KIRR, MARBACH & COMPANY, LLC

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THIS ISSUE

The Stock Market

Summary

"Recent regulatory reform, coupled with innovative technologies, has stimulated the development of financial products, such as asset-backed securities, collateral loan obligations, and credit default swaps, that facilitate the dispersion of risk… These increasingly complex financial instruments have contributed to a far more flexible, efficient, and hence resilient financial system than the one that existed just a quarter-century ago." – Former Fed Chairman Alan Greenspan (September 27, 2005)

Fear Factor

DEAR CLIENTS:

Fear "drove the bus" in the first quarter of 2008 as investors worldwide were bombarded with a constant barrage of doomsday headlines including, just to name a few: continuing signs of extreme stress in the financial sector, culminating (we hope) with the implosion of Bear Stearns; record declines in housing prices leading to record foreclosures; oil breaching $100/barrel on the way to $110/barrel and general economic calamity leading to comparisons with the 1930s. Fear-mongering sells newspapers and keeps viewers glued to the TV. We misjudged the breadth, depth and velocity of the spread of the fire that started in the subprime mortgage sector in 2007 and feel badly that client portfolios suffered what we still believe to be short-term damage. It's little consolation, but we firmly believe in "eating our own cooking" and KM personnel and their families have *significant* assets invested alongside you in the mutual fund we manage.

The period since last summer has been *among* the most difficult we and our clients have had to endure. We understand with absolute clarity that nobody is happy about the results. Still, we've endured other difficult periods and have always come back strong. We're not wasting any time wringing our hands or feeling sorry for ourselves. We're rolling up our sleeves and positioning portfolios for when the fog of fear lifts and securities are once again priced based on fundamentals, not panic-driven and/or forced liquidations into increasingly illiquid markets. The second quarter of 2008 has started on a positive note, but *nobody* can say with certainty that the markets have bottomed. We don't mean to minimize the significant challenges ahead facing many sectors of the economy and markets. Specifically, the credit/housing-related problems weren't created in a day and the resolution is more likely to be more of the painful, grinding variety. In other words, there are no quick fixes or silver bullets. However, we believe the stage has been set for better times ahead:

- Stocks held in client portfolios are **inexpensive and offer the best risk/reward** in recent memory.
  - When we evaluate a stock for purchase, we think if it has twice or three times as much upside potential as downside risk,

the odds favor the investor. By our calculations, client portfolios now have four or five times as much upside potential as downside risk. While this clearly doesn't mean stocks can't weaken further, we think the odds are in your favor.

- Investor **sentiment is extremely pessimistic**.

- As Sir John Templeton said, "Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria."

- The Fed Chairman Bernanke has proven his resolve to **aggressively utilize every and any conventional or unconventional tool at his disposal** to make sure the credit crisis doesn't cause catastrophic damage to the financial markets or the economy. We have criticized Bernanke in the past for being too slow on the trigger, but he appears to have broken free from the shackles of former chairman Greenspan's "legacy" and persona and is acting in a more confidence-inspiring, take-charge manner.

- Starting in September 2007, the Fed has reduced its target for federal funds six times, from 5.25% to 2.25%. While this was a rapid descent, there is typically a lag of several months before decreases/increases in federal funds targets begin to impact economic activity.

- On December 12, 2007, the Fed announced it was establishing a temporary Term Auction Facility (TAF) that enables banks to bid for funds and utilize a wide variety of assets as collateral. The size of the TAF has subsequently been boosted from the original $40 billion to $100 billion.

- On March 11, 2008, the Fed announced a new $200 billion Term Securities Lending Facility (TSLF) that enables a select group of broker-dealers (i.e. primary dealers) to borrow Treasury securities (which can be sold or used as collateral) secured by other highly-rated securities (i.e. AAA-rated, but possibly illiquid).

- On March 14, 2008, the Fed arranged for J.P. Morgan Chase & Co. to act as a conduit to provide The Bear Stearns Companies Inc. with emergency funding. Bear Stearns started the week of March 10, 2008 with a stock price of $70 and a statement that its "balance sheet, liquidity and capital remain strong." Bear ended the week needing emergency funding from the Fed. Two days later Bear had a choice between a Fed-brokered/guaranteed deal to sell itself to J.P. Morgan for $2 (subsequently quintupled to $10) or bankruptcy.

Periods ending March 31, 2008
(Total Returns-Cumulative-Bloomberg)

	Russell 3000 Index	S&P 500 Index
3-months	-9.52%	-9.44%
One-year	-6.06%	-5.08%
Two-years	4.53%	6.14%
Three-years	19.45%	18.58%
Five-years	76.77%	70.90%

THE STOCK MARKET

As shown below, pain was a global phenomenon in the first quarter of 2008. There were clearly differences in degrees of pain and the U.S. market actually held-up better than most.

