



QUARTER FOUR 2007

MARKET COMMENTARY

JANUARY, 2008

FOURTH QUARTER RECAP

After a tumultuous third quarter, global equity markets remained volatile during the final three months of 2007. Even though the fourth quarter is usually a seasonally strong period, the S&P 500 declined 3.3%, the first negative fourth quarter performance since 2000. Despite reaching an all-time high in early October, the S&P 500 subsequently fell 6.1% to end 2007 at 1468. The catalysts for this weak fourth quarter performance were investor cautiousness about the outlook for the economy, continued credit market concerns caused by the sub-prime debacle, and deteriorating corporate earnings growth. Following 14 quarters of double-digit increases during the 2004 through 2006 period, earnings growth decelerated markedly in the first half of 2007. Third quarter 2007 earnings posted their first decline since the beginning of 2002 and, because of additional revisions, earnings estimates are forecast to decrease at a low double-digit rate in the final quarter of 2007. Also during the fourth quarter, the Russell Mid Cap index fell 3.5%, slightly underperforming the S&P 500, while the Russell 2000, an index measuring small cap performance, dropped 4.6%. Despite the market's weak fourth quarter performance, the S&P 500 still generated a 5.5% return for all of 2007 and the Wilshire 5000, a broad market index, rose a similar amount. This performance was comparable to the full year gain of the mid cap index. Small cap stocks, which are more volatile, less liquid and generally lack exposure to international markets, failed to generate positive returns for the full year and the Russell 2000 declined 1.6% during 2007.

PERFORMANCE MATRIX

Index	2007 4Q	2007 YTD
S&P 500	-3.3%	5.5%
Russell 1000 Growth	-0.8%	11.8%
Russell 1000 Value	-5.8%	-0.2%
Russell Mid Cap	-3.5%	5.6%
Russell 2000 (small cap)	-4.6%	-1.6%
Wilshire 5000	-3.1%	5.7%
MSCI EAFE (international, \$, net)	-1.8%	11.2%
Lehman Municipal Bond	1.4%	3.4%
Lehman Aggregate Bond	3.0%	7.0%

Except for the strong emerging markets, especially Brazil, Russia, India and Eastern Europe, most developed markets also retreated during the fourth quarter. Measured in local currency, the MSCI EAFE lost 2.9%, though the weaker dollar reduced the loss to 1.8%. The decline in foreign developed markets was attributable to concerns that a U.S.-led global recession would adversely impact European economic growth and, ultimately, the earnings of corporations operating in these regions. For 2007, the MSCI EAFE generated an attractive 11.2% return measured in U.S. dollars. The weaker dollar contributed more than 7 percentage points to this return. Europe was +17.5% while Japan, which accounts for 9% of the index, was -4.1% in U.S. dollars (-11% in local currency), the only major developed market to experience a loss for the year. In addition to a stronger yen, which hurts the competitiveness of Japanese companies, and slowing economic growth, a series of company specific actions and court decisions led investors to believe that the managements of Japanese companies are backtracking on their earlier commitments to be more shareholder-friendly.

In contrast to the weak performance of equities, the fixed income markets performed extremely well during the fourth quarter. The "flight to quality trade" that emerged in the third quarter persisted in the last three months of the year. Credit availability remained tight and investors continued to flee to the safety of U.S. Treasury obligations. Non-investment grade spreads widened further, especially in corporate high yield bonds. With the exception of the high yield sector, all the other parts of the bond market generated positive returns during the quarter ranging from 1% to 5%. The Lehman Aggregate bond index, for example, a broad measure of the market, rose 3.0% during the fourth quarter. For the full year, bond returns ranged from 3.4% for municipals to just over 11% for Treasury Inflation Protected Securities (TIPS).

EQUITY MARKETS

During the fourth quarter, and for the full year, there was a dramatic disparity in performance among industry sectors. This disparity is shown in the table on the next page. During 2007, there was more than a 50 percentage point spread between the best and worst performing sector. As a result, the weights in the S&P 500 shifted significantly during the year. Energy, utilities and consumer staples were the three best performing sectors in the last three months of 2007. Energy stocks continued to benefit from record high oil prices. West Texas Intermediate (WTI) oil finished the year at \$95.92 per barrel, a 58% gain for the year. Healthy demand, combined with constrained supply and tight inventories, continued to be supportive of high energy prices. Financial speculation and political instability in the major producing regions were additional factors that pushed up the price of oil. In addition to energy, utilities and consumer staples performed well during the fourth quarter. This performance was attributable to the defensive nature of these sectors, both of which tend to do well during periods of economic uncertainty.

The weakest parts of the market at year-end, and throughout 2007, were financials and consumer discretionary. Economically sensitive sectors, like industrials, also gave back earlier gains in the last quarter of the year. As we discussed in the third quarter market commentary, the impact of the sub-prime mortgage fallout has been very broad and has adversely affected many investors and financial institutions. Banks, brokers and hedge funds have also had meaningful exposure to other financial instruments like structured investment vehicles (SIVs) and collateralized debt obligations (CDOs).

