote that the typical effect of a recession on the stock market is a drop of approximately 25%. As of this writing the major indices have dropped almost 20% from their peaks set last October, 2007. An official recession still has not been declared, but things are slowing considerably.

Oh, and just for the heck of it, let's throw in a presidential election to really mix things up! There is almost no better time that I can think of in the past thirty years to have an active investment management strategist like Hanlon Investment Management guiding your portfolio through these volatile times.

The Technical Picture – Equities

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 twelve-month chart of the NASDAQ Composite – it is the **Red Line** and it is the index that is down about 13% this year so far. This chart also shows three of the important market breadth indicators that we follow. Please note that the breadth indicators bottomed in March and one of them began to trend up in late April. They turned down sharply with the market in early June and so we exited the market, after only a thirty day investment or so.

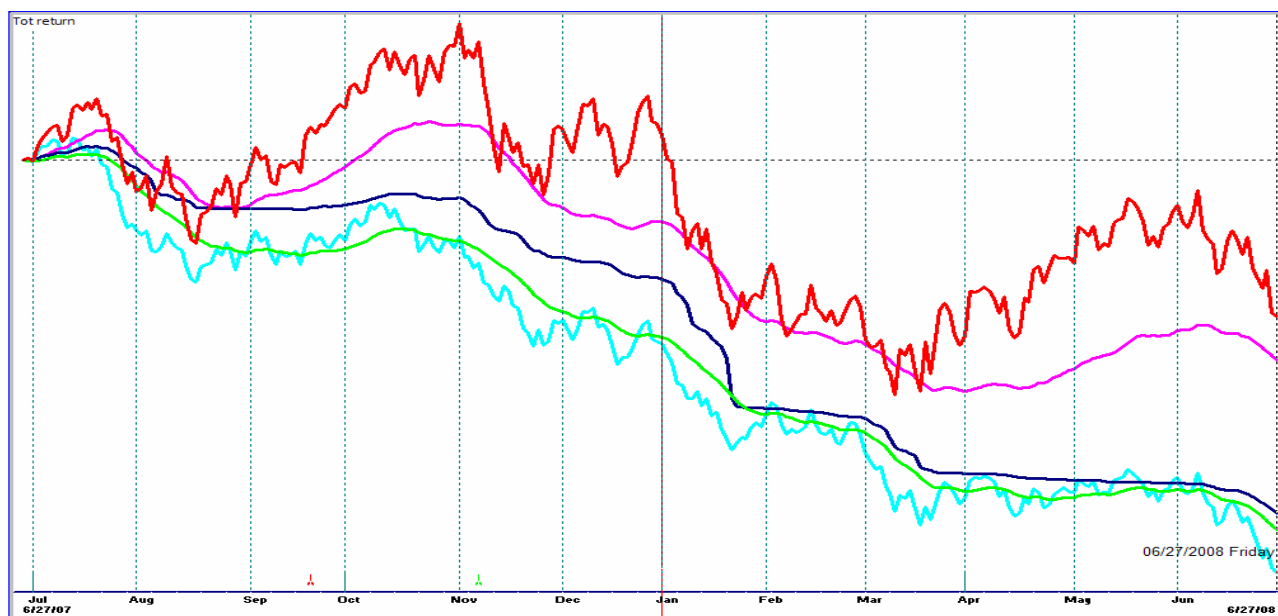


Chart 1 - NASDAQ Composite (Red Line) and Breadth Indicators YTD 2008

A description of these indicators is:

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.**

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.**

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.**

The other major domestic and international indices all look quite similar to the above chart of the NASDAQ, so this is clearly a time to be cautious and invest in the most conservative way. We remain 100% invested in money markets.

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. We did see some firming in prices in high yields during the second quarter, enough to warrant investing in them, but it was short lived and we are now 100% invested in money markets for the fixed income portion of our portfolios. 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 again approaching 10%+ and so when we get reinvested they could be very productive. But we remain cautious as you can clearly see the current downtrend in high yield bonds in the below chart.

