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ECONOMIC UPDATE

John C. Beuerlein
*Managing Director,
Chief Investment Officer*

Fed actions limit economic slowdown

SUMMARY:

Economic growth is slowing and, despite aggressive moves by the Federal Reserve, the double difficulties of the deflating housing bubble and tightening credit conditions are increasing the chances that there will be a slowdown across the rest of the economy this year. However, the Fed's aggressive actions should limit the severity of the economic downturn as the markets are expecting another 0.50% cut in the Fed Funds rate by the middle of summer. Investors perceive that many unknown and un-priced risks remain, thus keeping pressure on the financial markets. Uncertainty is the key characteristic of today's credit markets. Concerns caused by the housing problems and disruptions in the financial markets are being offset to some degree by the aggressive actions being taken by the Federal Reserve and Congress.

The first sign that the recovery is developing will be an improvement in the credit markets. The sooner that the financial sector recognizes losses associated with the various forms of securitized loans, the sooner the credit markets should begin to function more normally. Unfortunately, it will be difficult to assess losses until the housing market stabilizes. The U.S. economy is working through a de-leveraging process that will extend through the year and make the subsequent economic recovery slow to evolve. However, the aggressive moves by the Federal Reserve to add liquidity should cushion the severity of the economic slowdown.

The economy is expected to continue in its low-growth mode into the second half of 2008, based upon Leading Economic Indicators. The impact of the current liquidity crisis solidifies the likelihood of sub-par economic activity into the summer of 2008. It is important to note that the operating earnings of the S&P 500 for the fourth quarter of 2007 were divided between weak financial and consumer discretionary results, and relatively strong results from the other eight economic sectors. Earnings expectations going forward do remain subdued, however. Leading indicators in most developed countries are now pointing to slower growth in 2008. World growth is being downgraded to 3.5% - 4.0% due to the on-

going disruptions in the global credit markets and the increased scrutiny being employed by lending institutions. Central banks in England and Canada are responding to the prospect of slower growth by lowering interest rates. In this report, we have provided statistics that are current as of March 31, 2008.

Market Volatility

The credit and equity markets have opened 2008 with increased uncertainty and volatility. According to a study by Standard and Poor's, the U.S. stock market is the most volatile it has been in 70 years when employing the S&P 500 as the proxy for the overall U.S. market. The S&P 500 Index has advanced or declined one percent or more in more than 50% of the trading sessions to March 31. This is the highest percentage since 1938, when the S&P 500 advanced or declined by at least one percent during 57% of the trading days that year. For the record, the market advanced 25% that year.

The increased volatility is a reflection of the uncertainty that pervades the markets. On one hand, fear surrounding the weakness of the economy, the deterioration of the housing sector and the reduced liquidity of the credit markets is creating the general disruption within the financial sector. On the other hand, the Federal Reserve has aggressively supplied liquidity and initiated avenues for investment banks to access liquidity directly, while Congress has enacted a fiscal stimulus package and is exploring further measures to stabilize the housing sector.

Inflation

Inflationary pressures are increasing on a global basis and efforts to slow inflation mean slower growth in many countries. In the U.S., however, the Fed is more concerned about credit market issues and a slowing economy. On a year over year basis, the Consumer Price Index (CPI) was up 4.1% through February and the Producer Price Index (PPI) was up 6.8%. Headline inflation pressures are being reported at elevated levels due to recent strengthening in gasoline and crude oil prices. On the other hand, core inflationary pressures remain relatively contained. For the 12 months ending February, the Fed's preferred measure of inflation, the Core PCE (Personal Consumption Expenditures Price Index), is at 2.0% - the upper bound of the Fed's target range for inflation. Core CPI is 2.3%, and Core PPI is 2.5%. With core rates near the Fed's targeted range against a backdrop of a slowing economy, the Fed will likely concentrate more on resolving the disruptions in the credit markets than inflationary pressures. Inflation is more likely to fall than rise in an environment of deflating house prices, credit market stress, and weakening economic activity.



Employment

After averaging gains of 175,000 new jobs per month in 2006, employment gains in 2007 slowed to an average of 91,000 per month. The average job gain in the past 6 months has been 40,000. The first two months of 2008 have witnessed a decline in payroll employment of 85,000 jobs. Year over year payroll growth, which peaked at 2.1% in early 2005, is currently at 0.6%. Initial unemployment claims have stopped declining and are beginning to move higher. The Fed is paying close attention to initial employment claims, as they are a forward-looking indicator of developing employment weakness. Contraction in employment is a reliable indicator of a recession.

