KALORAMA Wealth Strategies

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First-Quarter 2008 Market Review ~ Independence Day 2008: April 23rd!

April 2008 - Stocks were pummeled in the first quarter as companies revealed their exposure to the turmoil in credit markets. Investor anxiety about a slowing economy and weak housing, employment, and corporate profits also continued to weigh on stock prices. The widespread sell-off left all indexes in the red, with Domestic Large Growth, Domestic Small Growth, and International Emerging Markets all posting double-digit declines. The best thing to happen to the first quarter was that it came to an end, providing for the first day of the second quarter and a rebound in most stock indexes of more than 3%.

The Federal Reserve continued to take extraordinary actions during the quarter to free up the gridlock in credit markets and prevent an unraveling of the financial system. In addition to cutting the Fed Funds rate three times by a total of 2.0% to 2.25%, in what has been characterized as the biggest expansion of Federal Reserve lending since the 1930s, the Fed created a $200 billion lending program for commercial banks and an auction program of an equal amount for investment banks. This was followed by the unprecedented step of opening its discount window to investment banks (also known as "securities dealers" or "primary brokers") to provide short-term loans in exchange for assets in which the credit market is not functioning.

The Fed also agreed to guarantee certain assets in connection with JPMorgan Chase's "purchase" of highly-leveraged Bear Stearns. Further, they extended agreements with other central banks which allow them to borrow dollars from the Fed to inject money into their financial systems.

Meanwhile, lower interest rates sent the yield on the 10-year Treasury Note below 3.40% during the quarter and at quarter-end the yield was 60 basis points lower to close at 3.42% (the yield as of April 10th was 3.54%). Consistent with lower yields and a weaker dollar, bond prices strengthened. Global Aggregate jumped 6.6%, U.S. Aggregate gained 2.2%, and International Emerging Markets crept up 0.2%. U.S. Corporate High Yield acquiesced to the credit-market turmoil by unloading 3.0%.

Table Changes:

Consistent with Kalorama's globally-diversified investment strategy, beginning with this newsletter, the FTSE EPRA/NAREIT Global Real Estate Index will replace the domestic-focused Dow Jones Wilshire REIT Index for the returns of the real estate asset class. In addition to representing the returns of stocks worldwide, the global index includes real estate companies which are not structured as REITs. Demonstrating the benefits of diversification, for the 10-year period ending December 31, 2007, the compound annual return for the broad-based global index was 12.8%, compared with 11.1% for the REIT-focused domestic index. Over the same period, the volatility of the global index (as measured by standard deviation) was lower at 18.7% versus 19.9% for the domestic index.

Another change includes the addition of the Lehman Brothers U.S. Treasury TIPs Index, representing the returns of treasury inflation-protected securities (TIPs). Initially issued by the U.S. Treasury in January 1997, these bonds have become a separate asset class in many investors' portfolios. The unique feature of TIPs is that they offer protection from inflation by adjusting the underlying principal and coupon payments to compensate for inflation as measured by the consumer price index (CPI).

Below are rates of return for selected market indices for the first quarter of 2008, full-year 2007, and the three, five, and 10-year compound annual returns as of December 31, 2007.

	1Q:2008	2007	3-Year	5-Year	10-Year
Equity (Stock) Indices					
Domestic Large Cap					
Russell 1000 - Growth	-10.18%	11.81%	8.68%	12.10%	3.83%
Russell 1000 - Value	-8.72%	-0.17%	9.32%	14.63%	7.68%
Russell 1000 - Blend	-9.48%	5.77%	9.08%	13.43%	6.20%
Domestic Small Cap					
Russell 2000 - Growth	-12.83%	7.05%	8.11%	16.50%	4.32%
Russell 2000 - Value	-6.53%	-9.78%	5.27%	15.80%	9.06%
Russell 2000 - Blend	-9.90%	-1.57%	6.80%	16.25%	7.08%
Real Estate (FTSE EPRA/NAREIT Global)	-5.63%	-6.96%	15.17%	24.28%	12.75%
International					
MSCI EAFE Developed Large Cap	-8.82%	11.63%	17.32%	22.08%	9.04%
MSCI EAFE Developed Small Cap	-6.16%	1.79%	15.55%	26.84%	NA
MSCI Emerging Markets	-10.92%	39.78%	35.60%	37.46%	14.53%
Fixed-Income (Bond) Indices					
Lehman Brothers					
Global Aggregate	6.63%	9.48%	3.70%	6.51%	6.08%
U.S. Aggregate	2.17%	6.97%	4.56%	4.42%	5.97%
U.S. Treasury TIPs	5.18%	11.63%	4.85%	6.27%	7.46%
U.S. Corporate High Yield	-3.02%	1.87%	5.39%	10.90%	5.51%
Municipal	-0.61%	3.36%	3.90%	4.30%	5.18%
International Emerging Markets	0.21%	5.21%	9.11%	13.03%	10.02%

Source: www.russell.com, www.nareit.com, www.mscibarra.com, www.lehman.com

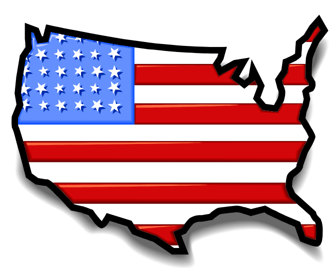
Independence Day 2008: April 23rd!

