



## Baltimore Capital Management

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Dear CLIENT

For the first quarter of 2008 your account has had a loss/gain of xxxx. The S&P 500 declined 10%.

The quarter we just finished was the worst quarter the market has had in five years. While it was bad in the US it was worse in Europe and much worse in emerging markets.

While the market decline was painful it is interesting to know that there was no place to hide. Residential real estate has declined 10% over the last year. The only comforting aspect to that is that we do not get a monthly statement showing the value of our homes!

So in spite of all the bad news I am going to take a contrarian and controversial view that the worst is behind us. Much of the negative news as it relates to the subprime loan market is already out. The government, the Federal Reserve lowering rates, and Secretary of Treasury Paulson's decisive actions has been well orchestrated. Some investors look for a defining moment like a bankruptcy to help signal the end of a bear market. They got that with the demise of Bear Sterns, the country's fourth largest broker.

As I pointed out in an email I sent out mid-quarter, in my view, this bear market started in October last year and is already 5 months old. In the past 20 years that has been the average duration for bear markets and recessions. In mid March the market was down as much as 20% from the October high thus ending the bear market, not starting it. There is a chance that the market will start to discount an economic recovery in the next few months.

As an investor, if one is not willing to buy the stock market after a 20% decline then one has to ask, when is the right time? There will always be doomsday pundits suggesting that things will get much worse, and they may, but the more likely scenario is that we survive the real estate debacle and things improve over the next few months.

A recent Wall Street Journal article caught my attention because it made reference to the fact that the US stock market has gone nowhere over the last 10 years. Our accounts have done much better. Emerging markets, developed foreign markets and commodities have also done much better over that period. What has worked over a five or ten year period is not necessarily what will work over the next five year cycle. In fact, some would argue (myself included) that what regression to the mean would dictate that what did not work over the past five years will work going forward. So if the US market has done nothing for ten years while real estate, commodities, private equity and emerging markets have been in the limelight then US large cap stocks are due for a period of outperformance.

With the recent decline in interest rates, bonds, especially US government bonds, are very unappealing. Higher current income yields are widely found in equities thus adding another reason for the markets potential upside.

So what is our strategy? For starters it is to be more fully invested than usual. We are also focusing much of

our buying on high quality names paying decent dividends. After reading Berkshire Hathaway's annual report it became clear to me that one could buy at least four names Warren Buffett bought last year for less than he paid. An easy example is Kraft Foods. During 2007 he purchased 8% of the company for \$33.37 a share. We have been buying it for \$31 and under for several months now. This stock is a good example of a quality name with a 3.5% dividend yield. Other names that can be bought for less or the same price that Buffett paid include Anheuser-Bush, Johnson and Johnson, US Bancorp and Wal-Mart. We already own or have bought the two first names.

Since this letter is longer than our usual one I will not bore you with writing a newsletter. My topic of choice would have been the current bear market, which I think I have addressed in this letter.

In conclusion, I, like our clients, prefer not to lose money. The reality is that in the stock market there are periods when one does lose money. This period, while painful, is not that different than others in history. It will pass and equities will recover and do well. As John Templeton (a famous investor and former client) said "when others are desperately selling buy and when they are desperately buying sell".

Should you have any questions please do not hesitate to call us or email me at [agraham@baltimorecapital.com](mailto:agraham@baltimorecapital.com)

Sincerely,

Alec Graham

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*Upon written request, we will deliver a copy of our Part II of the form ADV and a balance sheet.*