Corporate Profits

Even though operating earnings in the fourth quarter of 2007 declined sharply from the previous year, it is likely that earnings could improve in the fourth quarter this year, given the Fed's aggressive steps to increase liquidity. Fourth quarter 2007 S&P operating earnings were 30.8% lower than the prior year same period, making this the worst quarter since the fourth quarter of 2001. This number is skewed to the downside by the weak results in the financial and consumer discretionary sectors. Financials remain the most at-risk sector. Earnings, other than those of Financials, were up 12.1% in the fourth quarter of 2007. Financials are the most heavily weighted sector in the S&P 500, and thus their weakness results in a disproportionate impact to the overall index.

Despite lackluster results from Financials and certain areas within the Consumer Discretionary segment, the majority of the remaining sectors (Technology, Health Care, Energy, Industrials, Consumer Staples and Utilities) have been sufficiently robust to record double-digit profit expansion for the fourth quarter. Earnings expectations have declined sharply over the past six months however. At the end of the third quarter of 2007, expectations for the fourth quarter of 2007 were earnings growth of 10%. As mentioned above, the actual number was off by 30.8%. Consensus estimates indicate that fourth quarter of 2007 was the trough for earnings. Even if that is correct, a likely scenario is for the earnings recovery to be slow. Economic activity, typically, does not start to improve much until liquidity actually expands – and profit growth typically follows the improvement in economic activity.

Interest Rates

The disruptions in the credit markets over the past three quarters can easily be seen by looking at various credit spreads. Spreads started to widen in the second quarter of 2007 and have continued to widen in response to the slide in economic growth expectations and ongoing disruptions in the credit markets. Wider spreads are an indication that investors are demanding higher interest rates to compensate them for taking on additional quality risk. In other words, no one wants to own anything but the safest of credit instruments (Treasury securities) unless they are paid to assume higher risk via higher yields.

Since 1990, the average spread between 30-day Libor and the Fed Funds target rate has been 17.8 basis points (a basis point is 1/100 of 1%). In early December 2007, this spread spiked to 75 basis points. Additional credit facilities initiated by the Fed enabled this spread to return to historically normal levels during the first two months of 2008. Recently, however, the spread has started to widen again and by the end of the quarter was at 45 basis points. The spread between nonconforming mortgages and conforming mortgages is the widest it has been in the past 10 years. The average spread is about 25 basis points (nonconforming over conforming).

Near the end of the quarter, the spread was 204 basis points. With the announcement that the lending limits of Fannie Mae and Freddie Mac are being lifted, it is expected that there will be some tightening in this spread. The current spread between corporate debt rated BAA (the lowest tier of investment grade rated debt) and 10 Year Treasuries is the widest it has been in the past 20 years, with the exception of a couple of months in late 2002.

The tightness in the credit markets is reflected in the recent Senior Loan Officer Survey conducted by the Federal Reserve. It indicated a general tightening of lending standards in the major loan categories. Of particular interest is the sharp tightening of lending standards in commercial real estate. This area has been an area of relative strength, but if credit becomes less available, this sector may also become a drag on economic growth. The Senior Loan Officer Survey also points out a problem that the Fed is facing – although the Fed is aggressively expanding liquidity, borrowing is becoming more of a challenge as standards are tightened simultaneously.

Housing

The softness in the housing sector continues to detract from overall economic growth and is likely to persist throughout 2008. Up until now, some of the weakness in the housing sector has been countered by strength in non-residential fixed investment, but the continued slowing of the economy and the tightening of the credit markets may result in weakness in commercial construction, as well. The fourth quarter GDP report indicates that this may be starting to occur. In the fourth quarter of 2007, the weakness in the residential sector outweighed the strength in the non-residential sector. Over the past two years, housing starts have fallen 61%. New home sales have contracted 57%. During the same time, the median new home price has fallen 14%. Homebuilders are reducing prices and adding incentives to move inventory. Inventories remain elevated, however.

Affordability has shown some improvement as home prices have fallen and incomes continue to grow. The most likely way that affordability will continue to improve is via steady movement to lower prices over time coupled with further income growth. The tightening of lending standards for all types of mortgages creates another hurdle for the industry to overcome as it works its way through the excess inventory.

Stock Market

The Financial sector typically is one of the leading sectors in a market advance. Throughout 2007, the Financial sector was the weakest sector in the market – thus providing some forewarning of the issues we now encounter. Since mid-January, however, the Financial sector has stabilized as the market has bounced off its lows. It is too early to say that leadership by the Financials will develop, but it is unlikely that there will be a sustained market advance without participation and leadership from the Financial sector.

During 2007, equity markets were in a 10% - 12% trading range. Lows of the range were established in February and August, while the highs were reached in July and October. This trading range was effectively violated to the downside on January 8th as investors' concerns about the possibility of recession increased substantially after a number of economic reports came in weaker than expected. The heightened volatility that we have experienced in the equity markets since August reflects a tug of war between the impact of increasing liquidity from the Federal Reserve and the concerns surrounding the continued disruptions in the credit markets and concerns about the weakening economy.



