

THE TANDEM REPORT

Volume IX, Issue 2 April, 2008



"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it."

~ Ralph Waldo Emerson

Dear Clients,

Tandem is committed to the preservation of your wealth by minimizing risk while adding value through superior investment performance. This issue of *The TANDEM Report* provides a summary of our views pertaining to the investment landscape and subjects that influence our decision making. More information about our firm, including our investment style and process, is available on our web-site. Please visit www.tandemadvisors.com. We hope you find this report informative.

Respectfully,

John B. Carew
President,
Chief Investment Officer

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All performance figures, charts and graphs contained in this report are derived from publicly available sources believed to be reliable. Tandem makes no representation as to the accuracy of these numbers, nor should they be construed as any representation of past or future performance.

SPECIAL EDITION— THE BUBBLE DECADE

THE INFORMED INVESTOR IS THE BEST INVESTOR

We depart from our normal format this issue in an effort to address all that has gone on in the investment world. This is a mighty undertaking, and we recognize that the subject matter can be difficult to follow. We have tried as best we can to explain concisely and in plain language. Yet even after we read this ourselves, it can be tough going at times.

As you read on, please take your time to digest this complex information. We have broken the topics out into five separate subjects and suggest that you tackle one at a time.

These are perhaps (hopefully) once-in-a-lifetime events we are living through, and it is vitally important to realize that things are not as bad as they may seem. Investment bubbles are very rare, yet we

identify five that we have lived through or are presently experiencing, all within a ten-year time frame. Remarkable stuff. We know of no other comparable period in history.

Being informed makes you a better investor. Although you look to us to make your day-to-day decisions, you no doubt pay attention. We want you to be informed so that you are dealing with facts, not emotions. As we lay out the history of the last ten years, you may take comfort in having a clearer understanding of what has occurred and what you may reasonably expect in the future.

These are exciting times, and exciting times can produce exciting opportunities. Be forewarned this is a challenging read. We apologize, but think it necessary.

RESIDENTIAL REAL ESTATE

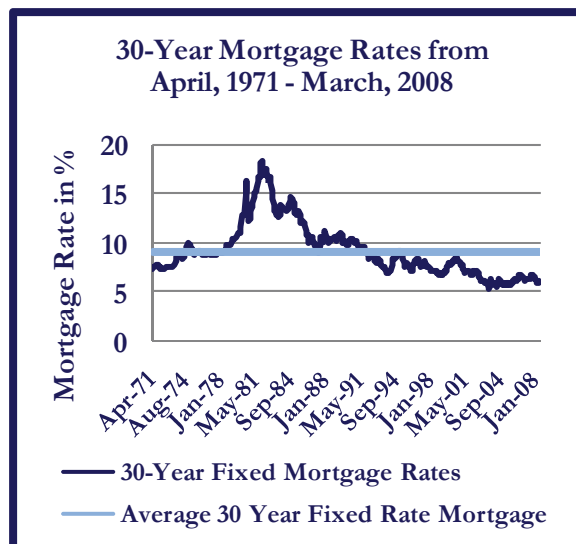
Historically, asset bubbles are rare. After the bursting of the dot-com bubble in 2000, investors turned their focus to residential real estate, creating the second (but not last) bubble within a 10-year span. Shunning the stock market and its negative returns early this decade, individuals seized upon historically low mortgage rates to make investments in properties they may never have previously considered. A quick look at the graph to the right gives a

clear image of just how low mortgage rates became.

There are typically two sound reasons to invest in developed real estate - personal use and rental income. The bubble that resulted from this craze created a third, far less sound reason - price appreciation.

The personal use reason is easy to grasp. If a person has the need or

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Data provided by the Federal Reserve Board website www.federalreserve.gov

RESIDENTIAL REAL ESTATE (CONTINUED)

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desire to own a piece of property, be it a residence, a second home or something else, he intends to actually make use of the property. This isn't really an investment as much as it is personal consumption.

The reason for investing for cash flow (rental income) may not be quite as obvious. If an investor can buy a condo for \$100,000 and rent it out for \$500/month, he will receive \$6,000/year in rental income. This example represents a 6% yield (\$6,000 in income divided by the cost of the condo). Real estate (in normal times) is relatively stable, so this can make for an attractive investment. Pre-bubble, this investment would have been made with minimal borrowing. As recently as the year 2000, mortgage rates were close to 8%, so you can see that if an investor had to borrow most of the \$100,000, it wasn't such a good deal (8% cost to borrow exceeds 6% return).

But as the Federal Reserve lowered interest rates to combat the recession of the post-dot-com and 9/11 era, mortgage rates fell. Investors began to discover that they could borrow larger sums of money and still be ahead. To continue the above example, a 5% borrowing cost and the 6% return is a better deal than the 8% borrowing cost with a 6% return. This phenomenon attracted a new pool of buyers to the market who were will to borrow larger sums

and still realize positive cash flow (having rental income exceed borrowing costs). As investors began to compete with those seeking real estate for personal use, prices rose.

And rising prices attracted another new class of investor called the speculator. The result was an even more rapid rise in prices, and soon we were in a bubble. Simply put, low rates attracted non-traditional buyers investing for non-traditional reasons, and price appreciation became the driving motive to buy real estate. But like all bubbles, this was destined to end badly. Unscrupulous lenders began offering more competitive (i.e., bad) mortgage packages, and unwitting or greedy investors began snapping up housing at an ever-increasing rate. Until there were no buyers left. We call this the greater fool theory. Paying too much for something is ok as long as there is a fool greater than you willing to buy it from you. But when there are no more fools, there are no more buyers. And the bubble bursts.

