

Capital Market Review • Second Quarter 2007

The second quarter of 2007 was mainly positive for the major averages with the exception of the Dow Jones Wilshire REIT Index. The Dow Jones Industrial Average and S&P 500 were close to all time highs halfway through the year. The DJIA was up 8.8% and the S&P 500 up 7.0% year-to-date. The stock market has moved higher in the face of sub-prime mortgage woes, oil price increases, a real estate market slowdown, and gas prices near all-time highs.

The sub-prime mortgage area of the market grabbed national headlines and it appears that it will be much worse than first anticipated. With a large number of mortgages yet to reset, the problem of defaults by homeowners and the financial implications to institutions could continue well into 2008. The CEO of Countywide recently made comments suggesting the housing market may not recover until 2009 at the earliest. Real estate mutual funds took a big hit during the quarter on this news with most of the losses coming in June. The Dow Jones Wilshire REIT Index lost 9.5% for the quarter.

Oil prices surged from \$65.87 at the start of the quarter to \$70.68 at the end of the quarter. The price of oil is now up 16% for the year mainly on concerns of increase demand and production cuts from OPEC. A major hurricane in the U.S. could send oil to record highs.

The economy continued to grow at a steady pace giving the Federal Reserve reason to keep a close eye on inflation. Inflation remains the main indicator to whether the Fed will raise or lower rates in the future. The Fed continued to hold short-term interest rates at 5.25%.

The second quarter of 2007 provided investors with gains across most of the major equity indices. The international markets continued to be the most rewarding place for investors with the MSCI EAFE gaining 6.4% for the quarter and 10.7% for the year-to-date. Large-cap stocks beat out small-caps in the second quarter and year-to-date. The trend toward large caps may be underway. Further evidence of that can be seen in the one year returns going back to July of last year with the S&P 500 gaining 20.6% compared to the Russell 2000 16.4%. Large-caps, represented by the S&P 500, returned 6.3% for the quarter and 7.0% for the first half of 2007. That compares to small-caps, represented by the Russell 2000, gain of 4.4% for the last three months and 6.5% year-to-date. The broad fixed income market,

represented by the Lehman Brothers Aggregate Bond Index, lost 0.5% during the quarter, but remained positive for the year with a 1.0% gain. The high yield market continued to show strength posting a 0.7% gain for the quarter. The real estate market, represented by the Dow Jones Wilshire REIT Index, fell sharply for the quarter losing 9.5% and was by far the worst performing part of the market in the quarter. Commodities were unchanged for the quarter, but remained solidly positive for 2007 with a 4.5% gain.

Some interesting things to think about as the third quarter and second half of the year play out. Will the Fed's next move be to lower, raise, or leave unchanged short-term interest rates? Will the sub-prime mortgage market get worse before it gets better or is the worst behind us? Will the price of oil hit a new all-time high with the increasing demand, summer traveling season, and possibility of hurricanes hitting the U.S.? Will real estate mutual funds', near decade run of remarkable performance, show signs of coming to an end?

STOCK MARKET

The second quarter was mixed with most of the indices building on gains from the first quarter with the one glaring exception, real estate. The **MSCI EAFE** led the way with a 6.4% gain barely edging out the **S&P 500's** gain of 6.3%. The MSCI EAFE now sits with a gain of 10.7% year-to-date compared to the S&P 500's 7.0%. Continuing the latest trend of large-caps beating small-caps, the **Russell 2000** gained 4.4%, trailing large-caps by over 2%. The year-to-date return for the Russell 2000 was 6.5%. **T-Bills** outpaced the broad fixed income market, represented by the **Lehman Brothers Aggregate Bond Index**, for the quarter and the first half of 2007. T-Bills gained 1.3% for the second quarter and 2.6% year-to-date compared to Lehman's -0.5% and 1.0%, respectively. The **Dow Jones AIG Commodity Index** was close to unchanged for the quarter losing 0.1%, but still showed an impressive return of 4.5% for 2007. The worst performing area of the market for the quarter and the first half of the year was real estate. Most of the losses came in June when the **Dow Jones Wilshire REIT Index** lost 9.5% for the month. The Index lost 9.5% for the second quarter and 6.2% year-to-date.

