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INTERNATIONAL HIGH DIVIDEND STRATEGY

1ST QUARTER 2008 INVESTMENT LETTER

Thank you for your continued interest in Cheswold Lane's international value equity strategy. During the 1st quarter 2008, our investment strategy composite returned -10.90% on a gross basis compared with a return of -8.91% in the MSCI EAFE (Morgan Stanley Capital International Europe, Australasia and Far East Index) including income, net of withholding taxes and expressed in US dollars.

Market Review & Outlook – 1Q 2008

Global credit markets reached severe crisis levels during the 1st quarter of 2008, as the US economy weakened sharply driven by the worst housing market since the 1930's. The large mortgage security related write-downs and subsequent capital raisings by the major US and European investment banks during the 4th quarter of 2007 were judged insufficient by the global credit markets. Credit spreads for financials, especially investment banks, expanded dramatically during the 1st quarter as other fixed income asset classes, like leveraged loans and commercial real estate, deteriorated severely. By the middle of March, the markets were consumed by counterparty risk – it started with the monoline insurers, but quickly spread to hedge funds and ultimately Wall St. investment banks. The financial market crisis claimed its third major institutional victim, as Bear Stearns proved unfit in the ruthless Darwinian survival game played in the modern global financial markets. It doesn't feel like this will be the last institution to succumb during this credit cycle.

In Europe, while caution for the economic outlook has already turned to fear, GDP growth among the major countries has diverged. Following the real estate decline in the US, overheated and overleveraged European markets cooled rapidly. Real estate prices, residential and commercial, are falling in the UK, Ireland and Spain. Construction spending is down markedly and consumer spending growth is faltering in these markets as well. Italy's GDP forecasts have been sharply reduced due to the economy's large and inflexible government structure. Germany, however, continues to see strength in the industrial segment of its economy. Wage inflation is supporting consumer spending as well. Scandinavia remains relatively immune to the economic weakness seen on the European continent. France continues to muddle along – never really participating in this economic cycle's strong upturn, but also not feeling a significant downdraft either. In Asia, Japan teeters on the edge of recession. Government shortcomings continue to hinder the Japanese economy. The combination of a weakening US consumer and a

strengthening Japanese yen looks like an insurmountable obstacle for Japan. Australia saw early signs of consumer weakness due to escalating interest rates and commodity prices. Its stock market rolled over sharply in the 1st quarter, as its high relative market valuation began to succumb to global equity market fears. Australian banks took their first major US sub prime write-downs, while local corporate and consumer credit losses ticked up from cyclical lows. In Hong Kong, the over valued stock market continues to mean revert. Fear of Chinese export demand slowing also weighed on the Hong Kong market.

As we enter the 2nd quarter of 2008, the economic landscape has become more lucid. The developed economies of Europe and Asia are generally following the US into economic malaise; the depth of which is still to be determined, but the direction is not. However, the decoupling theory of the emerging markets is still being touted as the “safe haven” of the global markets. Dressed in their protective, macro-inflationary garb, the emerging markets have yet to show their historical downside volatility this cycle. We’ll see if this trend is sustainable as the major consumers of their natural resources and manufactured products reduce their demand in 2008-2009.

Portfolio Review – 1st Quarter

The international markets proved extremely challenging during the 1st quarter of 2008. Cheswold Lane’s portfolio experienced its first negative return quarter since the strategy’s inception and underperformed our benchmark, the MSCI EAFE index, as well. Stock selection was the primary driver of our soft start, although the portfolio experienced some normal mean reversion from its very strong 4th quarter 2007. Holdings in the consumer staples, basic materials and utility sectors detracted from the portfolio’s relative results. Also, our large overweight in telecom hurt performance. Several of our large consumer staple positions, Henkel and Heineken, are currently involved in complex debt financed acquisitions. Unfortunately, the added financial risk caused by the global credit crisis depressed the earnings multiples of both stocks during the period. We expect these stocks to perform better in the coming months as the transactions close and the value of these acquisitions is demonstrated to the market. The adverse performance in the basic materials sector is related to our positions in the Japanese chemical space. These stocks have been punished due to their exposure to the weakening US consumer and the significant strengthening of the Japanese yen. The end markets they sell into are semiconductors and consumer electronics, like cell phones, LCD televisions and laptop computers. Historically, these high quality, R&D oriented businesses traded at 20-25x’s forward earnings. Today, these companies, Shin-Etsu Chemical, JSR Chemical, Nitto Denko, are trading between 12x’s and 14x’s CY 2008 earnings. With respect to the utilities and telecom sectors, in hindsight, both areas were beneficiaries of the 4th quarter’s strong sector rotation into large, stable, domestic companies in Europe; however, in the 1st quarter, as the European stock markets became notably more downbeat, stock market money flows turned very negative, and exited the utility and telecom sectors disproportionately. On the positive side, the portfolio’s stock selection in the energy sectors was very strong. We expect continued relative strength in energy due to meaningful positive earnings revisions driven by skyrocketing crude oil prices. Major European oil companies are currently valued at 7-8x’s 2008 earnings per share – more than 25% below the major European indices’ valuation multiples.