The unwinding of the residential real estate bubble will likely take time. The stock market hasn't appreciated meaningfully from its level ten years ago as a result of its bubble. We suspect the real estate market to have a similar hangover. The bottom may be near, but that doesn't mean prices begin to rise again. There are still a lot of "investors" out there stuck with property they can't sell, and it may take years to work off that inventory. We anticipate that prices won't rise appreciably until fundamentals make sense again.

DEBT

BONDS, CD'S, MONEY MARKETS & CONSUMER LOANS

After the boom in residential real estate, a third bubble became evident, this time in the credit markets. Credit is a broad term, but in general it refers to investment securities that involve debt. We are all familiar with credit in the sense that when we borrow, we use credit. But corporations and governments borrow as well. They sell bonds to investors like us. We buy the bonds, which means we become the lenders. Banks, too, sell bonds, but they borrow in other ways. They attract deposits with CD's, money market funds and savings accounts. These deposits are funds that banks borrow to then make loans to others. Banks pay interest for these deposits, which are actually loans. There are many forms of "credit" that trade in the market, but for the purpose of this conversation, think of the term credit as simply referring to any investment instrument that represents a contract between a lender and a borrower.

The cause of the credit bubble is debatable. There is certainly plenty of blame to go around. Whether it was Wall Street, banks, businesses or consumers, we all were tempted by the historically low cost of borrowing created by the policies of Central Banks around the globe.

Let's begin with consumer credit. The ways in which we can borrow are numerous. To buy a house, most finance the purchase. Same with a car or boat. College tuition, vacations, computers and plasma TV's are commonly paid for with credit. But have you ever wondered where all the money comes from that we borrow?

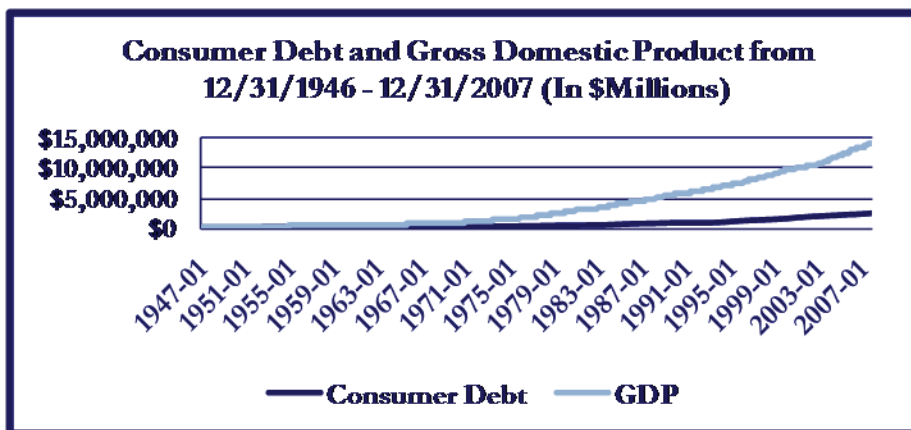
Before we explore who actually lends us all this money, lets take a look at history. Consumer borrowing habits have changed dramatically over the years as a result of law changes as well as the social acceptance of debt. Prior to the 1930's, a mortgage could not be for a term longer than five years. Imagine trying to pay for a home at today's prices in only five years. Prior to the 1960's, credit cards were almost non-existent. Society used to discourage borrowing, still following the maxim Benjamin Franklin laid out over a century before - "neither a borrower nor a lender be". But as consumer debt became more commonplace, a remarkable thing happened. The increased purchasing power certainly led to higher prices, but it also led to improved standards of living and remarkable economic growth. The graph at the top of the next page shows the growth of Consumer Debt

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DEBT (CONTINUED)

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compared with the growth of our economy (Gross Domestic Product, or GDP) since 1946. The naked eye can observe that both consumer borrowing and GDP experiencing break-out growth in the late 1960's (the emergence of the credit card). The two appear to be correlated, and debt had a positive impact on economic expansion.



Data provided by the Federal Reserve Board website www.federalreserve.gov

The same is true for credit card debt, college loans and car loans. Except these are called CDO's, or Collateralized Debt Obligations. And again, when you use your credit card or borrow in some other way to purchase something, your lenders are likely global.

But this doesn't tell the whole story. The graph below depicts consumer debt as a percentage of GDP. In the mid-

1990's, consumer debt as a percentage of GDP began to rise again. By the middle of this decade, it was at new highs. Over time, consumer demand for debt has grown, and lenders have been more than happy to comply. We cannot know how much consumer debt is too much for the



Data provided by the Federal Reserve Board website www.federalreserve.gov

economy to bear. As the economy has slowed, consumer debt has retreated a bit. But it remains historically high.

So now that we have a clearer picture of how much we borrow, lets see who actually lends us all this money.

The answer may surprise you. When you buy a house, you probably borrow the money from your bank, or so you think. The bank doesn't have enough money to loan to every customer that buys a house. They typically sell the mortgages they originate to Wall Street so that they have more money to lend. Wall Street packages all the mortgages they buy, carves them up into little pieces called tranches and sells the tranches to investors all over the world. They call these things CMO's, or Collateralized Mortgage Obligations. Your mortgage could be simultaneously owned by a bank in Paris, a pension fund in Hong Kong and a hedge fund in Bermuda. All your bank does is service the mortgage (send you a bill and collect your payments). So in reality, just by purchasing a home, you tap the credit markets around the globe to borrow money. Who knew?

