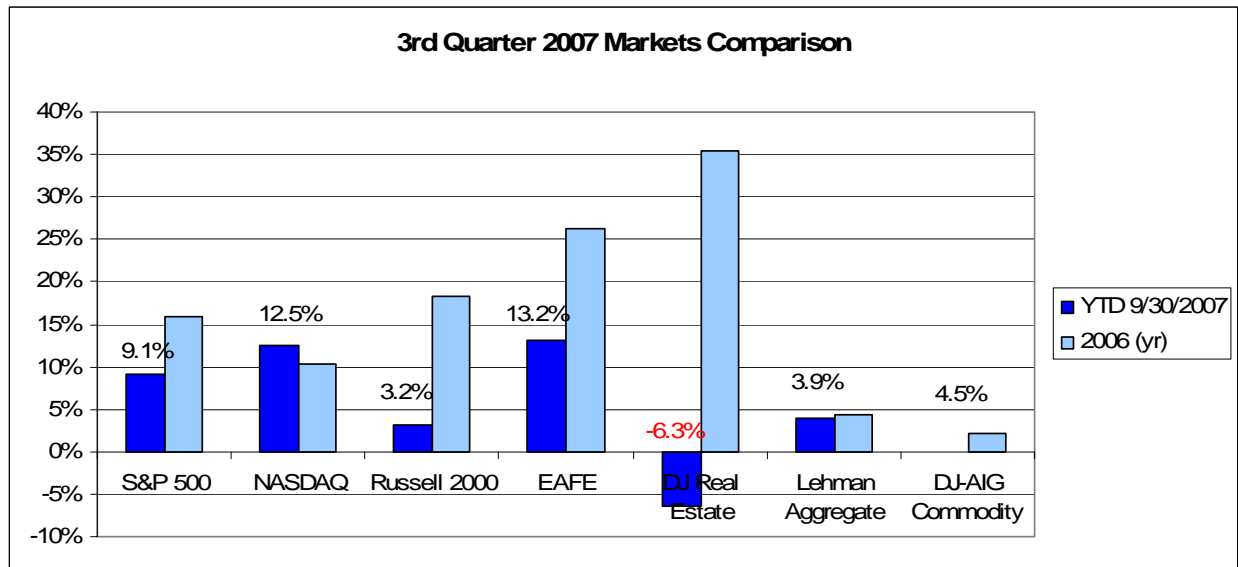




Markets and Economic Summary & Outlook September 30, 2007

U.S. equities performed very well year-to-date through 9/30/2007, however, heightened market volatility and a severe dip and subsequent rebound were the main stories during the third quarter. Most industry sectors continued to perform well, with the notable exceptions of the financial (banks) and consumer discretionary (home builders and retail) sectors. Energy, materials, industrials, rising star technology, and telecoms were the clear cut sector leaders year-to-date. The S&P 500, comprised of large and mid cap U.S. stocks, was up **2.0%** (total return) during the third quarter (+6.3% in Q2 07), while the NASDAQ Composite performed better, rising **4.0%** (+7.7% in Q2).

Non-U.S. equities, as measured by the MSCI EAFE index, continued to perform well rising **2.2%** during the third quarter 2007 (+6.4% in Q2). Most of this third quarter return was attributable to a weaker U.S. dollar. Small cap stocks, as measured by the Russell 2000, have been huge disappointments this year, up only 3.2% year-to-date, far trailing their large cap brethren. Commercial real estate, as measured by the performance of real estate investment trusts (DJ Real Estate), which did so poorly during the second quarter (**-8.6%**) seemed to have found a bottom during the third quarter. REIT yields in some real estate sub-sectors have starting looking attractive, having risen in line with historical norms. Performance on bonds in general improved during the quarter, however yields on most investment grade debt have fallen under 5%, not good news to ears of income-oriented investors.

