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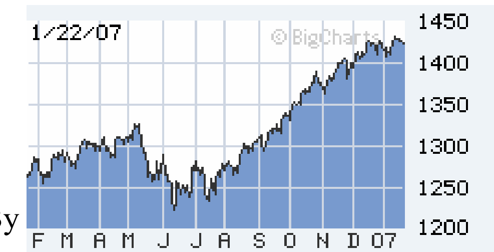
Investment Outlook First Quarter 2007

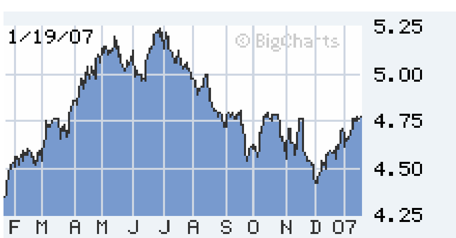
2006 Year In Review

S&P 500



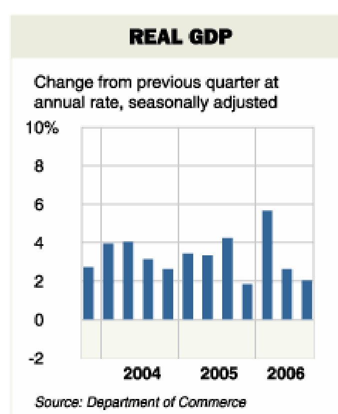
After a booming start to the year where US GDP growth rose 5.6%, the economy began a sustained slowdown in the subsequent three quarters. By year-end, economic growth had moderated to slightly over 2%, largely due to a slump in housing and softening in the manufacturing sector. Consumer spending, while impacted by high energy prices and the downturn in housing, remained resilient, albeit at a reduced pace from the past few years. Ben Bernanke assumed the chairmanship at the Federal Reserve Bank in early 2006, and, for the most part continued to pursue the same vigilant approach to containing inflation as his predecessor, Alan Greenspan. By June, when the Fed raised the discount rate for the seventeenth consecutive time, the rate stood at 5.25%, fully 4.25% points higher than just two years earlier. The Fed's actions, coupled with energy and commodity prices soaring to record highs, produced a mid-year decline in the stock market as investors began to fear the worst of all circumstances – stagflation (rising inflation with slow economic growth). But by mid-August, it had become apparent that the Fed's monetary action over the past two years, along with a much calmer than expected hurricane season, had not only produced moderating economic growth, but a contraction in energy and commodity prices. These factors, combined with a notable downturn in housing allowed the Fed to stop raising rates at their August meeting. In investor's eyes, the outlook had changed from gloomy to bright and a stock market rally coincided with the Fed's August decision and the rally extended through year-end. Strong corporate profits and signs of cooling inflation allowed the major market indexes to surge to multi-year highs, with the Dow Jones Industrial Average actually setting an all-time record high above the 12,000 mark. In other news, continued violence in Iraq and voter frustrations with a scandal plagued, do-nothing Republican controlled Congress, led to a Democratic sweep in mid-term elections for the first time since 1994. The economic and market implications of this change of control remain to be seen.

10 Year US Treasury Note Yield



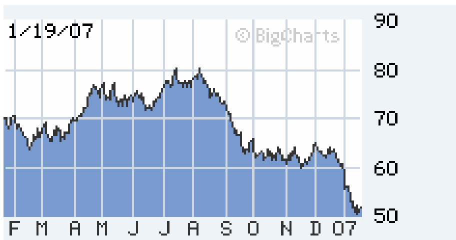
2007 Economic Outlook

Investor's concerns are shifting from a fear that the economic slowdown that began last year might slip into recession, to the opposite fear, that growth might become excessively strong later this year. The much desired soft-landing has become a reality proving once again that growth in our economy is exceptionally resilient. The weakness in housing and manufacturing has remained isolated to those two sectors, while the rest of the economy is generating new jobs and experiencing solid increased demand. Labor is clearly becoming scarcer, which is driving up the wages that firms must pay to attract workers.



Job growth and wage gains provide households with the income needed to sustain growth in spending. However, these gains have been strengthened by the recent decline in energy costs. Crude oil prices plunged this month to roughly $50 per barrel, while natural gas fell to under $6 per mcf, versus around $15 a year ago. And the mild winter weather in the Northeast implies that consumers will be spending far less on energy, as they will be using less fuel and paying less for what they use. And with the housing market appearing to have bottomed, discretionary spending is likely to re-accelerate at some point this year.