So now lets look at the role businesses play in this mess. We touched on why banks don't keep your loans. In truth, they keep the ones they can't sell, and maybe they hold onto some of the best ones too. But mostly they need to sell them so they

can get money to make more loans. And why do banks make these loans? Fees. Businesses are only slightly different. They are anxious to lend you money so they can sell you more stuff. Some of them are clever enough to start their own finance companies so they too can collect fees. But to be sure, they sell them to Wall Street so they can get paid for the stuff they sold you. And the lower the rate they give you to entice you to buy, the more stuff they sell. Credit card companies do the same thing for the same reason - fees.

So now can you guess Wall Street's motivation? Fees of course. They buy all these loans from banks, retailers and credit card companies, package them and carve them up into CMO's, CDO's and a few other alphabet names, and sell them to their customers. Not only do they hope to sell them for more than they paid, but they get a commission as well. And who gets left holding the bag? The investors that ended up loaning you money but have no idea who you are. We will discuss this in a bit.

The last piece of this ballooning debt puzzle is Central Banks. The Federal Reserve, the European Central Bank and the other central banks around the globe set interest rates for their respective economies in an attempt to achieve

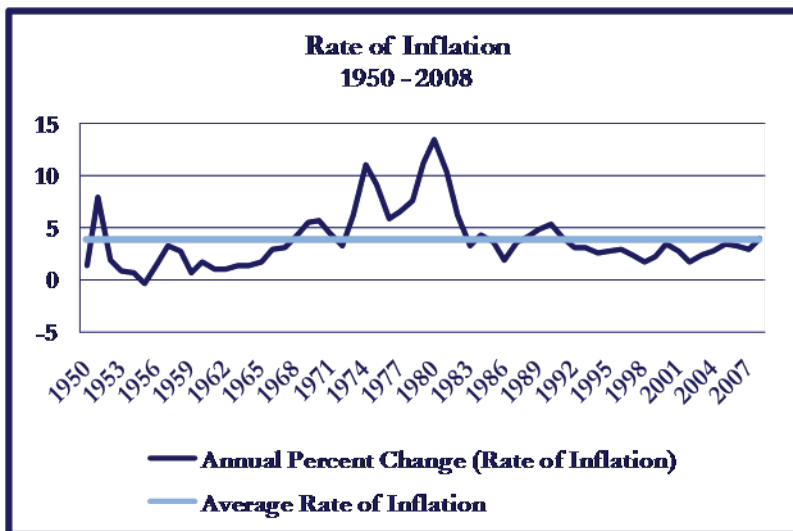
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DEBT (CONTINUED)

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the opposing outcomes of steady growth and low inflation. This is often a delicate balancing act, and one that they got wrong earlier this decade. Why do we consumers willingly borrow all this money? Is it because we are so easily tempted by a lure a 50 inch plasma TV? Maybe. But would we be as tempted if the interest rate were 10% instead of 0%? At least we might be inclined to *think* before we assumed more debt. The real answer is that we borrow because we can afford to. And we can afford to because rates remain low while the economy is healthy.

So where should rates be? As long as recession remains a concern, they will likely remain low. But the inflation chart to the right indicates that inflation is creeping back up toward the historical norm. Low rates fuel economic growth, which fuels inflation. If the economy emerges healthy (as we believe it will), rates need to go up quickly because inflation will continue to rise.



Data provided by the Federal Reserve Board website www.federalreserve.gov

When inflation rises in a healthy economy, central banks take action by raising the interest rates they control in an effort to slow down consumption (making it more expensive to borrow). But there are market forces at play as well. Think back to all the global investors stuck with a bunch a junk alphabet bonds. Do you think they will buy more at current interest rates, or is it more likely they will demand a higher interest rate on future purchases to compensate for the risk they are taking? They will no doubt expect greater compensation. Simultaneously, holders of these things want out. But they can't sell them for what they paid because no one else wants them. When the price of a bond (and these alphabet things are bonds) falls, the interest rate rises. Lets take an example. You invest in a bond and get an interest rate payment of 4%. You decide to sell your bond, but buyers demand 5%. How do you make that happen? The issuer of the bond is contractually obligated to pay only 4%. You must make up the difference by lowering the price of the bond you own. You paid \$1,000 for your bond, and you get \$40/year in interest. That is 4%. But a new buyer wants 5%. So he is only willing to pay you \$800 for your \$1,000 bond. At \$800, the \$40/year payment equals 5%. Now this is a gross oversimplification because it discounts the fact that the new buyer will get \$1,000 when the bond matures. But it serves

as a useful example.

So there are two forces at work that in our view will cause rates to rise - Central Banks responding to inflation and the market reacting to the excesses of the recent past. Therefore, our investment opinion for this sector is cautious at best. We have deferred purchasing bonds for our clients who desire to own them because we believe higher rates are inevitable. We own bonds primarily to preserve principal, and as the example in the preceding paragraph illustrated, principal is eroded when rates rise. So for our bond investors, be patient. We will put your cash to work eventually.

As a rule, we do not invest in CD's, but some of our readers do. We advise that you not do so at this time. Locking in rates right now is not advisable in our opinion. CD's have further risk because they are guaranteed by banks, and we are concerned about the health of banks. Remember that banks sell the loans they can. That leaves them holding some bad ones. While we do not mean to imply that the banking system is unstable, we do believe some will fail. In the late 1980's and early 1990's, over 1,000 banks failed during the S&L crisis. Our economy was fine, there was no panic. But for those with deposits at failed banks, they learned that the FDIC promises to return your money. It just doesn't promise when. Having faith in your bank is a good thing. But Ronald Reagan said it best when he verbalized his policy toward the Soviet Union as "Trust, but verify". If you can't verify that your bank is healthy, think before you assume.