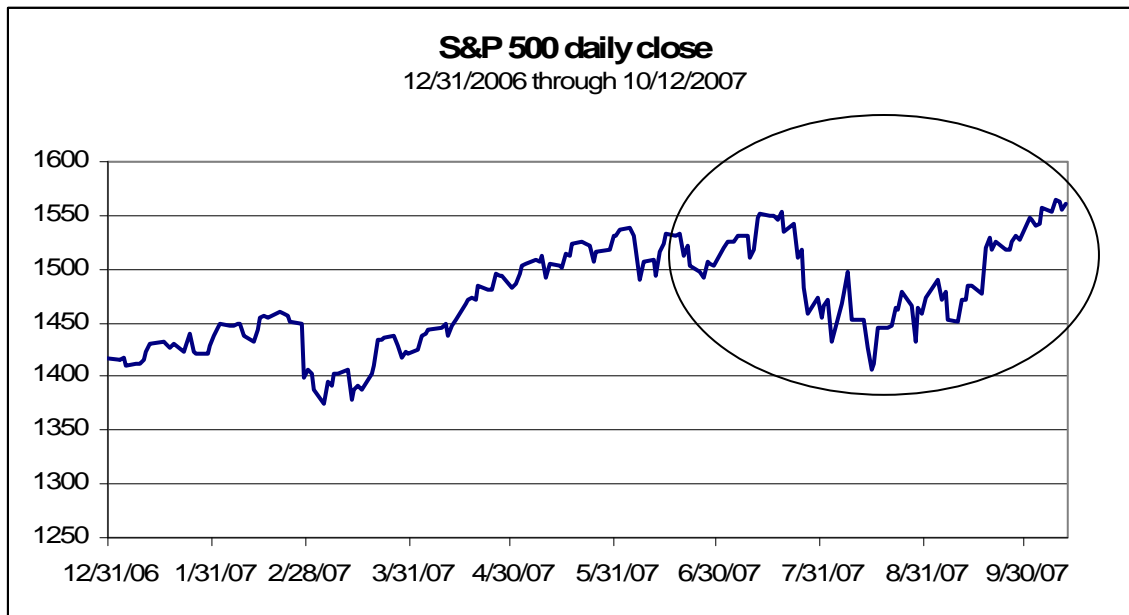


Total returns include capital gains and losses plus dividend and interest payments received and reinvested over the periods described. S&P 500 is an index of U.S. large and mid cap stocks; NASDAQ is the NASDAQ Composite Index; Russell 2000 is an index of U.S. small cap stocks; EAFE is an index of stocks from Europe, Australia, and Far East; DJ Real Estate is an index of traded U.S. REITs (real estate investment trusts); Lehman Aggregate is an index of U.S. Treasury, agency, and investment grade corporate bonds; DJ-AIG Commodity is a total return index of futures contracts on metal, agricultural, and energy commodities.

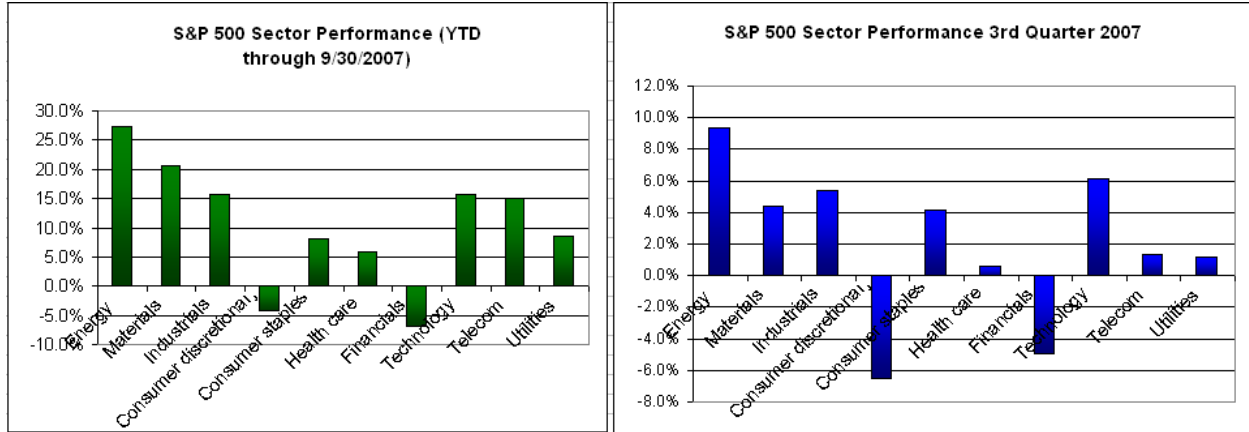
The next chart highlights the volatility evident over the last three months. Nearly all global equity markets experienced similar declines, followed by even larger "ups" over this period.