The carnage in certain sectors of the debt market has forced a number of banks and brokers to take enormous write-offs and to seek multi-billion dollar capital infusions. Credit availability, especially in the high yield sectors, remains constrained and spreads in riskier asset classes have widened. The inability of the banks to access these markets to offload their LBO (leveraged buyouts) loans has left them on the hook to provide several hundred billion dollars in leveraged buyout financing.

In addition to financials, the consumer discretionary sector experienced pronounced weakness at year-end and throughout 2007. Within the consumer discretionary sector, retailers and housing related stocks were hit especially hard. The poor performance of retail stocks was caused by a slowdown in consumer spending, a relatively weak Christmas selling season, a reduction in retail company earnings, and investors' expectations that spending will weaken further in the future. Housing related stocks were particularly poor performers throughout 2007 as credit availability contracted, home sales plummeted, and a number of the home builders were forced to take large write-offs. The housing market is still deteriorating and investors remain concerned that consumer spending will wane as housing prices decline and more of homeowners' income is siphoned off by rising mortgage payments. A disproportionate amount of this weakness is being felt in California, Florida, Nevada and Michigan. These regional markets are suffering from heavy over-supply that is likely to take multiple years, and further price declines, to absorb. As a result of this situation, the housing market continues to pose downside risks to economic growth during 2008, an issue that has been recognized by Fed policy makers and is one of the primary reasons for their willingness to lower interest rates.

S&P 500 SECTOR PERFORMANCE

S&P 500 Sector Performance	Sector Wt. (12/31/07)	2007 4Q	2007 YTD
Energy	12.9%	4.4%	34.4%
Materials	3.3%	0.1%	22.5%
Industrials	11.5%	-4.6%	12.0%
Consumer Disc.	8.5%	-10.0%	-13.2%
Cons. Staples	10.2%	3.8%	14.2%
Health Care	12.0%	0.0%	7.1%
Financials	17.6%	-14.3%	-18.6%
Info. Technology	16.7%	0.1%	16.3%
Telecomm. Serv.	3.6%	-5.1%	11.9%
Utilities	3.6%	7.6%	19.4%
S&P 500	100.0%	-3.3%	5.5%

Source: Standard & Poor's

Growth stocks outperformed value at the large, mid and small cap levels for the three-month period ending December 31st. For the full year, this trend was very pronounced with growth indices besting value indices by between 1200 and 1680 basis points. After seven years of value outperforming growth, the pendulum clearly swung back to growth in 2007. The large exposure of value funds to the financial and consumer discretionary sectors, combined with heavy technology weights and healthy levels of energy exposure in many growth portfolios, were the primary factors that contributed to the disparity in style performance. Most value managers had reduced their energy exposure because of high valuations. In addition, during periods when the economy is slowing, investors will gravitate toward growth stocks because of the ability of these companies to maintain relatively attractive increases in their earnings. Also, following historical patterns during periods of economic uncertainty and market turmoil, large cap stocks outperformed small caps during 2007, though mid cap sector performance was almost comparable to large caps.

FIXED INCOME

The deterioration in the sub-prime mortgage market that initially impacted credit markets in the third quarter of 2007 and tighter credit conditions, remained important issues during the last three months of the year. The flight to quality persisted as investors aggressively purchased U.S. Treasury obligations for their safety and security, and drove down interest rates across the yield curve. TIPS (Treasury Inflation Protected Securities) benefited from the flight to quality, as well as the ratcheting up of inflation expectations, and were the best performing fixed income sector in the fourth quarter returning nearly 5%. The performance of sovereign bonds (bonds issued by foreign governments), which are held in international and multi-strategy bond funds, were also favorably impacted by the move toward higher quality investments. The flight to quality and investors' expectations that the Federal Reserve would continue to cut interest rates because of weak economic data, caused the yield curve to steepen further. The two-year yield fell 93 basis points from the beginning to the end of the quarter to finish the year at just 3.1%, while the 10-year yield fell 56 basis points to 4.0%. (It subsequently broke the 4% level and, as of mid-January, has traded between 3.7% and 3.8%.)

Municipal bond performance was volatile during the quarter and the performance of this category lagged Treasuries. The yield of investment grade municipal bonds relative to Treasury yields rose to record highs, especially in the short-end of the curve. At one point in early December, tax-free yields in the two and three year part of the municipal curve were 110% of U.S. Treasuries. Although munis have since rallied, they remain historically cheap to Treasuries. The high yield municipal sector underperformed the investment grade part of the market and produced small losses for the quarter and the full year. High yield munis faced indiscriminate year-end selling that did not reflect the underlying fundamentals of the credits. We continue to believe that the high yield municipal bond sector is attractive and our expectation is that this fixed income category will rebound in subsequent quarters. (So far this has turned out to be true during the first half of January).