We feel the same way about money market funds. We have reviewed the holdings of the money market funds we use for our clients, and we believe them to be safe. But there are many funds out there investing in questionable assets in order to attract investors by offering a higher rate of return. In general, if a rate seems too good, it is.

Muni Bonds don't tempt us either. While we are certain that there are some very good opportunities in the municipal bond market, we would rather wait. There have been reported instances of municipalities getting themselves into trouble by taking on exotic risks that they didn't fully com-

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DEBT (CONTINUED)

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prehend. As a result, some municipalities could be at risk of default. Further, muni-bond insurance isn't terribly comforting these days, as the insurers are on the verge of bankruptcy. It is too difficult to discern good bonds from bad.

We believe the return to bond investors doesn't justify the risk. And there are many forms of risk, some not so

obvious. Obviously there is risk that the bond issuer can't pay investors back. We do not predict that this problem will be widespread. But the other risks worry us. First, there has been so much debt issued over the last several years that we fear investors may be leery of investing in even more at present interest rates. Second, we believe that inflation will force rates higher, thereby eroding investor principal.

Reviewing the history of bond yields tells us current

rates are historically low. The graph below depicts the yield on the 10-year U.S. Treasury Note - a very safe investment. One can easily see that we remain well below the norm. This situation will ultimately correct itself. As our regular readers now know, *"it is never different this time"*.

Our forecast of higher interest rates makes us averse to any investment that offers a fixed rate of return. We believe that fears of a deep recession are overblown and



Data provided by the Federal Reserve Board website www.federalreserve.gov

that rates will return to historically normal rates. When that happens, we will again buy bonds for our balanced and fixed income investors. Until then, we prefer to use money market as our investment vehicle of choice. Money market rates mirror overall rates - if interest rates rise, money market rates will

rise as well, without eroding principal. We have enjoyed a declining interest rate environment since the early 1980's, and in our view, the pendulum has now reversed. Ultimately, this is good news for retirees looking for a higher, more predictable rate of return.

ALTERNATIVE ASSETS

The Alternative Assets class has exploded on the scene in the last ten years. What was largely an afterthought a decade ago is now a major recipient of institutional investment dollars. Indications are that investor appetite for alternatives will continue to grow.

Alternatives are essentially defined as anything other than equity (stocks), fixed income (bonds) and real estate. They include Hedge Funds, Private Equity, and Commodities. We have devoted considerable press to Hedge Funds in recent issues, but they belong front-and-center in any bubble discussion. Hedge Funds are in and of themselves not "investments". They are vehicles (typically private partnerships) through which a variety of investments are made. Some of the brightest minds on Wall Street create these funds to raise capital from "sophisticated" investors and invest as they see fit the money they raise. Some funds specialize in a particular market like stocks, bonds or commodities. Others venture into any area they choose. There are few restrictions and exorbitant fees involved. And most importantly, they use borrowed money to increase the size of the bets they place. In fact, some funds that have recently failed borrowed more than 30 times the amount of money investors contributed to the fund. That is *huge* leverage, and as we pointed out in the last issue, borrowed money can lead to both substantial returns and substantial losses. Before we revisit this, let us touch briefly on

another investment vehicle that has recently fallen off the front pages.

Private Equity Funds experienced a painful bursting of their bubble with the onset of the credit crunch. Private Equity funds are similar in structure to hedge funds, yet their mission is different. They use the capital they raise in combination with borrowed money to acquire companies, operate them as private entities (hence "private equity"), increase their value and then sell them. This is a perfectly reasonable strategy, yet they fell victim in large part to their own success and popularity.

Historically, returns have been extraordinary for Private Equity funds. As a result, more and more were created, attracting massive sums of money from investors seeking astronomical returns. The crowding of this space brought two problems. First, they all borrowed money. When the credit crunch came, with so many funds competing for lenders to provide dollars to finance their deals, lenders quickly became overextended and retrenched. Second, when the space was less crowded, there was a market for the companies Private Equity sought to sell. As more and more PE firms tried to sell their portfolio companies, investors were saturated. Both the lending market and the end market for their companies dried up at the same time.

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ALTERNATIVE ASSETS (CONTINUED)

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We believe trouble looms for Hedge Fund investors as well. Much like real estate and Private Equity, Hedge Funds, in our view, will ultimately succumb to the greater fool phenomenon. In the mean time, they influence today's markets with large sums of borrowed money. The net effect of the proliferation of hedge funds is a lack of talent to run them all. The best and brightest no doubt can navigate through these turbulent times successfully. But we question the abilities of some of the less talented managers drawn to the industry by the riches a Hedge Fund manager amasses. This could spell trouble for those who invest in these second tier funds tempted by the track record the industry established when there were fewer players.

Hedge Funds can invest in virtually anything they choose, but their demand for debt instruments before the credit crunch was insatiable. In some sense, their demand created even more borrowing, which means they contributed to the credit bubble. Wall Street was eager to package as much debt as it could to sell to their Hedge Fund clients, and banks and other lenders were more than

happy to oblige. By the end of summer, 2007, the last fool had arrived. The demand to buy these loans dried up overnight. Because these bonds couldn't be sold, it was impossible to determine their value. Lenders to major funds and firms (Bear

Stearns) that held this debt on their books got nervous and demanded new collateral that could be valued. For firms that couldn't meet these demands, failure was inevitable.