	Q1 - 2008 Total Return
USA (Russell 3000)	-9.52%
USA (S&P 500)	-9.44%
USA (NASDAQ)	-13.88%
United Kingdom (FTSE 100)	-10.36%
France (CAC 40)	-16.12%
Germany (DAX)	-18.99%
Japan (Nikkei 225)	-17.54%
Hong Kong (Hang Seng)	-17.40%
China (Shanghai Composite)	-34.00%

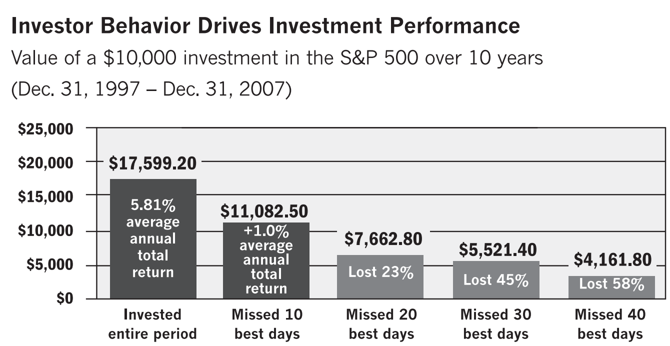
Also as shown below, while it's irrefutable that the quarter and six months ending March 31, 2008 were most difficult, we only have to look back to the quarter and six months ending September 30, 2002 for an even worse environment. Back then the S&P 500 made its eventual low on October 9, 2002 and had a total return of 24.40% for the 12-months ending September 30, 2003. We can't say if the market has made its low. It is also true that recoveries usually entail a period of "backing and filling" before trending higher. But history suggests the pain is most intense at the bottom and it generally pays to stick around for the eventual rebound.

	S&P 500 3-Month Total Return	S&P 500 6-Month Total Return
Period Ending 9/30/02	-17.28%	-28.36%
Period Ending 3/31/08	-9.44%	-12.46%

SUMMARY

As we've stated many times, investing (as opposed to speculation and/or trend chasing) is a long-term, probabilistic endeavor and the best practitioners emphasize process over outcome. Outcomes are clearly important, but we firmly believe a short-term period of subpar performance ***does not*** invalidate the process that has served our clients so well for what will be thirty-three years on May 1, 2008. We think you've been doing the hard part by allowing us to continue implementing the process while the headlines and pundits scream that financial Armageddon is just around the corner. We're confident we'll all reap the rewards of our collective fortitude. Exactly when this will happen is unknowable, but the important thing to remember is that reaping the rewards requires you to "be there" when the upturn comes. It's perfectly understandable that one question we've been receiving with some frequency is, "why don't you go to 50% cash and wait until the many serious issues have been resolved and the investment environment is less risky?" They say a picture paints a thousand words, so we'll leave you with two graphs from Ned Davis Research.

Graph #1—Missing Best Days Costly

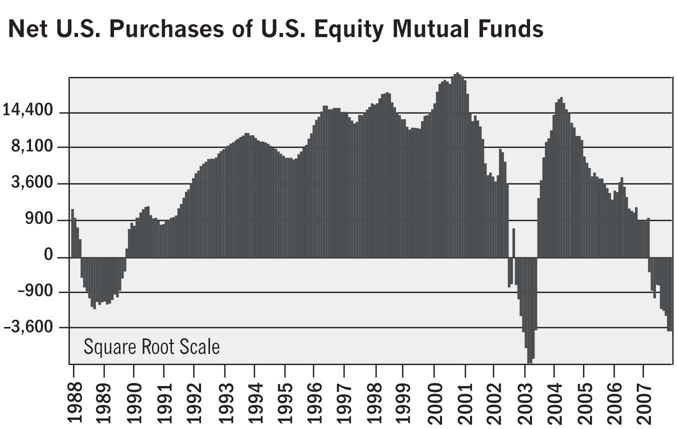


Source: Ned Davis Research, Inc.

Total market days between 12/31/1997 – 12/31/2007 = 2,515.
Total return includes dividends.

Graph #1 shows the penalty an investor would have paid for not "being there" for various numbers of "best days" for the S&P 500 for the 10-years 12/31/97-12/31/07 (2,515 market trading days). If you started with $10,000 invested in the S&P 500 on January 1, 1998 and did nothing else, you would have ended up with $17,599.20 at the end of the period. However, if you had missed just the 10 best days (i.e. 0.4% of the market trading days), you would have ended up with $11,082.50, a whopping 37% less than if you had gone on a 10-year vacation and left it alone. If you tack on missing the next 10 best days (i.e. 20 days or 0.8% of the market trading days), you would have ended up with $7,662.80 (which means you would have actually lost about 23% of your original stake and ended with 56% less than if left alone). The point is there is no way to tell when these "best days" are going to occur, so the only way you're sure to benefit is to "be there" at all times. This will demand enduring any number of periods of short-term pain, but this graph demonstrates the cost of trying to avoid that pain can be very great.

Graph #2—Net U.S. Purchases of U.S. Equity Funds



Source: Ned Davis Research, Inc.

Graph #2 shows the net U.S. purchases (i.e. purchases minus redemptions) of U.S. equity mutual funds. There have been only three periods in the past 20 years when investors took more money out of equity mutual funds than they put in. After 1988-1989, the S&P 500 was up *more than four-fold* over the next 10 years. After 2002, the S&P 500 gained *almost 70%* over the next 5 years. As we stated in the beginning of the letter, investors are very pessimistic and you can see evidence of that as we're now in the third period of net redemptions. We obviously can't guarantee what will follow, but believe the best opportunities occur when the skies are dark and filled with storms and investors are fearful and falling over themselves liquidating positions. We've certainly felt pits in our stomachs caused by the hysteria going on around us, but think this is precisely what creates opportunities.

KM's Form ADV-Part II

Securities and Exchange Commission Form ADV—Parts I and II describe an investment adviser's business and practices. Advisers registered with the Commission are required to electronically file an annual updating amendment to Part I and offer to provide to clients a copy of its annual updating amendment to Part II. KM filed its annual updating amendment to Part I on March 4, 2008. As a matter of practice for the past several years, we have provided each client account with a copy of our annual amended Form ADV—Part II and do so again this year.

Regards,

Kirr, Marbach & Company, LLC