In the spirit of the tax-filing season, happy Independence Day! What, you may ask, it's a little early for Independence Day?! No, not *that* Independence Day, the day we Americans celebrate our freedom from England -- Tax Freedom Day, a celebration of the day on which Americans have earned enough money to pay all their federal, state, and local taxes for the year.

According to the Tax Foundation (www.tax foundation.org/taxfreedomday/), for 2008, Tax Freedom Day will fall on April 23rd, three days earlier than in 2007. Using the latest government data on income and taxes, the Tax Foundation's annual calculation attributes the earlier celebration to stimulus rebates and a projection of slow growth.

Based on total tax collections and total income, taxes are projected to amount to nearly 31% of income, and the 113 days from January 1st to April 23rd is 31% of the year. The 31% is comprised of 20% federal taxes and 11% state and local taxes. Compared with the 74 days required to pay federal taxes and the 39 more days to pay state and local taxes, housing requires 60 days of work, health and medical care 50 days, food 35 days, transportation 29 days, recreation 21 days, and clothing 13 days.

In the Washington Metro Area, if the District of Columbia was a state, its May 3rd Tax Freedom Day would fall between California (April 30) and New York (May 5). The only other states which have to wait until May to celebrate are New Jersey (May 7) and Connecticut (May 8). Maryland is ranked 7th worst (April 28) and Virginia is 12th (April 25). Although the states with late Tax Freedom Days



have high state and local taxes, the primary reason is the progressive nature of federal income taxes. Residents of these states tend to have higher-paying jobs and earn enough to pay income tax at the highest federal income tax rates (currently 25%, 28%, 33%, and 35% versus 10% and 15% for the lowest tax brackets).

Some other interesting tax tidbits from the Tax Foundation:

- The mortgage interest deduction was first permitted in 1894. In fact, when the first modern federal income tax was created in 1894, all forms of interest were deductible. However, the Supreme Court ruled the tax to be unconstitutional, so it wasn't until 1913 that the Constitution was amended and federal taxes as we know them today were enacted. Tax Freedom Day in 1913 was January 19th and taxes as a percentage of income were 5.2%. It wasn't until 1941 that taxes as a percentage of income exceeded 20%.

- The Alternative Minimum Tax (AMT), a parallel federal tax system designed to ensure that high-income people with many deductions pay at least some tax, actually began as a 10 percent "minimum tax" in 1969, and wasn't fully replaced by the current "alternative minimum tax" until 1982. The minimum tax was originally created in 1969 after Congress was surprised to learn that 155 wealthy individuals were not paying tax because they used too many of the deductions Congress enacted. Because the AMT exemptions were not indexed for inflation, the tax has been capturing a rapidly increasing portion of taxpayers. If the exemptions are not adjusted for 2008, an estimated 26 million people will be caught by the AMT, up from about four million in 2006 and 2007.

- The year 1969 is also notable for being the first year taxes as a percentage of income rose above 30%. The April 23rd Tax Freedom Day was the same as it is for 2008.

- The Tax Reform Act of 1986 was celebrated for being the broadest revision of the federal income tax since its inception. It was intended to simplify the tax code by minimizing tax breaks and lowering rates. However, Congress has since passed thousands of changes, many of which reinstate tax loopholes eliminated by the Act. According to tax publisher CCH, based on its *Standard Federal Tax Reporter,* the number of pages including the tax code, regulations, and IRS rulings has swelled from 26,300 in 1984 to more than 67,500 in 2008.

- In 1986, Tax Freedom Day was April 19th and taxes as a percent of income were 29.7%. The proportion rose above 30% in 1987 and peaked out at 33.6% in 2000 as a result of increased tax collections attributed to previous years' economic growth and soaring stock prices. The recent bottom was 29% in 2003 after the 2001 and 2003 tax cuts. The higher percentage for 2008 is a result of escalating tax collections.

And so we all don't go away from this article completely jaded about paying taxes, according to an IRS Oversight Board 2007 Taxpayer Attitude Survey, a majority of taxpayers "tell the truth and nothing but the truth." When asked: "how much do you think is an acceptable amount to cheat on your income taxes?", a whopping 84% of respondents answered "not at all," 8% "a little here and there," and 5% "as much as possible" (percentages do not add up to 100% as the balance either said they don't know or didn't respond). The question remains: how many of the survey respondents answered truthfully?

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