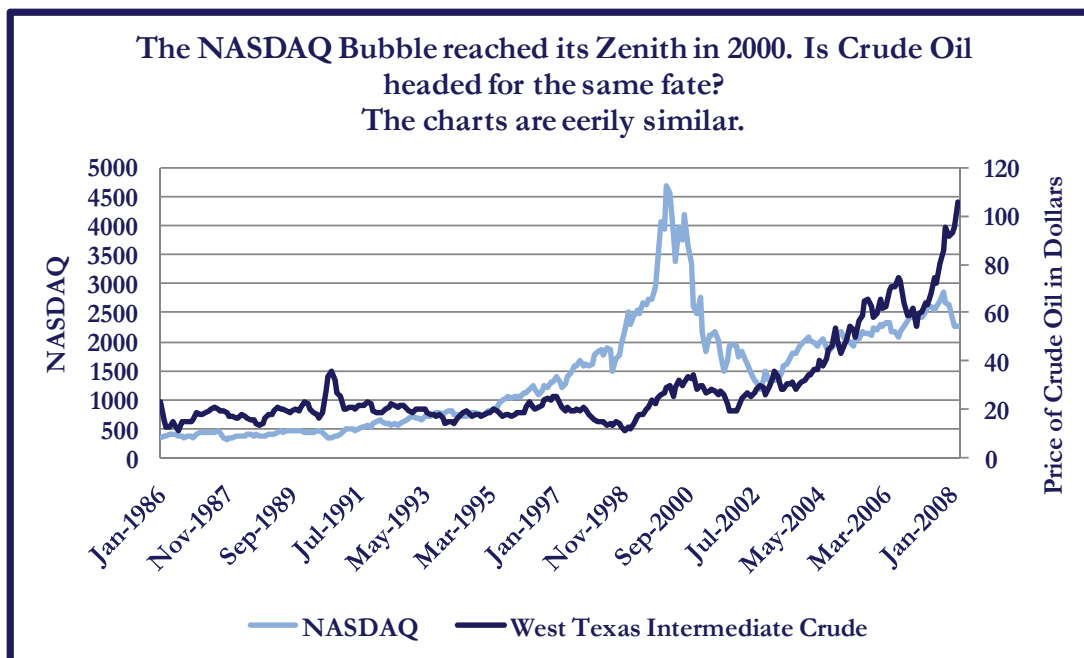
Those funds savvy enough to avoid the credit debacle had to find a new game to play. The commodity markets looked ripe for the picking. Developing nations around the globe like China and India were placing a considerable strain on world markets due to their increased demand for natural resources and food. Commodity prices have absolutely exploded this year, fueling inflation fears. But this rise isn't simply because of an increase in demand for the products. The biggest contributor to this new bubble is the increase in speculators (chiefly Hedge Funds). Commodity

markets, relative to stock and bond markets, are very small. When the flood of leveraged Hedge Fund money came pouring in, the markets were overwhelmed, and prices rose dramatically.

Certainly there are fundamental reason for commodity prices to rise. The use of corn to make ethanol has caused the price of corn and grains to rise. This new demand for corn to produce energy has caused the price of corn to jump. Farmers, being smart capitalists, have planted more corn at the expense of other crops. If there are fewer crops to supply the world, the price of the now scarce crops also rises. Corn-based ethanol has contributed to food price inflation. This is clearly not sound government policy. Nonetheless, speculators, led by the Hedge Funds, have plowed into these markets. The result is distorted demand - not for the commodities themselves, but for the financial contracts that represent the commodities.

Increased speculation in commodity markets has caused prices to be artificially inflated and unsustainable. Like every other bubble we have discussed in this issue, the commodity story will end badly. Using Crude Oil as

a representative of commodity prices in general, we compare a price chart of crude oil to a chart of the NASDAQ (home of the dot-coms). The chart to the left shows a disturbing similarity. Our conclusion is that the crude (or commodities in general)



bubble bursts in similar fashion. And notice, please, that the NASDAQ peaked in 2000 near 5,000. It remains below 2,500 to this day. We think a reasonable price for a barrel of crude oil is somewhere between \$65 and \$75/barrel. At the end of March, it traded at over \$100/barrel.

It is not our intention to indict all Hedge Funds. In general, they provide an important vehicle for investors to diversify risk. Most are well-run entities providing outstanding returns to sophisticated investors. Rather, we find fault with those investors that dismiss risk in pursuit of the latest hot returns. Bubbles are created when too many dollars chase a limited asset without regard to price. We have a fourth bubble.

INTERNATIONAL INVESTING

We believe this is the fifth, and final, bubble of this remarkable bubble era. U.S. investors who have fled our shores in droves seeking higher returns in foreign stock markets have been rewarded. But not necessarily for the reasons you might expect.

It would be foolish to assume that the best investments reside exclusively within our borders. Other economies

are growing, becoming more capitalistic and profiting as they create enterprises that can successfully compete with our own companies. Yet the biggest returns to U.S. investors have been derived simply because they didn't invest in U.S. dollars.

