L M Capital Group, LLC

2nd Quarter, 2008

Investment process:
Global macroeconomic / Fundamental

Total firm assets:
$3.70 billion

The Fed's Dilemma: Recession, Inflation or Financial Stability?

John Chalker, *Co-Founder & Managing Director*

The economy continues to struggle at a one percent growth rate with the housing, construction, auto and financial services industries in recession; however, this has been balanced by resilient strength in technology, healthcare and even the consumer sector despite low consumer confidence. One of our key questions is: "How long can the economy avoid a recession in a constrained credit environment?" The Fed faces a true dilemma, having to address three key problems: a possible recession, strong inflationary pressures, and a threat to the stability of the financial system. The capital markets are uncertain about which problem will receive the Fed's highest priority and this has caused extreme volatility in the fixed income marketplace.

Over the past nine months, the fixed income market has been affected by bad news, much of which was unforeseen. Although the market reaction to these negative surprises has been logical, the breadth and extent of the surprisingly negative news has made it difficult to accurately forecast interest rate trends. We expect this environment to continue through the third quarter, 2008.

Our Investment Strategy Group had previously discussed reducing our allocation to the Treasury sector. We have not yet done so in a meaningful fashion although we have increased our allocation to the investment grade corporate bank/financial and MBS sectors. Funding for these purchases came from cash, maturing issues and a slight reduction in the Treasury sector. We continue to believe that interest rates will not return to the low levels of March, 2008; however, it is clear that concerns over a weakening economy are pressuring rates lower despite inflationary concerns.

The second quarter's performance was significantly impacted by the fixed income market reversal in June and the poor performance of corporate bank and financial issues. We intend to hold our Treasury allocation in the near term and to raise our portfolio duration closer to the index. The portfolio is positioned for a recovery in the financial sectors as market sentiment and liquidity improves; we believe that actions by the Fed and other government agencies should bring a more positive tone to the market before year end.

Therefore, sectors that are under the greatest pressure today should recover and generate attractive performance in the future. We believe this positioning entails an acceptable degree of risk. Managing risk has received even greater attention during this period of economic and market uncertainty.

Emerging Markets Economic Commentary

Luis Maizel, ***Co-Founder and Senior Managing Director***

The Emerging Market Debt sector in general was pretty stable in the second quarter but the individual components were volatile. High quality debt like CVRD, PETROBRAS and PEMEX narrowed the spread to Treasuries, while lower quality issuers lost considerable value.

The flight to quality was selective and news headlines considerably influenced the value of the investments. When Hugo Chavez opens his mouth, the PDUSA paper tumbles and when the agricultural strike started in Argentina, the sovereign paper came down considerably. However, events like the military recovery of Ingrid Betancourt from the hands of her kidnappers helped to boost the Colombian issues.

Mexico has been an interesting case where the currency has appreciated about 5% against the dollar. The spread of its sovereign bonds has narrowed in what is defined as the "country risk", in spite of the fact that the oil reserves have declined and production is down almost one million barrels from its high point. I'm very concerned about what would happen if the current negotiations about energy reform breakdown and the country doesn't open up the sector to private investment, both domestic and international.

China is facing pressure for a major price increase and its position as the global low-cost producer is becoming untenable. There is no doubt that internal consumption is putting a strain on their system and the fact that there are hundreds of millions of potential workers is no guarantee of being able to produce goods at low-cost.

The emerging countries, mostly producers of commodities, have benefited from the inflation in raw material prices and have strenghtened up their balance sheets - making them safer borrowers and less prone to issue new paper. The lack of supply is helping to mitigate the pressure that the worldwide financial crisis would normally place on the lower quality paper.

Commodity Market Review & Forecast

James Meehan, CFA, ***Commodity Portfolio Manager - Roundstone Advisors***

The commodity markets have surged the first half of 2008, with the Dow Jones-AIG Commodity Index up over 27%. Energy and agricultural commodities have led the charge. Energy and grains have become interconnected over the past few years as Congress has passed various biofuel mandates; it has become increasingly rare to see the two markets trade in opposite directions. Natural gas futures are the best performer in the Dow Jones-AIG commodity index, up almost 72% since the beginning of the year. Natural gas soared on demand substitution amid the sky-rocketing price of distillate fuels and declining US supplies. Crude oil prices are up 48% on the year and traded to a new all-time intraday high on June 30th of $143.67. The market reacted to a number of threats to long-term crude supplies. Libya indicated that it may trim production in response to moves by the US Congress to put new legal pressure on OPEC. Militant attacks in Nigeria and rumors of a possible military strike on Iran by Israel also helped push crude prices higher. Unleaded gasoline and heating oil ended the first six months up more than 24% and 44%, respectively.

