



HANLON

INVESTMENT MANAGEMENT, INC.

A World of Investment Opportunities.

Quarterly Report

December 31, 2008

I am writing on January 5, 2009 and at this time we have moved to a 50% position in high yield bond funds in all our allocations and all accounts (where available). The other 50% remains in stable value money market funds. High yield corporate bond funds currently present the most compelling opportunity for returns, in our view. The current yield (rate of interest payment) is approximately 1% per month - that is not a typo - yes, 1% per month. Some funds pay monthly, some pay quarterly and in some cases (primarily variable annuities) the interest payment is imbedded in the actual daily security price.

We hope to see consistent prices in these high yield bond funds as well as continued payment at those interest rates. Rest assured we will, as always, keep an eye on these investment positions. **2008 was about principal preservation. 2009 will be about taking advantage of investment opportunities, but being very careful while doing so.** If your investor profile is such that your Hanlon account is invested only in the Managed Income Allocation you can stop reading here, if you like, because the remainder of this newsletter speaks mostly about stock investments. Much of what follows, however, may still be of interest to our conservative investors. Please know that of course we place equal importance on both the bond and stock allocations. Always have, always will.

Table 1 – 2008 Performance of the Major Equity Indices and HIM Allocations

Index	YTD as of 12/31/08
HIM Allocations Approximately*	Range of +3.00% to -4.00%
Dow Jones Industrials Average	-34.84%
S&P 500 Index	-37.03%
NASDAQ Composite Index	-40.50%
Russell 2000 Index	-34.80%
MSCI EAFE iShares	-41.04%
MSCI Emerging Markets iShares	-48.88%

Source : Investors FastTrack

I expect that you know of many people that have experienced considerable drops in their portfolio values in 2008. Fortunately, that did not happen in your managed account with Hanlon. Clearly last year was an excellent example of the value of the investment management strategies used in your account by Hanlon Investment Management. These active investment management strategies have kept your account from the significant drops in value experienced across asset classes worldwide in 2008.

At the core of our strategies is an approach that attempts to have a downside limit sell strategy in place whenever we make an investment, in an attempt to prevent possible large downside risk and loss. To us that is a very good idea. You and your Financial Advisor's selection of Hanlon Investment Management have proven to be a fortuitous move.

2008 Year in Review

What happened? Here is our four-point quick review of the factors that have led the economy to where it is today.

- First, there was the housing mess and the one-trillion-plus dollar losses worldwide in mortgage investments, as homeowners defaulted on their mortgages. This current overall economic mess started with housing and it will not begin to mend until housing finds a bottom. That, we believe, is still another year or two away.
- Secondly, the housing mess led to the US consumer getting hurt. They all thought that they had more equity in their homes and therefore more wealth. They were mistaken. Getting back on their feet is going to take longer than normal, especially now that the home equity loan – sarcastically referred to by some as the homeowner ATM machine - is closed for a long time. Many consumers are starting to feel the job loss and hours cut challenges also. So the US consumer is “on-hold”, which is 70% of our economy and about 25% of the world's economy. This will severely dampen GDP growth worldwide, perhaps putting us into a five year or longer period of some of the most anemic world economic growth since the Great Depression. This may happen even despite the promising opportunities that exist in the new third-world economies and their potential for growth. Stock prices fell dramatically in anticipation of the economic slowdown and the corresponding negative impact it will have on corporate earnings.
- Next, triggered in part by the two factors above happening so quickly and severely, massive amounts of leverage in the financial system had to be unwound – and quickly. This forced selling resulted in an exacerbated price decline in almost every investment type. Never before had the markets been propped up by such massive amounts of leverage. Leverage is now a dirty word and dead. Many hedge funds are liquidating.
- Lastly, for the first time in my twenty-six year career in the investment business, there is mild yet existent concern about the credit worthiness of Uncle Sam. Why? Because the government is getting so heavily involved in the "bail-out" game and has added huge liabilities on top of already large existing liabilities.

It is interesting to note how all this current financial disaster has removed from the headlines any mention of the longer-term concerns, such as the considerable and consistent annual federal budget deficits and the expected enormous future Social Security / Medicare shortfalls. With the above factors in mind one can begin to understand why investors lost trillions of dollars and U.S. stock prices plunged to 11-year lows. Overseas equity markets suffered even worse declines. What has typically been known as a fairly safe investment, the corporate, municipal and mortgage bond market, was crushed as well. Many things that sounded impossible at the start of the year now have to

be accepted as facts. Large, well-known corporations like AIG, General Motors and Citigroup have survived only due to the government bailouts. The market capitalization of General Motors is now lower than it was in 1927! Formally well-known companies like Lehman Brothers, Wachovia and Countrywide are gone.

In October and November, a 600-point plus daily swing in the Dow Jones Industrial Average became almost commonplace. The daily volatility of US stocks in October, November and December set a quarterly all-time record, averaging well over 3.5% per day! Roller-coaster you say? We all wish, because at least a roller-coaster has its up moments. No, 2008 was primarily a one-way plummet. Although it should be mentioned that in 2008 the number of down-days was equal to the number of up-days on the S&P 500 Index. Odd you say? Perhaps, but know that the down-days had far larger absolute values!

On November 20 of this past year, the S&P 500 Index dropped below the previous bear-market low of 776, made in October of 2002, to end at its lowest close since April, 1997 at 752. Please see the graph below. It did not stay there for long and rallied back above 800 rather quickly. But the damage was done and there still remains the outside chance we may revisit those lows before this is all over.