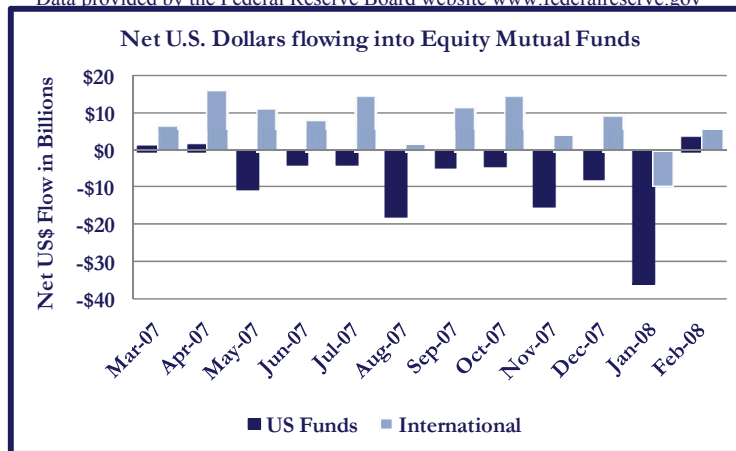
The U.S. Dollar (represented by the dollar index) has been in a steady but steep decline since 2002 (see chart above). This has rewarded investors that have sold dollars to buy other currencies. Foreign stocks trade in the local currency, so for an international mutual fund to invest overseas, it converts dollars to the currencies of the countries it invests in. An example may be useful.

Hypothetically, a fund wishes to buy a German company trading on a German stock exchange. It must first convert dollars to Euros. Assume an

exchange rate of one dollar for one Euro. With one Euro, the fund buys one share of German stock and holds it for one year. The stock remains at a price of one Euro and the funds sells it. During the year, the dollar has declined relative to the Euro, and now one Euro buys \$1.25. Even though the stock did absolutely nothing, the fund realized a gain of 25% just through the dollar's depreciation.



Data provided by the Federal Reserve Board website www.federalreserve.gov



Data provided by the Investment Company Institute website www.ici.org

We believe the dollar is close to a bottom. Even if it doesn't rise, the wind at the back of overseas investing will be gone. If the dollar actually appreciates from these low levels, gains through international investing will be difficult to achieve.

The trend of U.S. investors eschewing domestic investments in record numbers has no doubt contributed to the dollar's descent. The table to the left shows the dramatic difference in money flows between U.S. stock funds and their international counterparts. In the twelve months shown, total money going into International funds exceeded \$93 Billion, while money leaving U.S. funds topped \$90 Billion. During this period, the dollar declined by more than 9%. We believe this imbalance will likely end soon, deflating yet another bubble.

THE U.S. STOCK MARKET

The U. S. stock market was the first bubble, popping in 2000. The S&P 500, a measure of large stocks, lost half its value by the end of 2002. But the real bubble was in the NASDAQ (an index comprised of more speculative stocks). The dot-com debacle ended with the NASDAQ losing about 75% of its value. At quarter's end, the S&P 500 remains about 13% below its all-time high in 2000, but the NADAQ is still half its peak value.

The hangover from a bubble takes years to wear off. As a result, there is little enthusiasm from potential new buyers. Since 1950, the S&P 500 has averaged a 124.9% increase for a ten-year period. For the ten year period just ended March 31, the S&P is up only 20.05%. Without question, this has been a very challenging decade for Tandem, our clients and stock investors in general.

The post-bubble stock market found other headwinds

as well. First, the dollar's decline (see chart of the dollar index above) has incentivized both foreign and domestic investors to look abroad. We discussed this effect on stocks in greater detail in the International Investing segment. Second, for those who got caught in the real estate and credit bubbles, they may not have the money available to return to the stock market, if they were so inclined. Third, the market's decline earlier this decade was so severe that many no longer have the stomach for the market. Remember, prices go up and down because of supply and demand. If there is limited demand for stocks, it is difficult for their prices to rise.

Perhaps most importantly, large institutions have diversified away from stocks. As the returns in the stock market faltered, assets previously invested in stocks were re-

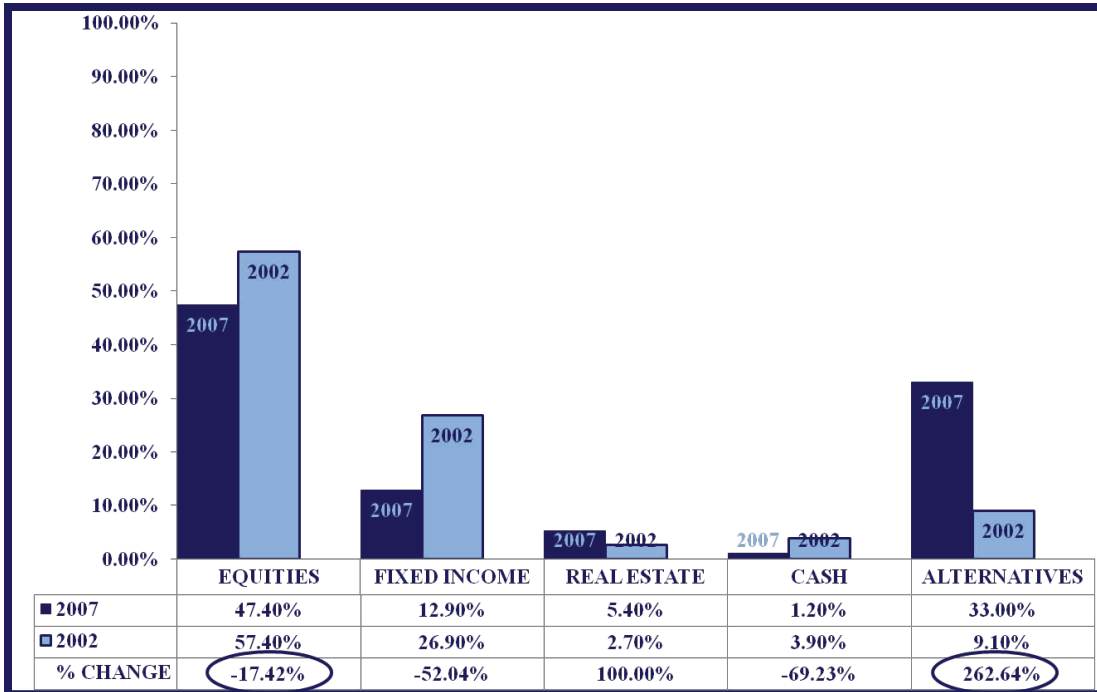
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THE U.S. STOCK MARKET (CONTINUED)