Devastating floods in the Midwestern US sparked huge rallies in corn, wheat, and soybean prices. According to estimates from the American Farm Bureau Federation, losses from the recent floods and other adverse weather will reach more than $8 billion. The floods caused widespread damage to crops in Iowa, Illinois, Wisconsin, Missouri, Kansas, and Indiana. In response, Corn has gained 51% on the year and the front month traded up to a new all time high of $7.54 per bushel on June 27 (new crop corn futures traded as high as $8.15 a bushel, also a record). Soybeans have gained 27% this year with the Argentina farmer's strikes adding upward pressure in addition to the flooding. Tensions flared in June in the long running Argentina labor battle over controversial export taxes; the violence hit a peak when shots were fired in mid-June at six trucks that tried to circumvent a highway roadblock. Still, there were indications that beleaguered Argentine President Cristina Fernandez was backing away from confrontation with striking farmers by sending the controversial tariff proposal to the country's legislature. (On July 18 the export tariff was repealed after the Argentine Senate voted down the proposal.) Wheat is down 9% due to an expected large rebuilding of US and world supplies after droughts last year severely reduced many nations' wheat crops.

Looking forward to the final six months of 2008, there are several events that will determine how the commodity markets fare. Speculation in the commodity markets has been the hot topic in the media of late but supply and demand still are the most significant factors determining price. The flooding in the Midwest in June caused soybeans and corn to rally to record highs but good weather has helped the crops recover. The weather between now and harvest will be crucial in determining the price direction of the grain markets. Supplies are still at historically tight levels so minor changes in supply and demand projections can have dramatic implications on prices.

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Commodity Review & Forecast (Continued)

The summer Olympics in Beijing may also have a huge bearing on commodity markets. With China on the national stage, the country has been importing vast amounts of metals, fuels, grains, and meat to meet needs for the Olympics. The big question is what happens after the Olympics are over. If demand from China slows it could be a major drag on commodity markets. Finally, the US dollar and the health of the US economy in general are also major factors that have a significant impact on commodity prices. A lower US dollar makes it cheaper for foreign countries to buy US commodities and thus increases demand and prices. The prospects of the US economy also reverberate through commodities and this was demonstrated in the first half of July when crude oil fell over $10 in a 2 day span in reaction to slowing US economic prospects, which in turn would lead to less demand for crude. If the commodity markets do take off again in the second half of the year, it wouldn't be a surprise if it was once again led by grains and energy.

Mr. Meehan is a Commodity Portfolio Manager with Roundstone Advisors, LLC. Roundstone Advisors works with LM Capital Group as a sub-advisor and portfolio manager on the LM Capital Enhanced Commodity Index Strategy.

LM Capital Expands Research Team

LM Capital is pleased to announce that Carolyn Lustfield and Todd Crescenzo have joined the firm's research team as Senior Vice President - Research and Vice President - Research, respectively. In this capacity, they will gather and analyze macro-economic data from sources around the world and specific financial data on individual corporate issuers. Additionally, they will provide portfolio attribution analysis to the firm's Investment Strategy Group and clients.

Ms. Lustfield has over 23 years of investment management experience. Prior to joining LM Capital, she co-founded JKMilne Asset Management and was responsible for the firm's portfolio management process including: strategy formation and implementation, trading and performance measurement. Ms. Lustfield received a Master of Business Administration from Duquesne University.

Mr. Crescenzo has over nine years of credit and commodity markets experience including 18 years at Mellon Bank. Prior to joining LM Capital, he worked on the Structuring and Trading desk at RBS Sempra Commodities and was responsible for the origination, structuring, hedging, negotiation and consummation of RBS Sempra Commodities' contracts with commercial and industrial counterparties. Mr. Crescenzo is a CFA Charterholder and received a Master's degree in International Business with an emphasis in finance from the University of California.