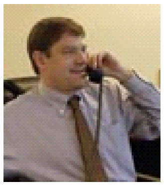
INVESTMENT UPDATE NEWSLETTER

ALLEN TRUST COMPANY

FIRST QUARTER 2008

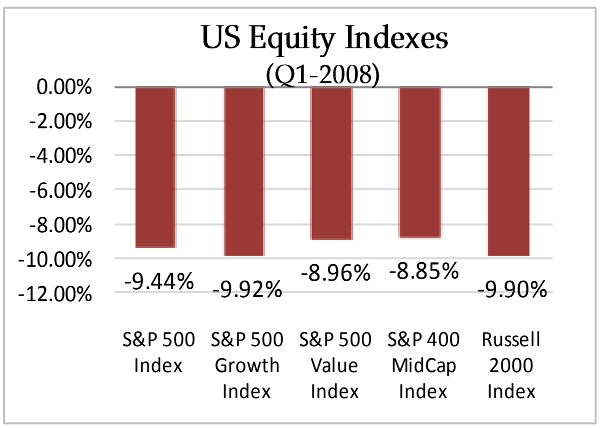


William A. Harris, CFA
Portfolio Manager

2008 First Quarter Review

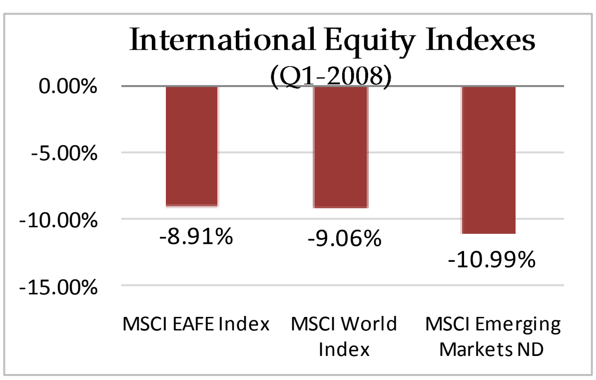
Stock Markets: Uniform Decline

It isn't news that stocks had a hard go of it through the first three months of 2008. What may interest some of you, however, is the uniformity of the decline, with foreign markets as well as domestic markets, stocks of big companies as well as midcap and small companies, value stocks as well as growth stocks, erstwhile defensive sectors as well as pro-cyclical sectors, all swooning in unison.



Sources: Northern Trust and Standard & Poor's

There wasn't a corner to hide in, which gets back to a point I made at the beginning of the year about market correlations increasing on the downside.



Sources: Northern Trust and Standard & Poor's

Correlations didn't just increase here… indeed, it's as if the markets linked arms before skipping off the cliff; the percentage losses are very tightly distributed for all eight indices shown.

Luckily, it was a short cliff. Which brings me to my next point: as stock market declines go, this one has been modest so far, all the popular hype notwithstanding. The market at its March low had barely retreated 20% from its briefly-attained October high, and ended the quarter not far from where it was a year ago. Though the pain has been especially severe for stockholders of Bear Stearns and some other imploding companies, altogether this retreat hasn't been of a magnitude to justify the ink spilled or pixels lit in fretting about it. Post-WW II bear markets have pulled down stocks by nearly a third, on average; at our worst hour in this cycle, we've only given up one fifth. As bears go, this hardly qualifies as a cub. Of course, cubs can grow, and a particular problem is that they sometimes dress up like little bulls – frantic surges in stock prices can happen ("sucker rallies") even in the midst of longer downtrends.

Bond Markets: Widening Spreads

Whereas pain, indiscriminately apportioned, was the story for stocks, the bond market was a study in contrast. US Treasuries rallied hard (even as the dollar kept sliding!), while any credit inviting the merest taint of skepticism languished in comparison. Investment grade corporate bonds underperformed Treasuries by almost 5%, and spreads on high-yield bonds reached levels not seen since the depths of the 2002-2003 washout. Treasury Inflation-Protected Securities (TIPS) surged to such an extreme that the five-year TIPS traded at negative real yields briefly (whereupon we sold our near-term TIPS holdings), while at the same time high quality tax-exempt municipals foundered by comparison, even yielding more than Treasuries of the same maturity.

Altogether, a yield curve that was as flat as a fence rail just a year ago has now steepened dramatically, the front end yanked lower by Fed moves aimed at righting a financial system that's been reeling about like a cowboy both drunk *and* gut-shot – albeit with rock salt, if not lead quite; the victim hasn't gone boots-up.

Allen Trust Company Performance

The bad news is that our stock portfolios shared some of the misery. The good news is that they suffered less, especially when looked at on a trailing twelve-month basis. Allen Trust's equity composite fell only about half as much at the S&P 500 in the first quarter, and over the previous year trounced the index, returning a gain of 4.00% vs. a loss of 5.07% for the S&P since 3/31/07. Our relative outperformance is due in no small part to our decision last year to go massively underweight on financial stocks.

Total Return First Quarter, 2008	
Allen Trust Equities	-4.81%
S&P500	*-9.44%*
Allen Trust Bonds	2.27%
Lehman Aggregate Bond	*2.17%*

As for ATC's bond composite, it edged out its Lehman Aggregate benchmark by a small margin. Of course, these are pretax returns, and given our considerable tax-exempt muni holdings, we compare more favorably especially on an aftertax basis. The muni bond market actually offered some rare excitement mid-way through the period. At the end of February, auction rate securities for many municipalities failed to find bidders, thus triggering onerous covenants imposing damnably high interest rates on perfectly sound credits. This was another instance of too many people having failed to read the fine print, or perhaps being too clever (or greedy) again by half. With the additional specter of monoline bond insurers facing ratings downgrades, the market panicked, and for a few days tax-exempt municipal bonds got cheap, with high quality munis yielding more than Treasuries on a *pretax* basis. We were among what felt like few buyers. Though munis' fortunes have improved (somewhat to our disappointment – we *like* buying cheap!), we're still finding and buying what we believe to be sound values.

Altogether, we're content now to "stick to our knitting," by which I mean that we continue to focus on good quality companies whose stocks, for the most part, pay dividends and have a history of raising them at a rate greater than inflation. We have also resumed buying foreign equities, following their shakeout, but have yet to venture back into financial stocks, which we believe still have a strong current running against them as they (and consumers) work to mend the damage done by reckless decisions made in the recent "good times." Lastly, we are edging into precious metals shares on weakness, not so much because we have any particular optimism regarding that most pessimistic of asset choices, but as a measure of insurance against the potential for extreme policy errors by central banking authorities here and abroad.

William A. Harris, CFA

Notes regarding performance measurement:

Performance data is calculated by third-party vendor Greenhill using its GHperf performance measurement system. All returns are time-weighted and reported gross of management fees. Returns for longer than one year are annualized. All returns include reinvestment of income. Data is calculated on a trade date basis and income is included in returns on an accrual basis. These composite calculations aggregate returns across accounts over which Allen Trust Company had discretionary investment authority for the most recent reporting period. Some accounts do not have GHperf histories for all years, quarters or months referenced, but their histories are incorporated from the inception of their inclusion in the GHperf measurement system. Actual performance of any individual client portfolio may differ from the aggregated results, and past performance is no guarantee of future returns. This performance data is for Allen Trust Company client accounts only; it does not include data for any Allen Capital Management accounts and should not be construed as representing Allen Capital Management investment performance. Please contact the ATC portfolio management team for more information.