OUTLOOK

More evidence that the U.S. economy is softening and may be headed for a recession, has caused the equity markets to sell-off in the early part of 2008. Up until recently, consumer spending, which accounts for about 70% of Gross Domestic Product (GDP), has held up relatively well. At year-end, however, deteriorating job growth and fresh signs that consumer spending is slowing have emerged. A number of retailers, for example, have announced significant earnings shortfalls relative to investor expectations. Even high-end retailers have been affected. At the same time, energy prices remain very high and the housing market continues to deteriorate. Fueled by easy credit, this bubble has clearly burst and housing is likely to be a drag on the economy throughout at least 2008. The implosion of the sub-prime mortgage market has had significant negative ramifications for the credit markets and financial institutions in particular. The extent of the write-offs by banks and brokers has been staggering, and the deterioration in the financial climate has forced these institutions to significantly raise their loan loss provisions while seeking additional capital at depressed prices to shore-up their impaired balance sheets. More bad assets and bad loans will need to be flushed out of the system. The convulsions in the banking system have caused credit conditions to remain tight. Fortunately, the Federal Reserve seems to finally "get it" and has provided liquidity to the system while reducing short-term interest rates. In fact, on January 22nd the Fed lowered the fed funds rate by an aggressive 75 basis points, reducing it to 3.5%. An additional cut in the federal funds rate after the FOMC (Federal Open Market Committee) meets at the end of January is also expected, and more reductions in interest rates are in store. Although inflation remains a concern, the Fed has clearly shifted its focus toward doing what it can to combat the worsening economic outlook.

In addition to economic uncertainty, corporate earnings are deteriorating and investors are reducing their expectations for future growth. The reporting season is getting underway and 4Q07 earnings are currently forecast to decline 11% after an 8% drop in the third quarter. Earnings for 2007 are now estimated to have been down slightly versus a high single-digit growth rate expectation at the beginning of 2007. For 2008, consensus earnings expectations for the S&P 500 have been ratcheted back from 10%+ growth to the mid single-digits. However, investors do not have a high degree of confidence in that forecast given the uncertain economic picture we currently face.

Although the investment landscape is filled with negatives, there are some positives. The biggest positive is that the Fed is on the case and is doing what it can to ameliorate the situation by lowering interest rates. Another potential positive is that 2008 is an election year and, recently, tax cuts and other actions have been proposed. Any fiscal stimulus would be positive for the economy. In addition, while the U.S. economy is weakening, Europe is expanding modestly (though the regional economy is softening) and the Asian markets continue to grow. Large companies with exposure to these international markets will benefit. Another positive is that U.S. equity valuations are reasonable and close to the historical average. As of mid-January, the S&P 500 was trading at 15 to 16 times trailing 12-month earnings. Finally, many investors are becoming increasingly pessimistic. Investor pessimism is usually a positive for the market.

So what does our crystal ball say about 2008? Given the issues we have discussed, and the already uncertain environment being clouded further by the outcome of the presidential election, the

outlook for the equity market is pretty hazy. No doubt, volatility will likely persist. In the short-term, our best guess is that stocks will remain under pressure. However, at some point this year, the market will discount a negative scenario and look forward to the next recovery. The market is a discounting mechanism and often looks ahead 1 – 2 years, so perhaps by the second half of 2008 investors will be looking ahead to an economic recovery in 2009 and the equity market will rebound. Two factors to keep in mind. First, recessions do not last forever and this one, if it happens, is expected to be relatively shallow. Second, equity markets have historically always recovered after down periods.

For fixed income markets, the equity market's pain is the fixed income market's gain. In other words, economic weakness will benefit fixed income returns, especially in the intermediate part of the yield curve. We would expect mid single-digit gains for calendar 2008. Bond investors should benefit from a further decline in interest rates and, hopefully at some point, a return to a more rational credit environment.

OTHER MATTERS

As we discussed last year at this time, mutual fund investors should expect to see a higher level of dividend and capital gain distributions in 2007 and, as a result, a potentially higher tax liability. Please keep this in mind as you file your tax returns in early 2008. As part of our investment process, we try to select low turnover, tax efficient funds and we proactively harvested tax losses at year-end. However, the stock market has risen for five consecutive years and many funds have enjoyed significant appreciation during this period. Most mutual funds have fully utilized their tax loss carryforwards at this point, so the funds can no longer shelter their realized gains.

Also, in accordance with SEC regulations, we request that you contact us in the event that there have been any material changes in your financial circumstances or investment objectives, or if you wish to impose any reasonable restrictions on the management of your accounts or modify existing restrictions on the management of your accounts.

We hope you have a healthy and prosperous New Year! As always, please call us if you have any questions or concerns.

Sincerely,

MINTZ LEVIN FINANCIAL ADVISORS, LLC

Robert J. Glovsky
Cary P. Geller
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