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allocated to other areas, chiefly alternatives. This reallocation has resulted in ongoing selling pressure as stocks must be sold in order to fund investments in new areas. The

performs well during inflationary times, but we do not expect this to be the case from current price levels. The same is true of commodities. So, essentially, stocks win by default.



Data provided by the National Association of College and University Business Officers (NACUBO) website www.nacubo.org

chart above illustrates the dramatic shift that college and university endowments have made in just the last five years. The average stock allocation was 57% on 2002. It is only 47% now and declining. Alternatives, on the other hand, have gone from a mere 9% allocation to fully one-third (see alternatives bubble conversation on page 6). Endowments tend to be more conservative than other large pools of money, so imagine what the rest of the big players are doing.

Because of, rather than in spite of, these significant headwinds, we are more optimistic about stocks than we have ever been before. If you have read the entirety of this report, you know that we are surrounded by bubbles everywhere. But not the stock market. There is certainly no bubble here. Where else can investors turn and not be afraid they will get blown-up? That already happened eight years ago.

We believe that all the other bubbles resulted from low interest rates brought about by the recession resulting from the stock bubble. As rates rise, other areas become less attractive. Higher rates increase borrowing costs and strengthen our dollar. Increased borrowing costs make bonds and alternatives (remember the amount of leverage they use) less compelling. A strengthening dollar brings investors back home, while attracting foreign investors as well. One of the few investments that is poised to do well in a rising rate environment is stocks. Traditionally real estate

Some worry that we are in a bear market. Perhaps we are. However, we do not view the current negativity as being a stock market event. Stocks have been sold because a) they can be, and b) people are scared. Yet stocks entered this sell-off from a very cheap level to begin with. Price/Earnings Ratio (PE) is a common measure of how expensive stocks are. The higher the PE, the more expensive stocks are deemed to be. At the market bottom in 2002 (after a 50% decline), the S&P 500 had a PE of 31.89. On September 30, 2007, before the recent sell-off began, the S&P had a PE of only 19.42. Clearly stocks aren't being sold because they are

too expensive.

Some worry about a recession and its impact on corporate earnings. Perhaps this too is a valid concern. But again, we believe stock prices already reflect pessimistic expectations. Some of the greatest investments in history have been made at precisely the time when no one else believed there was hope. Clearly, investors have not been holding out a lot of hope for stocks lately.

It is our conclusion, as we assess the landscape, that all of the trends that have been conspiring against stocks are closer to their end than their beginning. It is a little late in the game to be shifting away from stocks, so we anticipate that the headwinds will dissipate. We cannot predict a timeframe for the re-emergence of stocks as the preferred vehicle. History tells us that the greatest rewards come to the early few. No one can confidently say "that was the bottom, it is time to buy". We simply argue that stocks represent the only true value out there, so it is time to be optimistic.

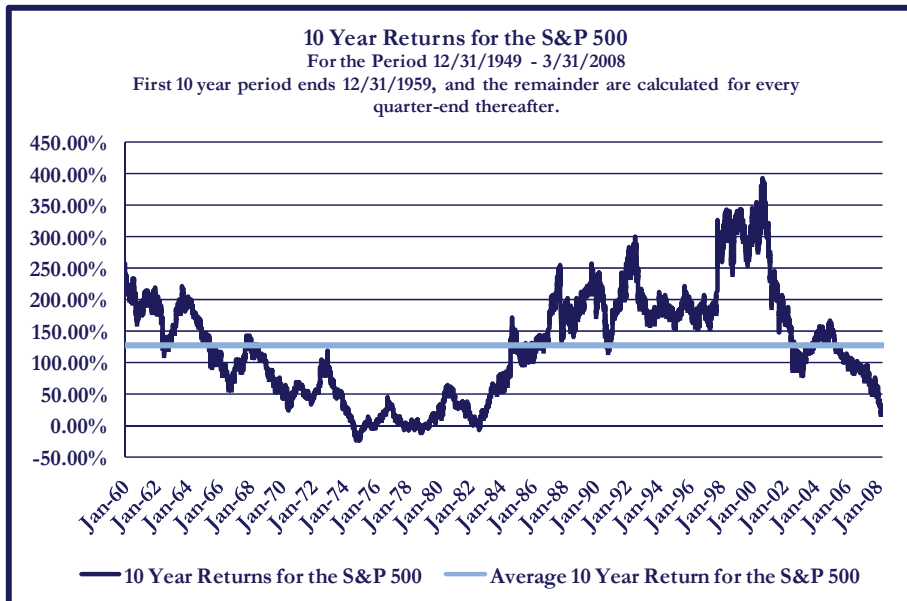
As our readers well know, we place stock (no pun intended) in history. History tells us that the returns for U.S. stock investors in this decade have been well below normal. That trend will surely reverse itself at some point. The chart at the top of the next page traces the 10-year returns for the

(Continued on page 9)

THE U.S. STOCK MARKET (CONTINUED)

(Continued from page 8)

S&P 500 from 1950 (the first 10 year period ending 12/31/1959) through March 31st. We are well below average. In fact, we are so far below average that even if the S&P 500 appreciates 30% by the end of the decade, the 2000's will still be the worst decade since World War I (the 1970's presently hold that dubious distinction). Just to get back to average, the S&P would need several years of double-digit returns.