REFLECTIONS ON THE MUNICIPAL BOND MARKET

James Rovner, CFA
Senior Investment Officer



The normally staid world of municipal bonds has received significant attention in recent months as municipal bond insurers have come under increased scrutiny. One result has been heightened volatility in the municipal bond market. An additional consequence has been a marked increase in the relative investment attractiveness of municipal bonds as fixed income investments.

Tax-exempt entities that issue municipal bonds at times purchase credit enhancement insurance from third party providers if the tax exempt entity does not have a AAA credit rating standing on its own. The tax exempt entity pays a “fee” or “premium” to the insurer and, because the insurer now promises to pay in the event the tax exempt entity can not, the bond is viewed by the credit rating agencies as carrying the credit rating of the insurer. Since the debt now has a higher credit rating, this allows the issuer to pay less interest on its debt and has worked well over the years. Municipal bonds rarely default and therefore borrowing costs are reduced.

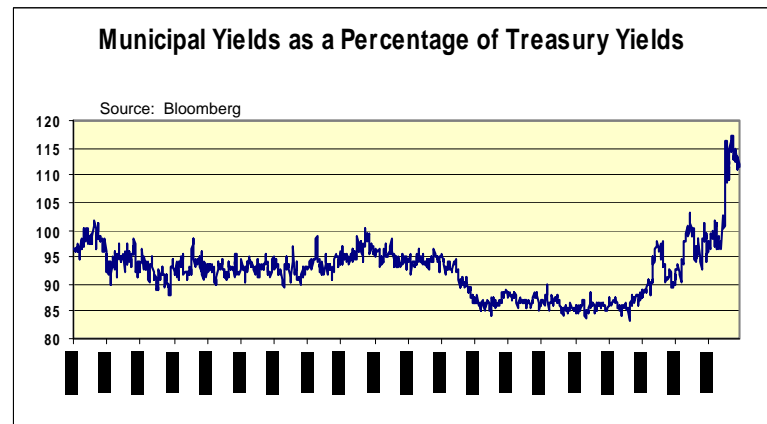
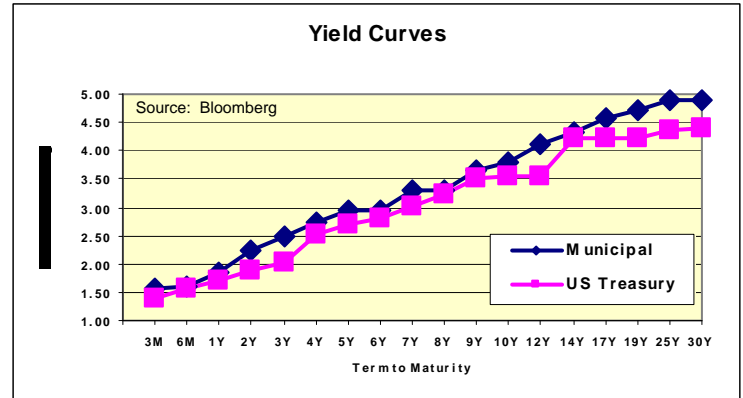
What has happened recently is that the municipal bond insurers, sometimes referred to as monolines, have also begun to insure non-municipal debt instruments. On some of these non-municipal debt instruments, the insurers are incurring major losses and write-downs.

While this does not affect the underlying credit of a particular municipal bond, the possibility exists that the insurance companies could lose their AAA rating. Although we do not believe this is likely to happen, if the monolines lose their AAA rating, the bonds they insure will revert to the higher of their underlying rating or the new monoline rating.

Our disciplined practice at Marquette Asset Management has always been to invest only in high quality bonds for client accounts (unless specifically directed otherwise). Moreover, we regularly monitor account holdings we manage. When we invest for our clients, we look at the underlying rating of the issuer to verify its investment quality and creditworthiness; we do not simply rely on credit enhancement insurance an issuer obtains.

The turbulence in the municipal market has also created opportunities. What we are seeing is the “throwing out the baby with the bathwater” effect. Many funds have been forced to liquidate municipal holdings, regardless of quality, as they reduce the leverage employed in their portfolios. In addition, Treasury yields are depressed due to a flight to quality. Finally, the supply of has longer-term municipals has increased as the demand for short-term instruments decreased.

Municipal bond yields relative to U.S. Treasuries are at historically attractive levels (see Charts). Chart 1 shows that AAA municipal bonds have higher yields than Treasuries over the entire curve. Chart 2 shows the measure of 20-year municipal yields versus a similar 20-year Treasury. Municipal bonds are yielding about 110% of Treasuries.



