Fund Overview

The student-managed investment fund at Appalachian State University was established in January 2000 with the dual purpose of providing students with an opportunity to obtain hands-on investment experience and to provide funds to benefit students and faculty in the Department of Finance, Banking, and Insurance. In September 2001 the fund was named in honor of Dr. Elbert V. Bowden to recognize his many contributions to the students at Appalachian.

The Bowden Investment Fund (BIF) is managed by a group of students known as the Bowden Investment Group (BIG). Participation in the BIG is limited to high achieving students who have a serious interest in investments and financial analysis. Students who are admitted to the group in the BIG are based on their academic standing, their finance background, and their interest in investments and financial analysis. Admission to the group is highly competitive.

The (BIF) is managed as a growth and income fund and is invested only in equities. The fund may have a mix of growth and value or may be biased in one direction depending on the view of the group regarding which style is likely to provide the best performance over time. The two principal goals of the Fund are:

1. To provide a unique, high quality learning experience for students.
2. To earn a return on invested funds that exceeds returns on benchmark portfolios.

The primary benchmark used for comparing the performance of the BIF is the Standard & Poor’s 500 Index. The fund currently is fully invested in a diversified portfolio of equities, ranging from small-cap companies like Darling International and Metalico, to large companies such as Microsoft and General Dynamics.

BIG members conduct extensive research and prepare detailed investment analysis reports for all securities considered for purchase. Their analysis considers a wide array of data and evaluates the overall industry environment, the company’s competitive advantages, and the company’s financial performance. Students have complete responsibility in the investment decision process, while the faculty advisor serves as a facilitator for discussion and ensures that certain guidelines are followed.

Approval of security recommendations requires a vote of two-thirds of the membership. Throughout the year students monitor all securities in the portfolio and make recommendations regarding the future investment potential of the securities.
2007-2008 Economic Review

In the fall of 2007 the US economy was hit by the sub-prime mortgage meltdown. Banks, after lending money to sub-prime borrowers, bundled loans and sold them in the form of collateralized debt obligations (CDO). As US home sales slowed, payment delinquencies and home foreclosures skyrocketed. This housing environment left banks and other entities holding billions of dollars in CDOs that would turn out to be worthless. As a result some of the world’s largest institutional lenders wrote-off billions of dollars in losses. In the Q4 2007 Citigroup wrote-off $18.1 billion on bad mortgage loans. Housing woes continue to plague the US economy. In November 2007 the US median home price had fallen to a record 6.7 percent from a year earlier.

Since 2003 the US dollar has weakened 30 percent relative to the Euro and other currencies. This has helped to offset housing weaknesses by narrowing the trade gap. The US dollar continues to see strong growth in overseas markets while demand in the US has slowed imports. The result as of January 2008 has been a .45% percentage point growth to real GDP over the past four quarters.

Unemployment and jobless claims continue to weigh down the economy. Initial jobless claims are averaging 358,000 for April, following averages of 372,000 in March, 346,000 in February, and 337,000 in January.

Oil and gas prices have steadily increased. As of May 3, 2008 crude oil had risen to $116.32 for June delivery. Average US retail gas prices as of April 14, 2008 had risen to $3.39, a .63 increase from a year ago. This increase in gas prices has prompted presidential candidates, Hillary Clinton and John McCain, to propose a lifting of the federal gas tax for the 2008 summer months.

Ben Bernanke and the Federal Reserve were increasingly creative and aggressive in trying to protect the US economy. Systematic rate cuts (most recent being a cut of ¼ percent, 2 ½ to 2 ¼), emergency rate cuts, opening of the FED discount window, and the 28 day term auction credit, were some of the weapons used by the Fed to fight recession and provide liquidity in the financial markets.

Also in response to the slowing economy the federal government approved a stimulus package. In May 2008, the US Treasury will begin sending out economic stimulus payments to more than 130 million households. Eligible people will receive up to $600 ($1,200 for married couples), and parents will receive an additional $300 for each eligible child younger than 17.

-Tommy Adams

Bowden Investment Group Economist
2007-2008 Bowden Investment Group

First Row (From Left to Right): Craig McCarter, Paul Pessina, Robert Sjolander, Ngoc-Vu Nguyen, Ian Costello, and Brandon Holmes.

