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INTERNATIONAL HIGH DIVIDEND STRATEGY

2007 ANNUAL INVESTMENT LETTER

Thank you for your continued interest in Cheswold Lane's international value equity strategy. Our investment strategy composite returned 15.32% on a gross basis compared with a rise of 11.17% 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. In the 4th quarter of 2007, the portfolio increased 0.91% on a gross basis compared with a return of -1.75% for the MSCI EAFE index.

Market Review – 2007

2007 was a year of transition for the financial markets. Global economic growth peaked during the summer as the world's largest economy, the US, started to crack under the weight of the housing correction and subprime mortgage debacle. US and European financial institutions, hit especially hard by the change in economic conditions, tightened credit standards significantly. At the same time, oil prices resumed their march towards \$100 a barrel. Fear of a consumer-led US recession spread across the globe, forcing portfolio managers to revise their revenue and earnings expectations down for the 2nd half of 2007 and 2008. As we expected, economically sensitive stocks, which lead the market in the 1st half of 2007, surrendered their market leadership to the non-cyclicals in the 2nd half of the year. Market participants' risk appetite was replaced with risk aversion during the 3rd and 4th quarters. Higher risk asset classes began to underperform – including small cap value, high yield bonds, bank loan funds, REITS, etc... As the US housing crisis became more pronounced, the Federal Reserve and the Bank of England cut interest rates and provided additional liquidity financing to the markets. This has yet to cure the major European wholesale lending problems. Libor spreads remain at extreme levels, thereby contracting lending to the global economy. During the 4th quarter, several major investment banks replaced their CEOs and began to look for outside capital to repair their depleted balance sheets. The markets ended the year on a low note – with investor confidence severely weakened while the economic outlook remains murky, at best.

On a US dollar basis, the top performing sectors in 2007 were basic materials (+32%), telecom services (+29%), consumer staples (+24%) and utilities (+24%). The underperforming sectors were lead by the financials (-2%), healthcare (+1%) and consumer discretionary (+4%) sectors. Regional performance continued to diverge, as countries that struggled with economic growth, like Japan, Italy and Ireland, lagged countries with stronger economic fundamentals – Hong

Kong, Australia, and Germany. Emerging markets, while encountering higher volatility, still returned almost 40% in 2007, driven in large part by the strength of the BRIC countries (Brazil, Russia, India and China) which were up nearly 60% for the year. High commodity prices and continued strength in export markets drove returns, as well as strong investor demand for growth-style equities.

The US dollar continued to weaken versus all of the major currencies in the MSCI-EAFE index due to a slowdown in the US economy and market anticipation of a change in the US Federal Reserve's stance on Fed Policy – from a “fear of inflation” to a “fear of recession.” Post year end, the Federal Reserve made it clear that it is now in the “fear of recession” camp. Among major currencies in our portfolio, the Norwegian Kronor strengthened 14.7%, the Euro 10.9%, the Japanese Yen 6.7%, and the Pound Sterling 1.7%.

Portfolio Review – 4th Quarter

The portfolio experienced only modest changes during the 4th quarter as our bias towards large cap, less cyclical stocks remains unchanged. As discussed in our 3rd quarter letter, we viewed the knee-jerk drop in the stock prices of Japanese exporters caused by a short term rise in the Japanese Yen, as an opportunistic time to increase our holdings in this area. During the 4th quarter we added new positions, at attractive prices, in Toyota Motors, Shin-Etsu Chemical and Canon. All three companies are high quality, global industry leaders which we believe will continue to perform strongly through the economic cycle. Toyota and Canon have been de-rated due to their large US consumer and corporate exposure. However, both companies are market share gainers in the US and have significant European and non-Japan Asia businesses that are growing rapidly. In Europe, we added three new positions: Fresenius Medical, Commerzbank, and Saipem. Stocks sold include Eisai Pharmaceutical, Hong Kong Electric, Kubota, UBS, Norsk Hydro and Altadis.