During the quarter, we increased the portfolio’s weight in energy, and modestly, in financials. Consumer discretionary and industrial stocks were slightly reduced. Our recent additions to the portfolio include Technip – the second largest oilfield service company in Europe; Tokyo

Electron – Japan’s leading semiconductor capital equipment company; and Axa – the global insurance company. Positions eliminated during the quarter include: Societe Generale, Nissan Motor, Centrica, Cheung Kong Infrastructure, Konami, Johnson Matthey and Mitsubishi Tanabe. The portfolio’s largest overweight sectors are energy, telecom and consumer staples. The largest underweight sectors continue to be industrials, financials and health care. Our country allocations have shifted modestly – the UK and Japan declined while Ireland, Spain and Germany increased. We remain overweight continental Europe, underweight the UK and Asia, which is primarily Japan and Hong Kong. We have no foreign exchange hedges or cross hedges in place.

At the end of the 1st quarter, world markets experienced a strong relief rally. This was driven by the financials – more specifically, the credit bailout of Bear Stearns. We don’t believe the challenges facing US and European financials have run their course yet. However, future expectations and valuations have dropped significantly during the last six months. The first quarter is likely to be the peak in asset write-downs at the major banks and investment banks. Credit spreads across many fixed income asset classes are now appreciably above historical averages, reducing the likelihood of further large write-downs. The goal is to find attractively valued banks, brokers and insurance companies, which undoubtedly are experiencing some financial stress, but are not likely to trade at truly distressed levels caused by company specific capital or liquidity issues. *We are looking for stocks in the storm, but not at the center of it.* With this in mind, we would expect to see the portfolio’s weight to increase in the financial sector over the balance of the year.

Best regards,

Colleen Quinn Scharpf
Eric Scharpf
Matt Taylor

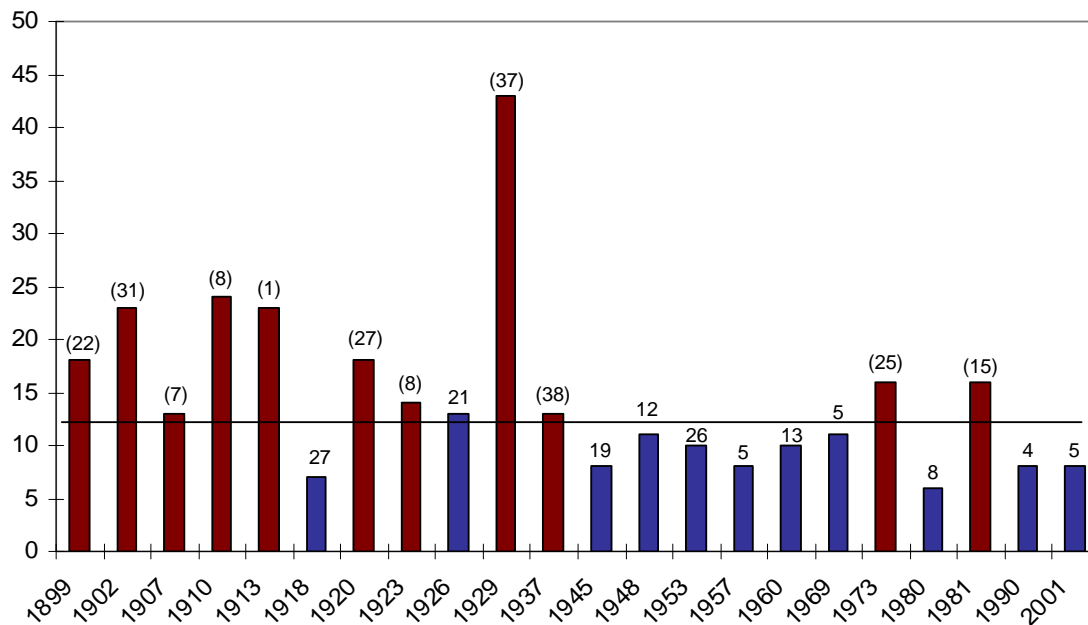
THE VIEW FROM CHESWOLD LANE...