Market Returns

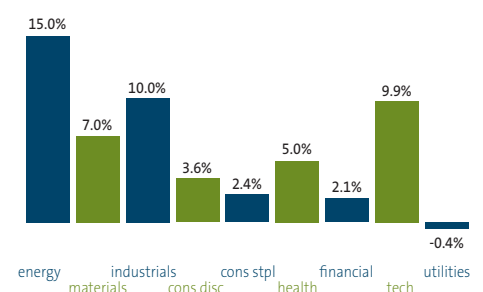
	3 months ended 06/30	YTD ended 06/30
T-Bills	1.3%	2.6%
Lehman Bros. Aggregate Bond Index	-0.5%	1.0%
S&P 500	6.3%	7.0%
Russell 2000	4.4%	6.5%
EAFE	6.4%	10.7%
Wilshire REIT	-9.5%	-6.2%

Returns by Equity Manager Style

	3 months ended 06/30	1 year ended 06/30
Large Value	6.1%	7.3%
Large Growth	6%	8.1%
Small Value	4.4%	7.0%
Small Growth	7.2%	10.5%
International	7.6%	11.5%
Real Estate	-7.8%	-4.4%

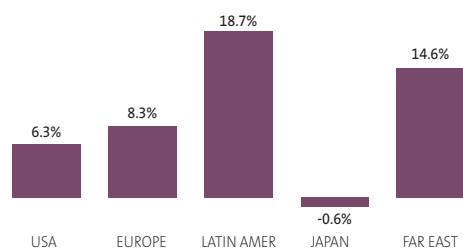
Every equity style posted solid gains for the quarter and year-to-date with the lone exception being real estate. **Internationals** led the way for both time periods gaining 7.6% and 11.5%, respectively. The growth styles remained ahead of value styles for the second quarter and 2007. **Small Company Growth** finished with a 7.2% return for the last three months and 10.5% year-to-date compared to **Small Company Value's** return of 4.4% and 7.0%, respectively. **Large Company Growth** continued to show strength and a possible rotation away from value with a gain of 6.7% for the last three months and 8.1% year-to-date. **Large Company Value** posted a 6.1% gain during the second quarter with a 7.3% return for the first half of the year. **Real Estate** posted a loss of 7.8% for the quarter finishing the first six months of 2007 with a 4.4% decline.

Stocks by Sector for the 3 months ended 06-30-07



Most sectors of the stock market had positive returns for the quarter and every sector gained for the six month period. **Energy** led the way during the quarter with a 15.0% gain on the strength of rising oil prices. The sector was also the best performing for the year-to-date period adding 18.4%. **Industrials** and **Technology** trailed Energy, but beat the other sectors for the second quarter returning 10.0% and 9.9%, respectively. Industrials and Technology finished in the middle of the pack for the six month period with a 11.9% and 10.2% return. **Materials** and **Healthcare** were in the middle of the pack for the three month period with solid gains of 7.0% and 5.0%, respectively. Materials trailed only Energy year-to-date posting a return of 16.7%. Healthcare meanwhile added 6.0% during the first half of the year. **Consumer Discretionary**, **Consumer Staples**, and **Financials** remained among the weakest sectors finishing with gains of 3.6%, 2.4%, and 2.1% respectively for the second quarter. Year-to-date, all three sectors were also among the worst performing with Consumer Discretionary gaining 2.8%, Consumer Staples coming in at 4.8%, and Financials losing 0.9%. **Utilities** was the only sector that lost money in the second quarter down 0.4%, but remained strong for 2007 returning 8.7%. The financial sector and technology sector had a large impact on the return of the Russell 1000 Value and the Russell 1000 Growth. Financials make up 33.5% of the Russell 1000 Value and 7.4% of the Russell 1000 Growth. The 0.9% loss of Financials obviously had a much larger impact on the Russell 1000 Value. On the other hand, Technology makes up 3.6% of the Russell 1000 Value and 27.0% of the Russell 1000 Growth. Technology returned 10.2% and has a much larger impact on the Russell 1000 Growth. The large disparity of weightings and returns for both sectors is a major reason why the Russell 1000 Growth returned 6.86% for the quarter and 8.13% year-to-date compared to the Russell 1000 Value's 4.93% and 6.23%.