Both Norsk Hydro and Altadis were involved in M&A transactions during 2007. Norsk Hydro was paid a significant premium by Statoil ASA for their oil and gas assets – which we received in the form of more Statoil shares. The Norwegian government owns a large stake of the remaining public company; a high-cost aluminum producer that is likely to be an acquirer of assets in the future. Also, we believe aluminum will be one of the weaker basic materials investment stories in 2008. We expect aluminum prices to continue to fall as construction and industrial demand in the US and Europe weakens. Post the closing of the transaction with Statoil, we sold the remaining Norsk Hydro stub company. Altadis, the Franco-Spanish tobacco company, agreed to be acquired by Imperial Tobacco for 50 Euros (cash) in 2007. Including currency appreciation, the stock returned over 50% since we added it to the portfolio in the 2nd half of 2006.

With respect to performance, the portfolio significantly outperformed the MSCI-EAFE index in the 4th quarter, driven by the strong performance of the telecom services (Telenor, France Telecom, Vodafone), consumer staples (Unilever, Henkel) and information technology (Nokia, Konami) sectors. The financials (Barclays, Societe Generale, Irish Life) and healthcare (Takeda Pharmaceutical) sectors detracted from the portfolio's relative performance in the 4th quarter, while sector selection generated substantial relative performance. This was due to a combination of factors; the most significant being the unusually large differences in the absolute returns of three sectors – telecom services, utilities and financials. The portfolio was significantly overweight the telecom services and utilities sectors, which appreciably outperformed during the

quarter, and was underweight the financials sector which meaningfully underperformed the market.

Investment Outlook – 2008

We believe global economic growth will continue to slow in 2008, but whether the result will be moderate growth, recession or deep recession is too early to call. What we do know is that the P/E multiple of the market is quite reasonable at current rates of interest and inflation; the issue is forecasting the proper “E” in the investment decision making process. Net profit margins are at cyclical highs in most industries, especially the economically sensitive and leveraged sectors such as industrials, basic materials, energy, financials and consumer discretionary. The most troublesome condition for the global economy revolves around the financials. Global liquidity has been significantly reduced due to the funding / commercial paper crisis in the UK, Europe and US. Banks are hoarding cash due to concerns that off-balance sheet vehicles used by their clients may be forced back on to their balance sheets. Additionally, the banks fear rapidly rising credit losses and the risk of solvency rumors in the wholesale liability market – i.e. the Northern Rock and Countrywide situations. General credit standards have been clamped down in the classic institutional mentality of – “closing the barn door after the horse has already run out”. All of this will have a very depressing effect on the global economy in the first half of 2008.

The depth of the economic slow down or recession will determine when our portfolio will shift to a more balanced cyclical versus non-cyclical stance. Obviously, with the markets being a forward discounting mechanism, we will have to take action before the economic data turns positive. This is where investing becomes more of an art than science for fundamental portfolio managers. The area of most interest to us is financials. These stocks have been severely de-rated in 2007. Earnings revisions are currently negative. But for the global economy to improve, financials must be effectively working in the market place – meaning credit must be available to good credits at reasonable prices. The future actions of the major central banks will play a crucial role in rebalancing the credit equation of availability versus credit standards. It may take some time for the impact of these actions to filter through the global markets, but financials will lead the way out of this economic downturn. In the meantime, our investment strategy will continue to own quality businesses with strong and stable cash flows, modest capital requirements, prudent balance sheet leverage and reasonable valuations.

In conclusion, we were pleased with the portfolio’s performance in 2007, especially considering the difficult economic conditions encountered in the 2nd half of the year. 2008 is shaping up to be equally challenging, but we believe Cheswold Lane’s investment strategy is well suited for this environment.

Best regards,

Colleen Quinn Scharpf
Eric Scharpf
Matt Taylor

THE VIEW FROM CHESWOLD LANE...

Where's Waldo, Now?

I recently described the last ten years of investing in the markets as *rolling from one bubble to the next*. And while the events are different and the industries and players change, in the end, the results are invariably the same. The market takes an industry or sector and drives its prices up to extreme levels, only to ride them all the way down the other side. In the last decade there were two enormous bubbles. The first was the great bull stock market of the late 1990's, accentuated by the meteoric rise and fall of the technology sector. The second was the US housing bubble which after a great run, has now turned into the subprime mortgage debacle.