Graph 1 – S&P 500 Index Monthly Closes 10 years



Source: www.MoneyCentral.MSN.com

We have mentioned time and again that markets are far more risky than most public and professional investors think. As has been well publicized, this has not been only a US debacle. The S&P Broad-Market index, which blends more than 11,000 stocks from developed and emerging markets, lost over \$17 trillion in 2008. The World Bank expects China's economy to expand at a 7.5% rate in 2009, its slowest pace since 1990. Stocks in Russia have now plunged 72%, those in Turkey are off 68%, and those in India have fallen 67%. In October, Japan's Nikkei 225 Index hit a 26-year closing low, Iceland's Exchange tumbled 81% as their banking system collapsed, and Brazil's Bovespa Index slumped 25%, its biggest one-month percentage loss in 10 years.

Couple the above losses with the estimated trillions in worldwide bond market losses, trillions in worldwide home value loss and trillions in commodity values lost, and it is easy to see how some have pegged the total worldwide losses in excess of \$40 trillion. Of course when it comes to volatile assets I have to mention that after its astonishing surge to nearly \$150 a barrel this summer, oil now trades near \$44 a barrel. Wow!

Unfortunately, all this had to happen to rid the financial system of the excesses that had been built up over years. This has lead investors to become more cautious than perhaps anytime in modern history. How so you ask? The need to protect one's savings became so pressing that on Dec. 9, the government sold 4-week Treasury bills at a yield of 0% - not a typo - 0%. That meant bond investors were happy to just have the principal they'd lent back to them without a loss. As the old Will Rogers saying goes "I am not as concerned with the return on my money as I am with the return of my money". The yields on other government bonds, considered the safest among all investment classes, also reached lows unseen since the government began keeping records in the 1950s. We caution investors not to invest in US Treasuries at these levels.

There are ways out of these challenges. My guess is that way probably consists of a combination of necessary inflation, ultimately higher taxes and significant economic growth. Where any / all of that may come from during these times is anyone's guess now.

There are some positives that bode well for consumers:

- ✓ A full tank of gas is less than \$40 again!
- ✓ Mortgage interest rates are falling. I believe the government wants to see conventional 30-yr mortgages at 4.5% or less for this coming spring selling season.
- ✓ The mortgage markets should experience "unfreezing" with the recently announced intention of the government's \$500 billion home mortgage market investments.
- ✓ Home heating bills should be much lower this winter.

Kudos to you and your Financial Advisor for instituting a good diversification strategy by including in your overall portfolio the Hanlon, non-correlated strategies. Be sure to stay close to your Financial Advisor during these volatile times, reassessing your risk profile, time horizon and investment objectives. As the Chairman, CEO and Chief Investment Officer at Hanlon Investment Management your overall portfolio returns and risks are very important to me and our team at HIM.

Thank you,



Sean Hanlon, CFP[®]
Chairman, CEO and Chief Investment Officer

* Allocation returns in Table 1 are simply an estimated average of all accounts managed by HIM net of HIM's investment management fees. Your exact return is available in the enclosed performance report. Actual investment management fees vary by individual client account, but generally range between 1.20% and 2.20% of the value of the assets under management. The net compounded impact of the deduction of such fees over time will be affected by the amount of the fees, the time period, and the investment performance. The performance presented herein does not reflect the deduction of transactional costs such as brokerage commissions, custodial costs, and other expenses. Estimated performance results have inherent limitations. Unlike an actual performance record, estimated results do not represent actual trading and do not reflect market factors. In addition, estimated returns do not involve financial risk, and no estimated performance can completely account for the impact of financial risk in actual trading. There is no guarantee that the estimates presented herein will come to pass. Past performance is not a guarantee of future results. Investing in the stock market involves gains and losses and may not be suitable for all investors. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. Comparison of the Hanlon Investment Management ("HIM") portfolios to other indices is for illustrative purposes only and the volatility of the indices used for comparison may be materially different from the volatility of the HIM portfolios due to varying degrees of diversification and/or other factors. Indices are unmanaged, reflect reinvestment of income and dividends and do not reflect the impact of advisory fees. Investors cannot invest directly in an index. HIM has prepared this report based on statistics provided by Investors FastTrack. HIM, while deeming such information to be reliable, does not guarantee the accuracy thereof. This data is subject to change without notice and should not be considered as a solicitation to buy or sell any security. This article contains general information that is not suitable for everyone. The information contained herein should not be construed as personalized investment advice. Past performance is not a guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice. Hanlon Investment Management, Inc. ("Hanlon Investment Management") is an SEC registered investment adviser with its principal place of business in the State of New Jersey. Hanlon Investment Management and its representatives are in compliance with the current registration and notice filing requirement imposed upon registered investment advisers by those states in which Hanlon Investment Management maintains clients. Hanlon Investment Management may only transact business in those states in which it is notice filed, or qualifies for an exemption or exclusion from notice filing requirements. This Research Perspective is limited to the dissemination of general information pertaining to its investment advisory services. Any subsequent, direct communication by Hanlon Investment Management with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of Hanlon Investment Management, please contact Hanlon Investment Management or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about Hanlon Investment Management, including fees and services, send for our disclosure statement as set forth on Form ADV from Hanlon Investment Management using the contact information herein. Please read the disclosure statement carefully before you invest or send money.