The S&P 500 fell **6.4%** from June 30 to its low during the quarter on August 15, and following the Federal Reserve's 0.5% Fed funds rate cut, has since rebounded **11%** through October 11. Investment banks, regional banks, and the large money center banks were the catalysts for sparking the most recent market turbulence. The perception of credit quality deterioration and impaired short-term liquidity, mainly among asset-backed commercial paper issuers, has negatively impacted the financial sector. These factors and general lack of transparency in the financial sector will continue to linger over the market for several more months.



While the financials skidded down an icy path, other sectors were more than able to pick up the slack including the previously mentioned energy, materials, industrial, and technology sectors. **Since the beginning of the year, the price of oil has risen nearly 30% and the U.S. dollar has fallen 7.5% relative to the Euro.** Obviously, higher energy commodity prices benefit most companies in the energy sector to the detriment of higher costs passed on to other parties in the economy. A lower dollar and strong economic growth outside the U.S. has brought benefits to U.S. export-oriented sectors as well as companies with a large proportion of increasingly more valuable non-U.S. revenue. A few companies that come immediately to mind as direct beneficiaries among many others include McDonalds, Nike, IBM, and Proctor and Gamble.



The best performing equity markets outside the U.S. continued to be paced by an interesting mix of developed/developing, resource-owning, and manufacturing-oriented economies. China continued to pace international equities, while providing large one-day stock price swings disquietingly reminiscent of the go-go dot-com days. Clearly, the Chinese economy is likely to grow 2X-3X the rate of the U.S., but +75% annual returns are not sustainable over a multi-year horizon. Aside from pockets of seeming market excess, there still appear to be opportunities to diversify internationally at attractive valuations in Europe, Asia, and Latin America.



Name	Return ▲
Single Country	
FTSE/Xinhua China 25 Index	+77.95%
MSCI Brazil Index(SM)	+69.70%
MSCI Korea Index(SM)	+45.33%
MSCI Australia Index	+39.76%
MSCI Singapore Index	+38.53%
MSCI Hong Kong Index	+35.97%
MSCI Malaysia Index	+35.64%
MSCI Canada Index	+33.25%
MSCI Germany Index	+30.66%
MSCI Netherlands Index	+25.63%
MSCI South Africa Index	+23.25%
MSCI Mexico Index	+22.03%

Source: Barclay's Global Investors (through October 10, 2007)



Late 2007 Outlook Update

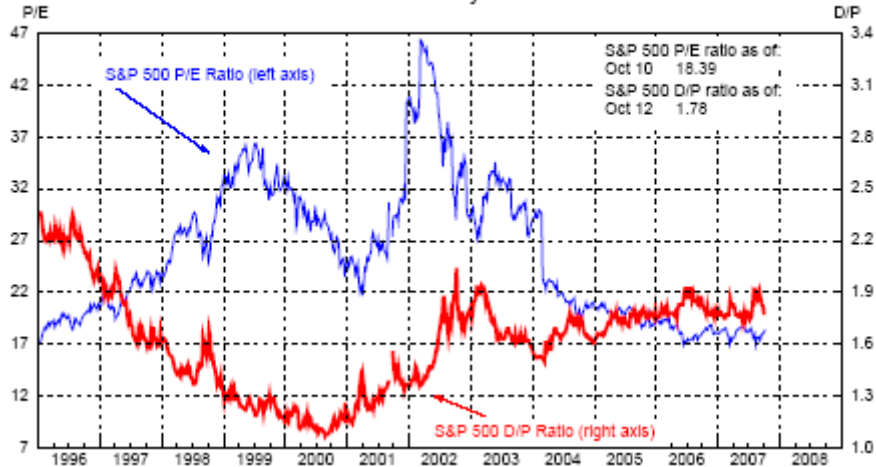
Life goes on and opportunities remain even as the financial sector continues to be dogged by credit, liquidity, and rate spread issues, and as the U.S. housing market adjusts to rising inventory and falling prices. In the U.S., unusually strong capital goods orders and backlogs, so far steady consumer sentiment, and corporate earnings and cash flow continue to surprise favorably. Corporate valuations based on earnings and cash flow multiples remain attractive for the most part. Substantial economic growth continues outside the U.S., which presents another set of investment opportunities.