All bubbles have an “alluring premise” that forms the foundation of the future froth. In the “Go-Go 1990's” Professor Jeremy Siegel of the Wharton School provided the market with this premise in his book *Stocks for the Long Run*, published in 1994. Professor Siegel's research concluded that *stocks are better investments than bonds – so, just buy stocks!* And it worked. In the 2nd half of the 1990's the US stock market experienced an unprecedented run of five consecutive years of 20+% returns per year. In the middle of this run, Al Gore created the internet and the technology sector proceeded to drive the stock market to extreme heights. The mantra became – *It's the “new” economy, valuation doesn't matter!* The market had become a self fulfilling fallacy because investors – big or small, experienced or novices, institutional or retail – are all human, and humans often succumb to the seduction of chasing returns. And it was a global phenomenon.

MSCI World P/E Multiple



Source: Citi Investment Research, FactSet

Investors' current nightmare, the US housing bubble, was predicated on annual home price data collected by US financial regulators (OFHEO). This data, which became the “alluring premise” of the current crisis, was that US home prices had not fallen in 50+ years (on a national basis). The message conveyed to investors was – *you can't lose investing in US residential real estate, prices only go up!* At the same time, Federal Reserve Chairman Alan Greenspan publicly promoted the use of adjustable rate mortgages on the basis that homeowners were systematically overpaying for traditional fixed rate mortgages. For Chairman Greenspan, this was an ideological position; for the housing market, it was nirvana. When the US entered the recession of 2002, the Federal Reserve lowered short term rates to less than 1.5% driving prices of hard assets, like homes, up dramatically. Affordability was a non-issue for many US homeowners and speculators because lenders created even more lax adjustable rate products such as option

arms, negative amortization arms, 100% financed arms, interest-only arms, no doc/low doc arms, etc... Institutional investors, rating agencies and the investment banks had taken home price appreciation as “a given” in their financial models because of the strong historical data, especially the most recent price appreciation. And when questions arose about how the mortgage market would handle the eventual rise in short term interest rates – the industry had an appealing answer – *we’ll just refinance them into new mortgages!*

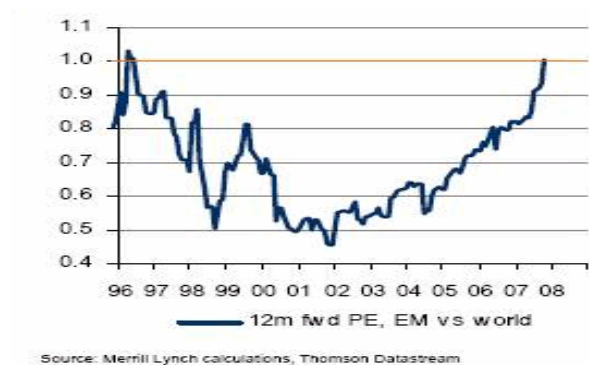
What does this mean for Cheswold Lane’s clients?

My point is not to say that investing in stocks is bad or that housing will be a poor investment forever, but rather to look at the past in an attempt to improve our decision making in the future – to spot the “*alluring premise*” before it turns into the false premise that inflicts serious harm to our portfolio. One final look back to the past – it’s worth noting that the financial pain experienced during the housing crash is concentrated in the major financial institutions which created, promoted and distributed these mortgage products. This is very different from the technology bubble. In the technology bubble, the general public effectively sent a large portion of their savings to Silicon Valley, net of commissions paid to Wall Street. In the housing bubble, many US consumers were effectively offered very inexpensive call options on the price of US housing by the major investment banks, institutional bond funds and hedge funds around the world. The US consumer bought these options in the form of cash-out mortgages, option arms and high LTV home equity loans and spent the money. And it’s gone forever. Lenders foolishly believed that US housing was no longer a cash flow based loan, but rather an asset loan – an asset that would never go down in price. Now, the media has argued that millions of people will be displaced from their homes. I think the speculators and the fraudulent purveyors will be eliminated, which is simply the capitalistic system working; however, I believe the renter who became a homeowner based on aggressive mortgage products has a very good chance of staying in that home. Banks learned in the early 1990’s that the only thing worse than a delinquent home loan, is a delinquent home loan attached to an empty home. Banks and other investors, with some cajoling from the state and federal government, have already started making deals with consumers, and the deals will only get better if the US goes into a recession in the first half of 2008.

