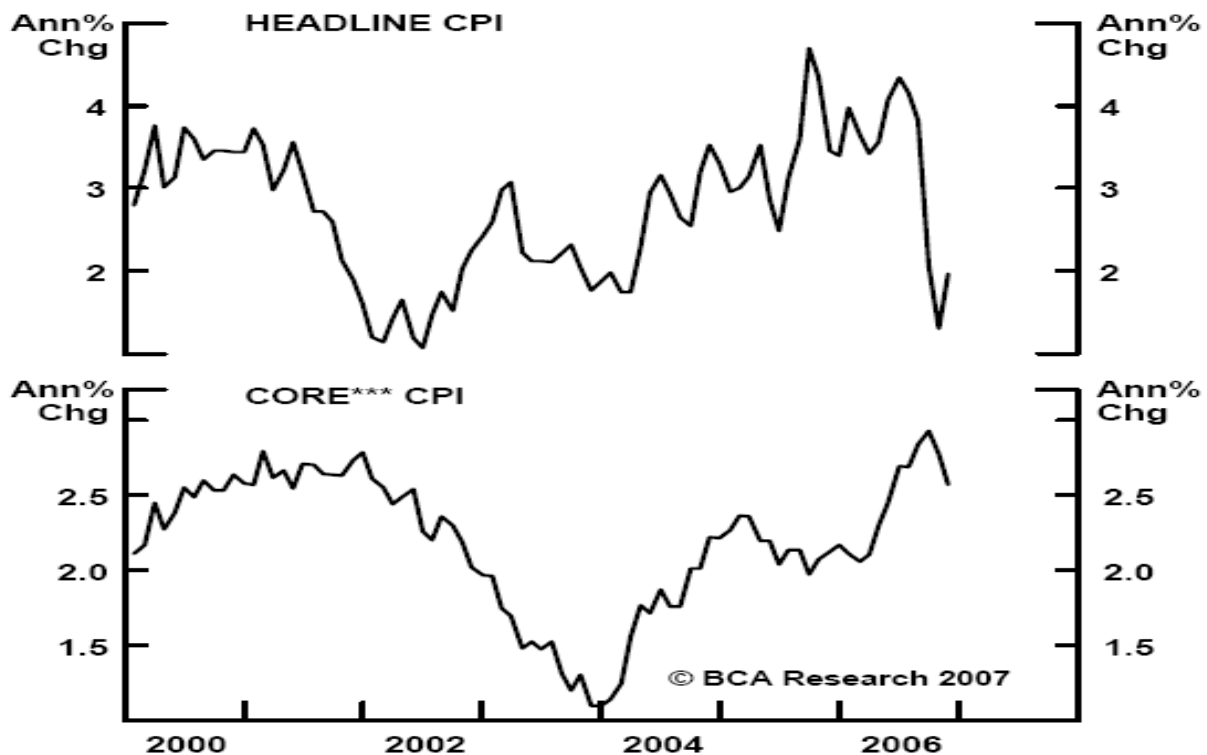




ECONOMIC & MARKET COMMENTARY

We expect U.S. real Gross Domestic Product (GDP) to increase between 2.0-2.5% in 2007, with the economy growing at a somewhat slower pace in the first half of the year than the second. The slowdown in the housing and automobile markets will be the primary culprits for weakness in U.S. GDP, with the impact from reduced demand affecting suppliers and headcount in each sector. As a result, we expect employment to grow more slowly than the overall labor force, leading to a rise in the currently low 4.5% unemployment rate. In the aggregate, consumers remain quite stretched, with little personal savings, relatively high debt burdens and modest income growth, constraining their ability to spend as strongly as they have the last few years. While we think the most likely scenario is that the U.S. economy will manage to escape a recession, the chance of an economic downturn has increased.

We believe the outlook for inflation continues to improve. Headline inflation has already made a decisive turn down and core inflation (less food and energy) has also started to rollover. As the core inflation rate gets closer to the Federal Reserve's target of 1-2% and the economy remains below trend line, we think the Fed will begin to reduce the federal funds target rate from its current 5.25% level.



*SOURCE: NATIONAL FEDERATION OF INDEPENDENT BUSINESS
**SOURCE: INSTITUTE FOR SUPPLY MANAGEMENT
***EXCLUDES FOOD AND ENERGY



Unusually warm weather both last winter and this year has negatively impacted the demand for natural gas and heating oil, causing inventories to rise above historical levels and the price of the commodity to fall sharply. While this may not be good for energy company earnings and investor psychology toward the energy sector in the near-term, it will certainly help consumers and businesses. We continue to believe the longer-term supply/demand outlook for energy argues for a price between \$50-\$70 a barrel for oil and \$8-\$10 per thousand cubic feet for natural gas. If prices were to stay sustainably below those levels, energy companies would likely reduce their spending on exploration and production projects, as they have often done in previous periods.

The outlook for stocks remains attractive in our opinion. While we expect somewhat slower U.S. economic and corporate profit growth, international economic activity should be relatively strong. Many of the companies we have purchased for our clients have meaningful international operations, which we expect will continue to grow. We expect S&P 500 operating profits to increase 7% to \$91.00 a share in 2007, which means the 2007 price/earnings ratio for the market is 15.5 times, slightly above the long run average. However, companies are in much better financial shape today than they have been in a long time. As a result, companies have been generating cash flow well above what they need to invest in their business (free cash flow) and have been able to use these excess funds to make potentially accretive acquisitions, raise their dividends and buy back their shares. We would expect in an environment of relatively slow economic growth and modest pricing power, many companies will continue to look at acquisitions as a means to supplement their organic growth.

When compared to inflation and the 4.86% yield of a 10 year U.S. Treasury Note, U.S. stocks would normally be trading closer to 20 times earnings on average. Another way of evaluating the relative attractiveness of stocks and bonds is to compare the market's earnings yield (which is the inverse of the price/earnings ratio) to the 10 year Treasury Note yield. The S&P 500 earnings yield is currently 6% or about 1.2 percentage points more than the 10 year Treasury yield, which is generally positive for stocks.

Investor psychology has improved dramatically from July when geopolitical tensions were particularly high, oil prices were around \$75 a barrel, inflation was rising and the Fed was tightening. As these issues dissipated somewhat, the U.S. stock market responded by rising 16% from the summer lows. While we believe U.S. inflation has peaked for the time being, the economy is moderating and the Fed is on hold, we do not think the world's geopolitical and energy problems have been resolved. As some of these issues reassert themselves, we think the volatility of the market and risk premiums could increase again. This potentially challenging environment may create additional opportunities to purchase good companies at a discount to our estimate of their underlying value.