Second Row (From Left to Right): Kyle Brown, Eric Dinwiddie, Ryan Hennessy, Tommy Adams, Reuben Hannon, and Austin Pantaleo

President: Ian Costello
Vice-Presidents: Kyle Brown and Ngoc-Vu Nguyen
Accountant: Eric Dinwiddie
Secretary: Brandon Holmes
Economic Analysts: Tommy Adams and Robert Sjolander
Industry Analysts: Craig McCarter, Paul Pessina, Ryan Hennessy, Reuben Hannon, and Austin Pantaleo
Fund Performance

The Bowden Investment Fund trailed its benchmark portfolios in 2007. The Fund had a one year return of 4.54 percent relative the S&P 500 index return of 5.5 percent. Overweighting in financials was a major source of weakness in 2007 as banks experienced major write downs. During the 2007 year, the Fund took positions in Darling International, Dril - Quip, EMC, Reality Income and VF Corp. These positions will help to further diversify the portfolio while capitalizing on a booming commodities market, a growing alternative energies market, and improved consumer spending resulting from government stimulus.

Moving forward through 2008, the Fund is well positioned to weather a down market. The Fund maintains a down capture of 95.28 percent and an up capture of 100.48 percent. This translates into matching market gains while outperforming in a down market. With an alpha of 1.72 percent, the Fund has a risk adjusted return in excess of the market of 1.72 percent. The true strength of the Bowden Investment Fund will be clear over the next 2 years as the US equity markets experience significant problems.

### Sector Holdings

<table>
<thead>
<tr>
<th>Sector Holdings</th>
<th>% of Portfolio</th>
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<tbody>
<tr>
<td>Financials</td>
<td>21.94%</td>
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<tr>
<td>Technology</td>
<td>13.90%</td>
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<td>Health Care</td>
<td>4.82%</td>
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<td>Industrials</td>
<td>19.71%</td>
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<td>Consumer Goods</td>
<td>10.14%</td>
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<tr>
<td>Consumer Services</td>
<td>10.00%</td>
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<tr>
<td>Energy</td>
<td>10.72%</td>
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<tr>
<td>Materials</td>
<td>1.71%</td>
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<tr>
<td>Utilities</td>
<td>2.42%</td>
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<tr>
<td>Communications</td>
<td>2.57%</td>
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### Security Holdings

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<th>% of Portfolio</th>
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<tr>
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<td>DAR</td>
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<td>DRQ</td>
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<td>O</td>
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<td>WFC</td>
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<td>USA</td>
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<tr>
<td>Cash</td>
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</tbody>
</table>

Total: **108,805.25**

### Bowden Investment Fund Annual Returns

- 2000: 8.5%, -14.3%, -23.4%
- 2001: 20.4%, 3.6%, 10.5%
- 2002: 21.3%, 4.5%
- 2003: 20.4%
- 2004: 21.3%
- 2005: 3.6%
- 2006: 4.5%
- 2007: 10.5%
Bowden Investment Fund
Returns for 2007

Bowden Investment Fund
S&P 500 Index
Wilshire 5000 Index

Bowden Investment Fund
Cumulative Returns Since Inception

Bowden Investment Fund
S&P 500 Index
Wilshire 5000 Index
BIG Trip to New York City

Bowden members traveled to NYC in late October 2007 to tour the financial capitol of the world. The group visited the facilities of Alliance Bernstein, Merrill Lynch, Banc of America Securities, and the New York Stock Exchange. At Alliance Bernstein, students had the opportunity to speak with Chris Marx, a portfolio manager and Hans Dijs, Client Relations Manager. The group learned about portfolio management and risk-return measures they implement in their product lines. At Merrill Lynch, the group had the chance to learn about the history of the building and how the firm responded to the terrorist attacks of September 11, 2001. In addition, the group had the opportunity to speak with a security analyst.

The following day, the group visited Banc of America Securities, and spoke with numerous traders and toured the trading floor. A very rare opportunity, the BIG was able to be on the trading floor of the New York Stock Exchange at the closing bell. Free time was spent enjoying the sights and sounds of New York City by attending a Broadway musical, visiting the Empire State Building, and other activities.
2008 Economic Outlook

The US economy will face considerable head winds for the next three to five years. Overall, the US economy has proven to be resilient through the first quarter of 2008 and the Bowden Investment Group economists anticipate this strength will carry through the remainder of the year. Major concerns include a weakening employment market, reduced consumer spending, and high inflation. On the whole, we do not feel that the US economy will experience a single quarter of negative GDP growth and thus will not enter a recession.

A weakening employment market will continue to erode consumer spending. Recent data has shown decreases in nonfarm payroll; however, as Figure 1 shows, these numbers are far from the levels of job losses experienced in the 2001 recession. While the US consumer will probably never stop spending, the overall growth rate of consumer spending is anticipated to decrease to a 1.2 percent growth rate in 2008 compared to the 2.7 percent growth rate of 2007. In addition to weaker employment markets, soft housing markets are creating a negative wealth effect on consumers while lower home sales are decreasing consumer purchases of durable goods that are typically associated with home purchases such as appliances and furniture.