The Dreaded “R” Word

“A significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales” – this is the official National Bureau of Economic Research (NBER) definition of a recession. On Wall Street, recessions are most commonly described as two successive quarters of negative GDP growth, and on Main Street it’s simply a worrisome and painful time in the economy.

Considering the recent US economic data released, it is most likely that the US economy entered recession during the 1st quarter of 2008. There, I said it. The US is in an economic recession – Okay, so now what? From a financial market perspective, this is actually good news. That may sound strange, but after analyzing the US stock market’s historic performance in and around periods of recession – it’s clearly better, from a market perspective, to get this recession started.

Length of US Recessions and Subsequent 12 Month Market Returns



Source: Cheswold Lane, JP Morgan

Left Axis is length of recession in months; Blue bars represent positive market returns in the subsequent 12 month periods from the start of the recession, Red bars represent negative returns; the return % is shown above the bars.

The chart above chronologically graphs each US recession beginning in 1900. The height of the bars represents the number of months of each recession. The color depicts whether the market returns were positive (blue) or negative (red) 1 year after the start of the recession. The number above each bar is the actual market returns (Dow Jones Industrial) 1 year after the start of each recession.

A couple of interesting points regarding the chart: (1) the length of US recessions has dramatically shortened over the last half century. This has been driven by better financial discipline, technology, supply chain management, a more flexible workforce and a gradual shift away from a manufacturing based economy. (2) Shorter recessions, defined as less than 12 months in duration, have always coincided with *positive* stock market returns in the subsequent year. The average return of the US stock market in short recessions is more than 12%. In fact, according to Thomas Lee, JP Morgan's chief US equity strategist, the return "sweet spot" of short recessions starts after the 3rd month of a recession, whereby US stock market returns have averaged more than 19% during the subsequent 1 year period.

The key question therefore is – *what is the likely duration of the current recession: Long or Short?*

The answer, of course, is what the global markets are wrestling with today. The positive case is that US policy makers know this historical data and therefore have swung into action, which by most accounts, is considered "an aggressive policy response". The Federal Reserve has cut interest rates by more than 300 basis points, provided multi-billion dollar liquidity facilities to the markets, allowed investment banks to borrow directly from the discount window and successfully orchestrated the credit bail out of the fifth largest broker dealer in the US, Bear Stearns. At the same time, the US congress has passed a \$150 billion tax refund geared towards the middle class in record time and is considering a more targeted program for the housing market in the May/June timeframe. In a word, the US policy response for the downward spiraling economy is "inflate". Looking at the response of the US dollar, gold and corn prices – the market definitely thinks inflation is rising rapidly. In fact, "real" interest rates have actually turned negative which should encourage investment and risk taking as opposed to cash hoarding.

The cynics, of whom Wall Street has no shortage of, would say that the Federal Reserve's response has been remarkable, even historic, considering that opening the discount window to investment banks had not been done in the last 70+ years; however, this action only highlights how dire the economic situation truly is. Even comparisons to the Great Depression have become commonplace on financial, bobble-head television. This seems more than extreme – but don't worry, Chairman Bernanke's academic specialty is the Great Depression.

