MARYLAND CAPITAL ADVISORS INC.
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INVESTMENT COMMENT — April 7, 2008
Update on our Passive, Asset Class Balanced Strategy

Equity markets had a rough first quarter. 2007 ended with bond and stock markets foretelling two vastly different views of the future. In our August, 2007[1] articles we detailed the early stages of the credit crisis. By year-end, the economic implications of pricing in the credit markets became dire. Prices of some AAA-rated credit instruments were trading as low as 70-75% of face value, which implied substantial risk to principal. Meanwhile, domestic equity markets finished the year with a modest gain (+5.2%) and a moderated level of fear[2].

As we mentioned in our August 21 article, "…the Fed is in the process of providing liquidity to stabilize the banking system, but it seems certain there will be more financial firms that fail in the coming weeks and months." Credit market conditions deteriorated further from year-end and the Fed responded in Q1 with three interest-rate cuts and several innovative and substantial lending facilities. Unfortunately, global equity markets responded by trading lower, with US equities -9.3% for Q1 2008 and rest-of-the-world[3] stocks -8.5%. There has not been a final resolution to the year-end incongruency between bond and stock market pricing – the process is on-going. ***Given current conditions, what are the implications for our investment portfolios? We will continue with our disciplined process.***

As investors with a globally-balanced asset allocation strategy, ***our focus is not on anticipating how or when such an imbalanced situation may impact any given asset class, but rather on monitoring and refining our long-term allocations to ensure portfolio diversity at several levels:***

- **Equity Risk / Fixed-Income allocation.** Returns between Stocks and Bonds are intuitively and verifiably negatively correlated over time. This is the primary risk-taking decision agreed upon and declared in each client's Investment Policy Statement. *The Equity / Fixed-Income balance is determined by each client's situation – we do not actively change this allocation to time market entries or exits.*
- **Diversification within Equities.** We establish targeted long-term exposures to academically-determined risk factors: Size (small to large companies) and Valuation (low to high Book Value/Price). *The degree to which we "tilt" portfolio allocations toward Small and Value are static over time – again, we do not actively manage or speculate on future risk-factor performance.*
- **Prudent sub-allocations within Fixed-Income investments.** We select these targets by reviewing the yield compensation offered for underlying bond market risks: credit risk, interest-rate risk, and timing-of-cashflows risk. Unlike stocks, bond prices translate to yields that allow investors to compare each risk with a yield-to-maturity. In the context of our investment philosophy, each of these bond market risks are acceptable, diversifying portfolio risks, provided there is adequate yield compensation to the portfolio. We periodically refine these sub-allocations when the market price for each risk warrants a change.
- **Selected Alternative asset classes – Real Estate and Commodities.** Real Estate exposure is determined as part of the overall equity risk target. The allocation to Commodities is part of each portfolio's inflation-hedge, which includes inflation-protected bonds.

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[1] See "Repricing Risk Due to Sub-Prime Mortgages and Leveraged Loans" August 6, 2007 and "A Crisis of Confidence in Money Markets" August 21, 2007 at www.marylandcapitaladvisors.com
[2] Measured by the CBOE S&P 500 Volatility Index, which reflects a market estimate of future volatility
[3] Total return of MSCI US and MSCI World ex-US Indexes

These are important long-term diversifying asset classes and our portfolio exposures are rebalanced to strategic targets and not influenced by short-term market events.

Since it is impossible to "market time" with any benefit[4] in the long-run, we implement the discipline of asset allocation with periodic transactions that return client portfolios to their long-term exposure targets. ***The current environment is no exception.*** There are two important aspects of our strategy that allow us to prudently rely on the power of capital markets to maximize returns, while minimizing risk:

- **We do not employ financial leverage.** Our client portfolios do not utilize margin loans to increase asset class exposures. Such financial leverage magnifies movements in *both* directions and can obviously necessitate risk-reducing transactions (often too late) should the portfolio manager fear lower prices. *Our client portfolios require no such leverage-induced risk-management transactions.*
- **We do not purchase individual equities.** We own stocks for the purpose of gaining exposure to the various academically-defined dimensions of equity risk (Small-Large, Growth-Value). *Client portfolios are best served by owning funds that diversify-away single-stock risk and allow the strategic asset allocation to capture capital market returns.*

Our framework for investment management decision-making performed relatively well in Q1. Specific metrics of performance are client-specific and detailed in each individual Quarterly Client Portfolio Report. However, as shown in Table 1, 60% Equity / 40% Bond balanced portfolios from Vanguard and DFA were -4.9% and -4.7%, respectively. ***Our client portfolios have several diversifying factors these portfolios lack –*** **Commodities (+14.4%)**, **International Bonds (+8.4%)**, and **Treasury IPS (+5.3%)** ***– that were positive contributors in Q1.***

Table 1: Passive Portfolios vs. Indexes 1st Quarter Performance	Price 3/31/2008	Return Q1	Return 1-Year	Risk 1-Year
Passively-Managed 60/40 Funds				
Vanguard 60/40 Allocation (ticker: VBINX)	$20.81	-4.9%	-0.4%	6.7
DFA 60/40 Allocation (ticker: DGSIX)	$12.23	-4.7%	-2.3%	7.4
Popular Market Index Funds				
Dow Jones Industrial Average	12,262.9	-7.2%	+1.2%	11.3
S&P 500 Index	1,322.7	-9.4%	-5.3%	8.0
NASDAQ Composite Index	2,279.1	-14.6%	+0.7%	19.2

Source: Bloomberg L.P.
Note: Returns are calculated inclusive of reinvested dividends.
Risk is standard deviation of returns.
Index risk and return are calculated using tradeable, index-equivalent ETFs.

The 1st Quarter of 2008 had several highlights that passively-managed, asset class diverse investors were not subjected to:

- Several large hedge funds either substantially or entirely wiped-out investor capital,
- Some high-profile actively-managed funds significantly underperformed market benchmarks[5]
- Many individual company stocks lost significant value, particularly in the financial services sector. Bears Stearns (-88.1%) was the prime example of single-stock risk in Q1.
- Fundamental research, on average, proved useless. According to Bloomberg[6], earnings reports compiled in Q1 show that Wall Street analysts overestimated 2007 Q4 profits by 33.5%.

[4] Academic studies such as Brinson et al. (1986, 1991), Ibbotson and Kaplan (2000), Vanguard (2003)
[5] For example, the manager Fortune dubbed "one of the greatest investors of our time" in 2006, Bill Miller's Legg Mason Value Trust (LMVTX) was -19.7% in Q1 2008.

Against this back-drop for Q1, we remain committed to our process and respectful of the power and diversity of global capital markets. We are working diligently to monitor the investment vehicles we employ for each asset class to ensure each portfolio is exposed to compensated risks – not unintended risks.

[6] “Schwab Asks Who Needs Analysts After Biggest Flub”, Bloomberg