Figure 1

![Graph showing Changes in US Non Farm Payrolls](image)

Tax rebates will provide a boost to third quarter consumer spending. While some believe that these checks will be used to pay off debt or placed in savings, historical evidence presents a much different picture. Data from the 2001 rebate checks shows that approximately 60 percent of the rebate amount was spent within the first ninety days of receiving the rebate. With this rebate focused on lower income individuals, it is reasonable to assume that a greater portion will be spent within the first 90 days this time around. For those who do pay down debt, it is anticipated that much of this debt will be built back up within one year.
The housing market is continuing to weigh on the economy. The supply of existing homes is at historically high levels of 4.06 million unsold homes, representing a 9.9 month inventory at current the current sales rate. Of major concern are an increasing number of home owners walking away from homes, a problem stemming from home values falling below actual mortgage values. Housing prices will continue to fall through 2009 before finding a bottom. On the upside, home affordability has continued to climb.

The Federal Reserve began easing ahead of any weak economic data and it is unlikely that it will cut rates any further despite the weak economic data that will continue through the end of the 2008 year. The next major issue facing the Federal Reserve is high inflation.

**Figure 2**

Credit pricing is sensitive to both risk and inflation. Overall, the economy is moving past recession fears and beginning to focus on the problem of inflation. Inflation is continuing to rise and it is being reflected in treasury yields. Since January consumer inflation has continued to increase in line with increases in commodity prices. This is apparent in the recent flattening of the yield curve pictured on Figure 2. The spread between short term treasuries and long term treasuries is continuing to decrease, indicating that the market is anticipating the end in Federal Reserve interest rate easing and also higher inflation towards the end of the year, prompting interest rate hikes.

Inflation will be the most significant problem faced over the course of the next five years. Ethanol is already proving to be a poorly made policy choice. Increases in standards of living worldwide will continue to drive commodity prices higher as counties such as China continue to consume greater amounts of raw materials for infrastructure and greater amounts agricultural products to meet the demand of its large population.

Generally a weaker economy will help ease inflationary pressures; however, we anticipate that the Federal Reserve will be forced to increase interest rates throughout 2009 to combat inflationary pressures stemming from the explosion in commodity prices. We feel that this assumption is supported by recent comments from regional Fed presidents Lacker and Fischer which stated major concerns regarding interest rate reductions and the overall inflation picture.

The recent announcement of first quarter GDP growth of 0.6 percent has reaffirmed our forecast of positive growth through the entire year. Overall changes in the trade balance are generating positive growth numbers and offsetting losses in certain sectors of the economy. Consumer spending has continued to decline along with business fixed investment. Weakness in consumer spending is clear with
durable goods sales currently declining at a 6.1 percent annual rate and spending on non durable goods declining at 1.3 percent annual pace. With spending accounting for 70 percent of GDP, it is critically important to overall GDP growth.

GDP growth remained positive because of the overall shift in the trade balance. A significant portion of consumer purchases are of imported goods and thus these imported goods are absorbing a disproportionate amount of the declines in consumer spending. At the same time, a weakening dollar is spurring substantial growth in US exports. We anticipate this trend will continue through the end of 2008. These two forces coupled together are resulting in a decrease in the trade deficit and making a positive contribution to real GDP growth.

-Robert Sjolander

Bowden Investment Group Economist
Acknowledgement of Donors and Thanks

The Bowden Investment Group would like to sincerely thanks those who have contributed to the Bowden Investment Fund for their financial gifts. Your contributions have enabled us to have an unique education experience that exceeds a typical classroom experience.

We would also like to give special thanks to the follow individuals who were able to share their experiences and time with our group:

Mr. Chris Pavese, CFA, Managing Director, Broyhill Wakin Capital Advisors
Ms. Kay Norwood, CFA, Director, Equity Research, Evergreen Investments
Ms. Marcia Tillotson, Manager, Wachovia Securities
Mr. David Labiak, CFA, Portfolio Manager, Trent Capital Management
Mr. Leigh Dunston, Attorney (retired) and Business Law Faculty, Appalachian State University
Mr. Mike Hall, Owner, Bandanas Bar B Que & Grill
Mr. Daniel Eller, Banc of America Securities
Ms. Sheri Gillete, Executive Director, North Carolina CFA Society

Contributions to The Elbert V. Bowden Student Managed Investment Fund are tax deuctible. For information about making contributions, please contact Dr. Delbert Goff.

For More Information:

Dr. Delbert C. Goff
Department of Finance, Banking and Insurance
Appalachian State University
P.O. Box 32058
Boone, NC 28608-2058
(828) 262-6188
goffdc@appstate.edu

Bowden Investment Group