Stocks by Region for the 3 months ended 06-30-07



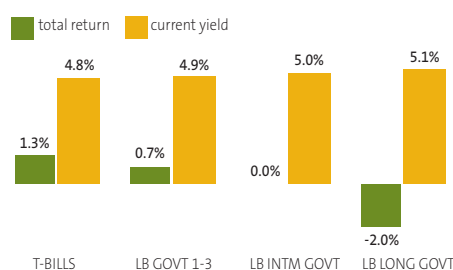
Four of the five major regions around the globe posted solid gains for the quarter with

Japan being the only exception. **Japan** was the only region to decline in the quarter falling 0.6%. It was also the worst performing region so far in 2007 gaining only 2.9%. USA and Europe finished second and third trailing Latin America and the Far East by a wide margin. **USA** posted a nice 6.3% gain during the second quarter while **Europe** came in 2% better at 8.3%. Year-to-date, USA and Europe are also second and third posting gains of 7.0% and 12.5%, respectively. Most of the **Far East's** gains came during the second quarter when it added 14.6% to bring its 2007 total return to 15.6%. The best performing region for three months and the six month periods was **Latin America** with a surge of 18.7% and 25.3%, respectively.

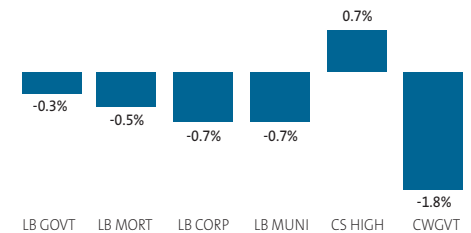
BOND MARKET

The Federal Reserve continued to keep the Fed fund's rate at 5.25% for the fourth consecutive quarter and the eighth consecutive meeting. Investors seemed uncertain as to whether the Fed's next move would be to lower or raise rates. A lot will depend on economic data, in particular inflation, that will be released in the coming months. The bond market returns were mixed for both the second quarter and the first half of the year. The Lehman Brothers Aggregate Bond Index, a broad fixed income benchmark, dropped 0.5% for the quarter, but added 1.0% for the first half of the year. T-Bills handily beat that with gains of 1.3% and 2.6%, respectively. The longer end of the government bond market, represented by the **Lehman Brothers Long Government Index**, struggled during the quarter losing 2.0%. The loss pushed its year-to-date return into negative territory finishing down 1.0%. The shorter end of the market, represented by the **Lehman Brothers Government 1-3 Year Index**, held up much better adding 0.7% for the quarter and 2.1% for 2007 through June. The intermediate government bond market, represented by the **Lehman Brothers Intermediate Government Index**, finished unchanged for the second quarter, but was able to gain 1.5% year-to-date

Bonds by Maturity for the 3 months ended 06-30-07



Bonds by Sector for the 3 months ended 06-30-07



Most of the sectors in the bond market fell during the second quarter of the year. **World Government** bonds dropped 1.8% for the quarter pushing it into negative territory for the year down 0.8%. **Municipals** and **Corporates** both fell 0.7% during the quarter, but were able to both finish in positive territory for the six month period. Year-to-date, Corporates gained 0.8% and Municipals added 0.1%. **Mortgages** and **Governments** couldn't escape the negative sentiment in the bond market and they too fell 0.5% and 0.3%, respectively. Both finished up 1.1% year-to-date, however. **High Yield** bonds were able to end the quarter on the positive note and post a return of 0.7% pushing its return for six months to 3.7%

COMMODITIES MARKET

The Dow Jones AIG Commodity Index was unable to keep its momentum going from the first quarter and finished close to unchanged at a loss of 0.1% for the quarter. The index is still up 4.5% year-to-date. The price of oil spiked up to a ten month high finishing the quarter at \$70.68 per barrel. Lead rose 37% during the quarter to contribute positively to the index. Copper also rose during the quarter 9.9%. Coming off record highs in the first quarter, Nickel dropped 18% for the second quarter. Gold dropped to \$648.10 per ounce, a loss of 2.2%.

CURRENCY MARKET

The U.S. dollar continued to weaken even further against Euro from its first quarter drop of 1%. The Euro gained 5.5% against the U.S. Dollar for the first six months of this year. The Dollar strengthened against the Yen during the quarter rising 6.5% to end the first half of 2007 7.6% stronger. ■