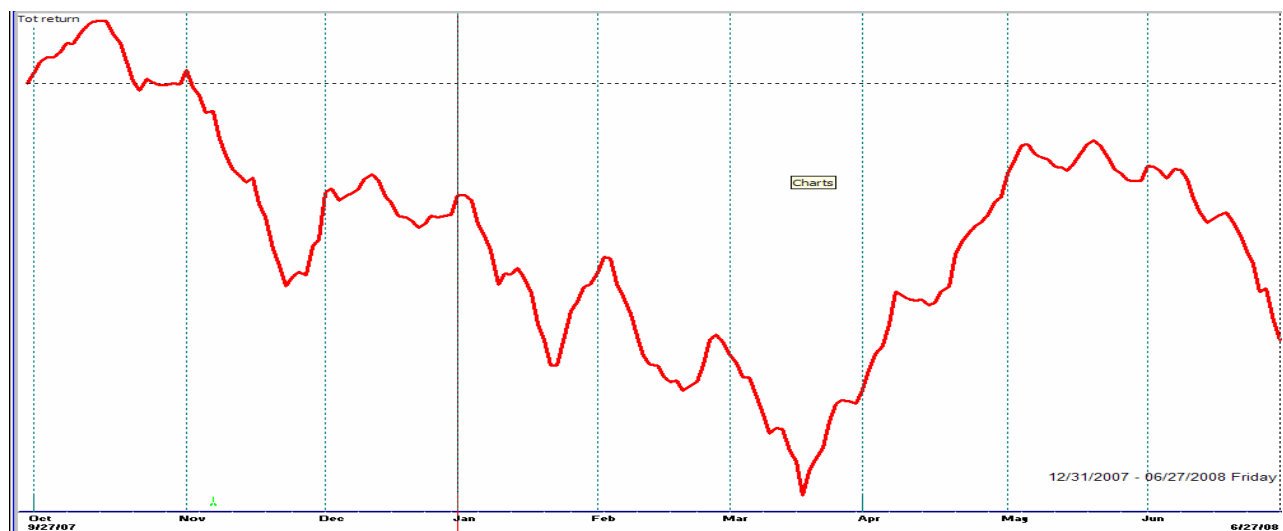


Chart 2 – High Yield Bond Index (Red Line)

Source: Investors FastTrack

Long time clients of HIM are aware of the valuable benefits that our investment management in the fixed income 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.

Final Thoughts

There is clearly a massive change occurring globally in the markets. One reason is the integration of another one billion plus people into capitalism! This leads to adjustments, which are often associated with some sort of pain and casualties. One of those casualties has been the US Dollar, which is down 21% against a basket of international currencies since January 2006 and is now resulting in inflation here in the United States. Let

me share a positive thought on why inflation may not get out of control and actually subside in the coming year.

Let us take a glass half-full approach. The source of the inflation is clear. One is rising food costs and the other is the rising cost of oil. Everyone now believes that food costs are going to go up, energy will continue to rise and the dollar will continue to fall. And maybe all these trends continue? But Farmers around the world are going to respond to high food prices and by this time next year we could see a rise in supply that more than meets the rise in demand. Food prices might begin to actually fall. Energy prices have risen so much that demand destruction is beginning to happen. US drivers are using less gas, and as Asia takes away its subsidies demand will fall there as well. You could see oil prices drop over the next year. If oil prices drop that means the US is shipping less of our dollars offshore, which slows the growth of available dollars, raises the price of the dollar which further lowers the cost of commodities.

There are two forces at work that will help to moderate inflation in the coming year. One is the extraordinary decrease in credit offered by banks around the world, which has come to almost a complete net halt. Lending institutions are deleveraging and experiencing almost unprecedented distress and their distress is going to translate into distress for businesses and individuals who need to borrow money. This is deflationary. The second is the US consumer, who has been a large supplier of money to the world by running a massive trade deficit but has now had to throttle back on expenditures and thus is buying less and less foreign goods. So there should be a significant slowing in the supply of US Dollars in the world because of this combined slowdown by lenders and US consumers. Financial assets (stocks and bonds) and home values are also clearly deflating. That is serious wealth deflation.

In a world of decreased leverage and debt, and housing deflation, coupled with lower food and energy costs and a higher dollar, it is possible that inflation becomes tame again by this time next year.

As the CEO and Chief Investment Officer (CIO) at Hanlon Investment Management your overall portfolio returns are very important to me and our 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. Hopefully the markets find their footing soon, we re-enter the markets and proceed to have a nice profitable year. Until then we remain very cautious, just as I believe you would want us to be.

Thank you,



Sean Hanlon, CFP®
CEO and CIO

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