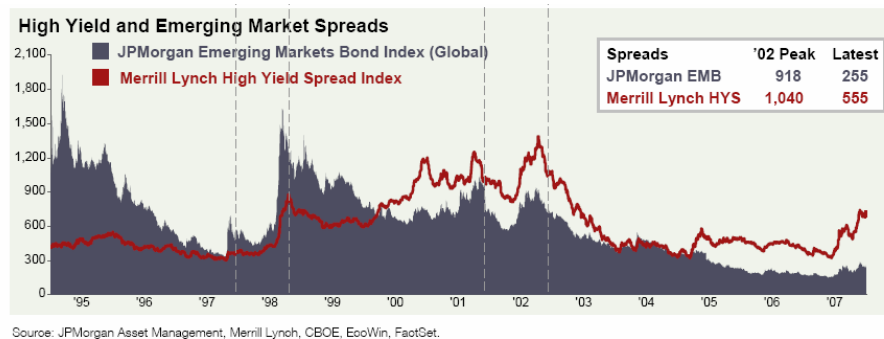
So, “*Where’s Waldo Now?*” What is the next asset bubble threatening the global financial markets? In my opinion, the most obvious large market inefficiency is the emerging markets, a market that we monitor but do not invest in. At Cheswold Lane, we believe the market looks to the past, especially the most recent past, to project future rates of growth and returns of a stock, sector or country. Focusing on the most recent past is what causes market inefficiencies. In the second half of 2007, as the global economy started to slow, the financial markets recognized that future expectations of economically sensitive sectors were too high and thus they were re-priced lower. This revaluation also included riskier asset classes such as high yield bonds, REITS, small cap value stocks and other levered asset classes. The only “risky” asset class that didn’t suffer significantly was the emerging markets. I doubt this will remain true if the global economy continues to cool in 2008, which is my expectation. The emerging market bulls point to the favorable growth rates of the emerging markets versus the United States and Western Europe combined with only modest relative valuation premiums. They argue that the emerging market economies have decoupled from the United States and Western European economies because the emerging markets’ economies are far less dependent on exporting due to the increased size of their domestic economies. And lastly, that “*it’s different this time*” because of the large foreign currency reserves their central banks hold compared to the last emerging market meltdown of 1997-1998. I will grant the emerging market bulls the currency reserve premise,

but I think it's a stretch to believe that the emerging economies, which are primarily exporters of basic resources and labor-intensive, manufactured products, can possibly decouple from the United States and European economies. However, the most overstated premise is the attractive valuation of emerging markets versus the developed markets. This ignores the historical data which demonstrates that emerging markets usually trade at significant discounts to developed market valuations.

Emerging Market versus World Relative P/E Multiple



Today's valuation anomaly is related to the markets' cyclical low emerging market debt spreads relative to US Treasuries. When emerging market debt spreads revert back to their historical norms, like high yield bonds have recently, then the discount rate used to value the emerging markets will increase significantly, driving their P/E multiples meaningfully lower. Also, emerging market profit margins are at cyclical highs, like other economically sensitive asset classes or sectors, and if the global economy continues to slow in 2008, then the earnings applied to the lower P/E multiple will be much lower, too.



The final issue for emerging markets is liquidity. Foreign investors have piled billions of dollars, euros, pounds and yen into the emerging markets chasing the stellar returns; however, this phenomenon also works in reverse. Institutional investors will most likely be trying to get out at the same time, causing the valuations to be reduced even more.

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

Best regards,

Eric Scharpf
 Portfolio Manager
 Cheswold Lane International High Dividend Strategy