So here is what we boldly anticipate. We expect: the dollar to strengthen, the global economy to slow, interest rates to rise, investors to decrease allocations to alternative investments as bubbles there burst, and investors to move away from international stocks and into U.S. stocks. If we are right, we expect a long, sustained rally in U.S. stocks, and

particularly growth stocks, until we once again find that U.S. stocks are overvalued. But that will take some time.

COMMENTARY

This issue of *The TANDEM Report* was quite an undertaking. We hope you have derived some benefit from it. We have laid out our position, and find ourselves more optimistic than we have ever been. We learned a lot from this exercise, and can assure you we will *not* be repeating it soon. We promise to return to our regular format in July.

In the meantime, we found the quarter just ended to be extremely challenging, yet strangely rewarding. Challenging because we have worked hard to preserve your principal while navigating through the turbulence. We were not immune to losses, but did manage to minimize the effects of the market on your portfolio. Rewarding because TVM has come through a major challenge with flying colors. Many of our TVM purchases, like Praxair, Jacobs Engineering and Aptar, have provided handsome *positive* returns. More importantly, our TVM sales caused a reduction in

areas like financials *before* disaster struck.

You have likely observed an increase in activity. Since last spring, we have correctly anticipated much of the volatility that has unfolded. We felt compelled to lock in some profits while jettisoning other stocks we grew concerned about. In the last twelve months, the environment has changed significantly. These are truly once-in a-lifetime events that have hit us in succession. As a result, we adopted a more active approach as we repositioned your portfolio. We have not changed how we manage portfolios. We simply adapted to the environment. As volatility returns to normal, so too will our activity.

Thank you for your support of and belief in us as we have navigated challenging markets. Hopefully, the good times are just around the corner.

TANDEM NEWS

Please join us in welcoming Jameson Pyle to the Tandem fold. Jameson interned for us for several months in our Charleston office, and in January, we officially brought him on board. He works part-time as a research associate for Billy Little. He assists Billy in the daily management of TVM and the research of the companies TVM rates buy or sell. Jameson is a 2007 graduate of Ohio Wesleyan University with a BA in Journalism and a minor in Economics Management. You can reach him via e-mail the same way you reach all of us - *first initial last name @ tandemadvisors.com*, or more specifically at *jpyle@tandemadvisors.com*. He has already proven to be a valuable addition.

There is some exciting news on the nuptials front as well. Billy Little will wed Lauren Worthington in June. Billy has been a vital member of the Tandem team since he joined us in 2006. Beginning as a research associate, he is now a Portfolio Manager. He has risen in stature and importance because he has earned every bit of it. Billy is responsible for the day-to-day operations of TVM and the associated research and portfolio management that results from it. In addition, he is scheduled to sit for his Level II CFA exam in June. Wow, that's a busy month. You can reach him at *wlittle@tandemadvisors.com*.

Contact Information:

Tandem Investment Advisors, Inc.

145 King Street
Suite 225
Charleston, SC 29401

(800) 303-8316
(843) 720-3413

or

PO Box 4545
Charlottesville, VA 22905

(800) 527-0101
(434) 979-4300

www.tandemadvisors.com

MARKET REPORT CARD

YIELD TABLE				STOCK MARKET INDEX DATA				
	Current	3 months ago	1 year ago	Stock Market Indices	3/31/2008 Close	% Change 1 Year	% Change 5 Years	% Change 10 Years
3-month Treasury Bill	1.37%	3.25%	5.03%	S&P 500	1,322.70	-6.91%	55.95%	20.05%
5-year Treasury Note	2.74%	3.28%	4.54%	Russell 3000 Growth	2,429.61	-1.45%	62.96%	13.63%
10-year Treasury Note	3.60%	3.90%	4.65%	DJ Industrials	12,262.89	-0.74%	53.44%	39.35%
30-year Treasury Bond	4.41%	4.35%	4.84%	NASDAQ 100	1,781.93	0.54%	74.93%	45.98%
Prime Rate	5.25%	7.25%	8.25%	Russell Mid-Cap	5,134.07	-8.92%	112.87%	109.06%
Federal Funds Rate	2.25%	4.25%	5.25%	Russell 2000	687.97	-14.08%	88.72%	43.12%
Discount Rate	2.50%	4.75%	6.25%	GLOBAL MARKET INDEX DATA				
3-Month LIBOR	2.70%	4.68%	5.35%	Hang Seng	22,849.20	15.39%	164.62%	98.37%
				Shanghai	3,472.71	9.07%	129.89%	NA
				Nikkei 225	12,525.54	-27.55%	57.11%	-24.21%
				Brazilian Bovespa	60,698.00	33.10%	440.78%	410.32%
				London FTSE 100	5,702.10	-9.61%	57.81%	-3.88%
				German Xetra DAX	6,534.97	-5.52%	169.61%	28.20%

The data used to compile the above tables come from publicly available sources. Tandem believes it to be reliable, but makes no such assertions. Such data is not meant to imply past or future performance for Tandem or any securities market.