The negative points for the US economy are focused on US housing. This asset bubble has burst and homeowners and financial institutions must now de-lever in the wake of unprecedented national home price declines. Consumers are feeling the pain of higher interest payments and negative wealth effects of declining home prices. As for the major banks, the sub-prime credit losses have hurt earnings and reduced capital ratios. This has had the knock-on effect of making the banks pull back from lending. Scarcity of credit causes the economy to slow even more which increases credit losses further, making banks extend even less credit – this negative feedback loop continues until the economy crashes or the negative cycle is broken. Considering the consumer represents 65-70% of US economic activity, this retrenchment likely caused the US to enter recession during the 1st quarter of 2008.

So, is the US recession going to be long or short? At this time, it's too early to call. What is clear is that it is going to be a consumer lead recession, which is very different from the last recession in 2001. The depth of the recession is still in question.

What can we learn about international stock market returns during periods of US Recession?

This exercise entailed overlaying international stock market returns over the periods of US recessions to determine if there were any insights to glean from prior experiences. The analysis is limited by the inception of the MSCI EAFE data in 1969.

MSCI World Returns before, during, after US Recessions

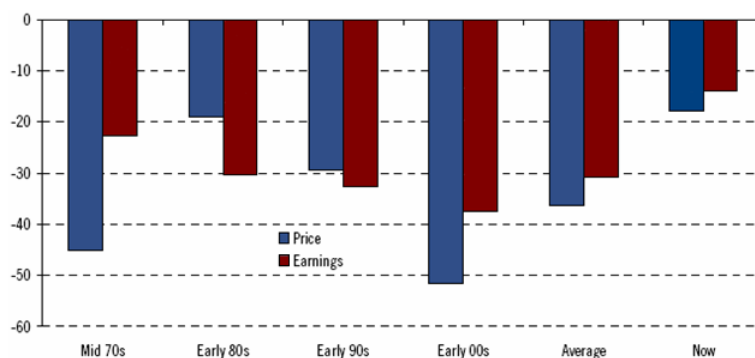
| US Recession | Months | 6M Before | Total Recession | First Half | Second Half | 12M After |
|-----------------|--------|-----------|-----------------|------------|-------------|-----------|
| Dec 73 – Mar 75 | 16 | -10.1 | -12.3 | -16.6 | 5.2 | 16.9 |
| Feb 80 – Jul 80 | 6 | 9.9 | 4.4 | -5.5 | 10.8 | 12.0 |
| Aug 81 – Nov 82 | 16 | 6.0 | 2.5 | -12.3 | 16.9 | 23.0 |
| Aug 90 – Mar 91 | 8 | -5.1 | -3.0 | -17.0 | 16.8 | 8.0 |
| Apr 01 – Nov 01 | 8 | -16.8 | -6.5 | 0.8 | -7.3 | -19.2 |

Source: Citigroup, Cheswold Lane

While the data is interesting, it's not clear how helpful it is to investors today. The general picture is that international returns are negative going into and during the first half of US recessions, but that buying stocks after the first half has been a very profitable strategy. It's probably fair to assume that half way through the recession; the markets fully discount the poor earnings outlook in stock prices. Of course, this begs the question of how to predict when we are in the middle of a US recession.

A potentially better way to understand the effect of US recessions on international stock returns is to disaggregate the price, valuation and earnings components of international companies during these time periods.

MSCI World Market Price and Earnings Declines Around US Recessions (Local %)



Source: Citigroup

As you can see, in the bar chart above, international earnings estimates have fallen approximately 25-30% Y/Y during recent US recessions. However, stock prices have experienced changes greater and lesser than earnings changes – meaning international valuation multiples have both expanded and contracted during periods of US recessions. It seems logical that during recessions the market would expand P/E multiples signaling that the current profit margins are cyclically low and will rebound – effectively trading off of “mid-cycle” earnings.

This occurred in the early 1980's and 1990's recessions. But what explains the multiple contractions during the other US recessions – the early 1970's and 2001?