Interest rates are likely to hover near current levels, and the Federal Reserve has little reason cut the Fed funds rate further below 4.75%. Low unemployment, slowing productivity growth, a weak dollar, and higher commodity prices threaten higher inflation, causing the Fed to hesitate pulling the trigger on additional interest rate relief. The Fed also does not want to be seen encouraging the availability of cheap credit that contributed to the most recent housing bubble.

Portfolio implications for the next 6 to 12 months

- U.S. equities continue to remain reasonably valued relative to historical standards. Quarterly corporate earnings and cash flow remain strong and have been the driving force behind this year's stock market performance. Revenue and earnings shortfalls, aside from the banks, thus far have been modest to nonexistent during the third quarter earnings releases. For example, Caterpillar, which faces slowing equipment demand for U.S. homebuilding, still was able to increase revenue and earnings 9% and 21%, respectively year over year, bolstered by strong overseas equipment demand.
- The following chart illustrates the average price/earnings ratio for the S&P 500 (blue line), which continues to hover near its ten-year low. Sectors that still appear attractive from a valuation perspective include industrials, materials, and technology.

S&P 500 PRICE/EARNINGS AND DIVIDEND/PRICE RATIOS Weekly



- The financial sector will remain stressed the next several quarters, as certain types of loans and structured securities continue to deteriorate. Rapidly rising credit losses and the flat yield curve, which continues to compress interest rate spreads, make for a very difficult environment for banks. Banks burdened by large exposures to leveraged transactions appear to be most vulnerable. The use of off-balance sheet vehicles among the larger commercial and investment banks for eye-popping commercial paper issuance similarly does not inspire confidence, and has been the primary factor behind the tightening of liquidity the last several months. Third quarter bank earnings reports have, with some exceptions, been dreadful and more likely than not will worsen near-term.
- Unfortunately, while a weaker dollar brings nasty surprises to the U.S. traveler in Europe, it works to the benefit of the U.S.'s export-oriented companies. Technology, industrials, materials continue to come to mind as beneficiaries of America's unsustainable current account deficit. There are numerous investment opportunities amongst companies with extremely healthy balance sheets within these sectors.
- International equities should continue to do well, although investors need be cautious when assessing the probability of repeating +50% returns in the "hot" countries like China or India. Developing markets will continue to do relatively well over extended periods of time as many of these economies grow at relative higher rates along with the greater internal demand for goods and services from more numerous consumers with available cash to spend. Near-term, investors should expect periods of very high volatility and large price swings in the developing world, but the trend is unmistakable as the U.S. economy's share of total global output and consumption becomes smaller over time.
- Two-thirds of the U.S.'s supply of oil must be imported daily, and at a higher cost in dollars, which further feeds U.S.'s ballooning current account deficit. Demand for oil remains shockingly inelastic given higher oil and gas prices. It will take sharply higher prices beyond today's \$85-\$90 price per barrel, before serious changes impact the demand and substitution sides of the equation. This being the case,



investments in oil and gas will continue to hold appeal, especially at what appear to be still bargain price valuations among many oil and gas companies.

- With respect to interest rates, it's very unclear that rates will deviate too far from the current range. The Fed must balance the fight against inflation with the need for stability in the financial markets. The Fed's fight does not include bailing out imprudent investors and speculators, and besides, an already pretty low 4.75% Fed funds rate doesn't leave too much room for material rate cuts without opening the door again to a new set of market excesses that landed us into the current mess.

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