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Technology Bounce: Still Meat on the Bone

After being one of the best performing sectors in 2007, technology is off to a rock start in 2008. While slightly surprised, its performance year-to-date is not without precedent. Technology rarely sets the world on fire in the first quarter. Analysts often blame the seasonality of the sector on corporate budgeting. In the first quarter budgets are being finalized and there are few catalysts to drive spending. For the opposite reason, the 4th quarter has historically been the strongest quarter as corporate IT managers must use it or lose it and there is often a budget flush. The reason for the underperformance is less important than the fact that it has occurred, and may be creating an opportunity in the short-term for traders. In our opinion, technology stocks are putting in a significant short-term bottom and have very little resistance in front of them until they encounter their January 08 lows which may translate to 10-15% upside in the near-term.

This is more a trading call since our long-term view on technology is neutral at best. Over the long-term (20+ years) technology has been a loser as an investment because the pace of innovation is so fast and the leader-board has historically changed rapidly. Additionally, technology demand has been highly correlated to corporate spending, which we expect to slow as a U.S. economic recession surfaces.

Therefore, we recommend traders buy technology stocks anticipating a short-term pop, but implement tight risk management in the event our indicators are flashing a false signal. In choosing technology stocks, we recommend steering clear of those companies with the closest ties to corporate spending, particularly those servicing the retail and financial sectors.

Sub-sectors of technology that we believe are most immune to corporate spending weakness include home and entertainment software, consumer electronics, wireless communications and analog semiconductors. Sub-sectors we would avoid due to their high correlation with corporate spending include PC manufacturers, enterprise software companies and IT service/consulting companies.

A few names we own in the portfolio consistent with this thesis include: Apple (AAPL-O-\$), Texas Instruments (TXN-N-\$), and Electronic Arts (ERTS-O-\$).

The specific securities identified do not represent all of the securities purchased, sold or recommended for client portfolios. Riverfront Investment Group client portfolios currently own shares of AAPL, TXN, and ERTS. Other securities mentioned may be considered by Riverfront Investment Group for purchase or sale in client portfolios in the future. The opinions expressed are current as of the date shown and are subject to change. They are not intended to be investment recommendations.