For the long-term investor who usually holds bonds to maturity, this presents a significant opportunity. A recent example:

	Pre-tax Yield	After-tax Yield
<u>10 Year Maturity</u>		
US Treasury	3.50%	2.35%
AAA Municipal	3.75%	3.75%

The after-tax return on the Treasury is 2.35% (assuming highest Federal tax bracket). The municipal bond provides the investor with a 3.75% after-tax yield or a pick up of 1.40%. We at Marquette Asset Management are methodically taking advantage of the situation to increase yields without taking on additional risk for our clients.

Certain short-term municipal paper has been affected as well. Yields of certain short-term instruments have jumped substantially, but at the cost of potential liquidity. We do not believe that the incremental return is worth the liquidity risk.



"It's just a correction. The fundamentals are still good."



THE IMPORTANCE OF COMPLIANCE—FROM THE CLIENT’S PERSPECTIVE

Jean Gullikson
Chief Compliance Officer

Our financial system is based on confidence: confidence that our government and the Federal Reserve know what they are doing; confidence in our financial institutions; confidence that the companies we invest in will grow and prosper; confidence that we will have income later for goods and services we buy on credit now; confidence that our investments, while not guaranteed to grow, are at least safe from theft or mismanagement by the person or firm with whom we entrust them.

While the current economic environment may be trying your level of confidence in our government, financial institutions and corporate profits, you can be assured that your accounts at Marquette are properly managed in accordance with stringent requirements. All financial advisors are not created equal. Trustees, registered investment advisors, stockbrokers, insurance professionals, certified financial planners, CPAs, and other financial professionals are each subject to specific rules and regulations based on their relationship with their clients. Sometimes, stockbrokers and registered investment advisors play similar roles with respect to their clients. Do you know which rules each *should* follow? Do they? Likewise, just as in other professions where a few people flout the rules, there are some ‘professionals’ in the financial services industry that put their profits above your interests. The news is full of examples so there is no need to repeat them here.

At the heart of many rules is the government’s objective that unscrupulous or incompetent advisors do not take advantage of investors, in particular, small or vulnerable investors. Other rules ensure that we strive to protect your privacy, while still others exist to prevent money laundering and funding for terrorism. While choosing an advisor who values compliance with regulatory requirements does not guarantee that you will have great financial success, it certainly increases your chance of a successful long-term relationship.

The primary regulatory focus for Marquette Asset Management as a registered investment advisor is our fiduciary responsibility toward our clients. We are required by law to put our clients’ interests first and to disclose any potential conflicts of interest. We are required by law to have policies and procedures in place to govern our investment management activities and to review them annually. Our regulators conduct periodic audits to ensure that we are following our procedures and that we are fulfilling our fiduciary responsibilities. Finally, we are required to ‘air our dirty laundry’ publicly by disclosing serious violations of the rules.

At Marquette, we incorporate our compliance responsibilities into our daily activities and our interactions with our clients. This means that clients can expect that we will strive to meet our obligations to them - to provide them with services designed to meet their particular needs, to treat them fairly, to disclose information about our firm, fees, employees, and potential conflicts of interest, and to protect their privacy.

Past issues of this newsletter are posted under “News and Press” on our website at www.marquetteam.com.



GLEN MASON JOINS MARQUETTE ASSET MANAGEMENT

Glen O. Mason, former head coach of the University of Minnesota Gopher football team, has joined Marquette Asset Management (MAM) as of April 2008. Glen works in business development and relationship management and is based at the firm’s downtown Minneapolis office.

Mason, who coached the Gophers from 1997 to 2006, has been a long-time client of MAM. “I’ve found Marquette Asset Management to be unique among firms in the business,” Mason said. “The attention to customer service, the investment approach and – most importantly – the trust that has developed with my family led me to the decision to join MAM and the Marquette Financial Companies family of businesses.”

Mason’s great appreciation for the importance of direct communication, his strong business relationships and his advocacy for clients all make him ideal for his new position. “As one of our valued clients for years, Glen has consistently asked tough questions and used the full range of our capabilities to help develop a long-term investment plan for his family,” said John Pohlada, managing director of MAM. “His decision to join us was a compliment to MAM as well as an opportunity to benefit from his exceptional skills.”

1st QUARTER 2008 INDEX PERFORMANCE

Domestic Equity Indices

S&P 500	- 9.45%
Dow Jones Indust. Avg.	- 7.00%
NASDAQ	-14.06%
Russell 1000	- 9.49%
Russell 2000	- 9.90%
Russell 3000	- 9.52%

International Equity Index

MSCI EAFE	- 8.91%
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Domestic Fixed Income Indices

Lehman Aggregate Bond	2.17%
Merrill Lynch 1-12 Yr Muni	1.46%

OUR GUIDING PRINCIPLES

Integrity	The core of who we are and the way we live
Expertise	Knowing our profession and practicing it with passion
Advocacy	Being active champions of our clients’ financial interests
Confidentiality	Ensuring client privacy