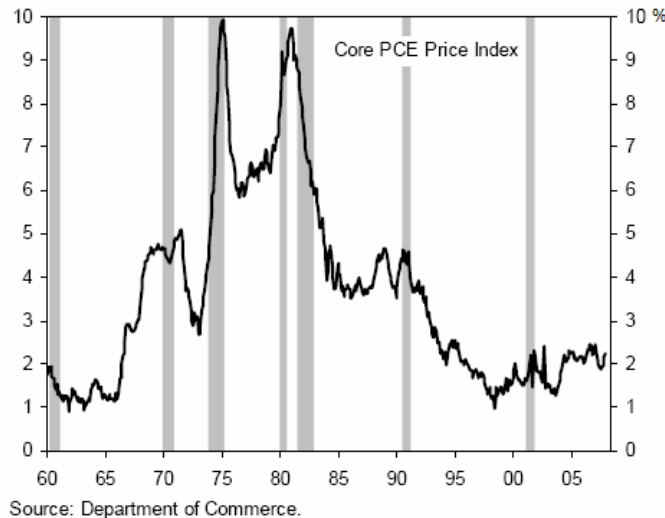
MSCI World P/E Multiples



Source: Data Stream

Explaining the multiple contraction in the post technology bubble era of 2001-2002 is pretty simple – 30-35 P/E multiples were significantly above the historical average, implying almost no risk premium for stocks. When the bubble burst, the markets reverted back to the mean. The significant multiple contraction of the early 1970's was different because the market P/E's were close to the historical mean (including the 1950's and 1960's) but still contracted significantly during the recession. What drove this?

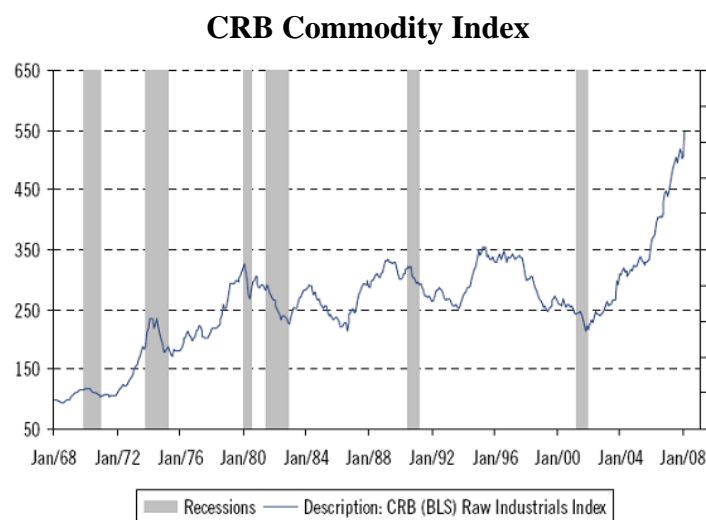
US Government Inflation Index



Source: Department of Commerce.

The stock market began to anticipate a significant rise in inflation rates in the early/mid 1970's – otherwise described by the US commerce department parlance as “Core PCE Price Index”. Higher inflation rates correspond with higher discount rates for stocks and thus lower P/E multiples. Today, the US government inflation statistics have increased to slightly more than

3%. However, the world stock markets are looking at other signs of inflation, like commodity prices, and thus anticipating a significant acceleration in inflation.



Source: Goldman Sachs

What does this mean for Cheswold Lane's clients?

The answer to the question of whether the US recession is going to be long or short, and ultimately, where the global equity markets are headed in the next 12-18 months, are really questions regarding future US inflation expectations. Unfortunately, due to the housing and financial crises, the Federal Reserve has been forced, in the short term, to choose economic stability and growth over inflation containment. This is driving market expectations of future inflation substantially higher. Whether we actually experience inflation rates in the 5-6% level has yet to be determined. However, the longer the housing and financial crises continue, the more monetary and fiscal stimulus will be injected – which means higher future inflation.

At Cheswold Lane, we remain patient, waiting for the safety of margin in European and Asian cyclical stocks to improve. Earnings estimates for 2008-2009 remain too high in our opinion, but we are starting to see value in financials and some segments of the industrial sector. Volatility is close to 10 year highs in the global stock markets, so our bias is not to chase stocks on rallies – we expect more opportunities to purchase quality companies at discounted prices as the financial stress in the global credit markets starts to show its knock-on effects in the “real” economy during the 2nd and 3rd quarters of 2008. Besides valuation, the key fundamental signal we are watching for is data which supports a general easing of inflation pressure on the global economy.

As always, we appreciate your support and welcome your thoughts and ideas.

Best regards,

Eric Scharpf
Portfolio Manager
Cheswold Lane International High Dividend Strategy