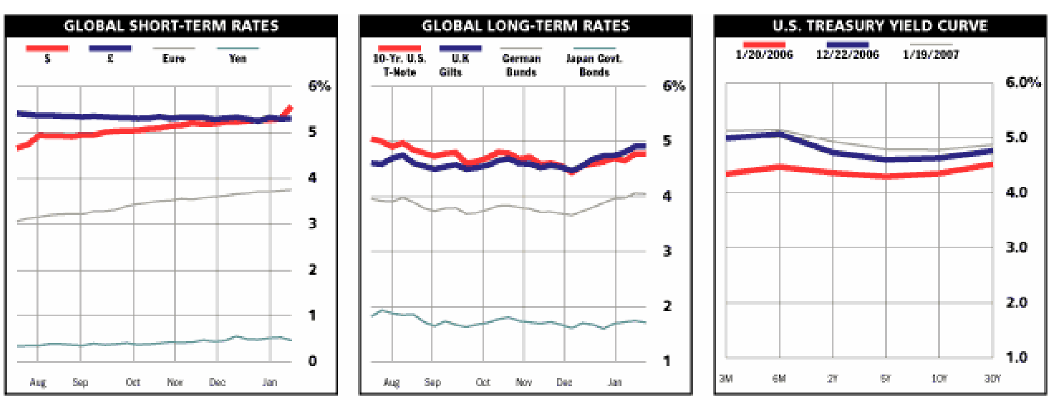
Crude Oil



The strengthening growth prospects for the economy implied by the latest data preclude any chance for the Fed to reduce interest rates anytime soon. The economy does not require any stimulus for faster growth and it is becoming apparent that the Fed is unlikely to provide any. But, it is possible that if these trends continue, the economy may advance too quickly for the Fed's tastes and instead of rate cuts, we might be confronted with more rate hikes later in the year. With the scarcity of labor pushing up labor costs at an accelerating pace, at some point businesses may be forced to pass those higher costs along in the form of higher consumer prices. Perhaps the decline in energy costs has delayed this outcome for the time being, but as the labor market tightens further, the impetus to increase consumer prices will rise.

Capital Markets Analysis

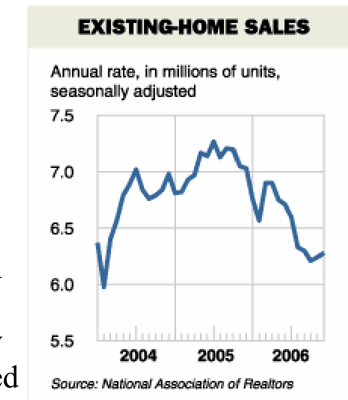
In light of our economic assumptions, we would expect stocks to continue their advance until Fed tightening expectations become the consensus. Corporate earnings are likely to slow as margin pressures appear and energy companies feel the effects of lower oil prices for the first time in five years. At the same time, corporate earnings growth is projected to be the most balanced we've seen since the economy began expanding again in 2002. And with energy prices in decline and housing prices stabilizing, consumer spending may also improve, providing an attractive backdrop for retailers. With global liquidity plentiful, corporate balance sheets, strong and cash flow abundant, merger and acquisition (M&A) activity is likely to continue at an active pace. Private equity is becoming an increasingly important force in M&A as the U.S. regulatory environment after Sarbanes-Oxley has pushed companies to avoid the elevated scrutiny of U.S. public markets. And, while the initial public offering (IPO) market is likely to remain strong, many of the largest deals will continue to be executed in foreign markets unless Sarbanes-Oxley regulations are eased. Given our expectations of moderate economic growth in the first part of 2007, contained inflation expectations, and still reasonable valuation levels, we believe price/earnings (P/E) ratios stand a good chance of expanding this year. In terms of size preferences, with small caps having outperformed large caps for seven years running (long by historical standards), we believe conditions are ripe for a reversal of this trend to begin soon.



Source: Barrons Statistics / Bloomberg

As to economic sectors, after being among the best performers four consecutive years, we would expect energy stocks to take a break from the sector leader board this year. Banks may also be under pressure as the yield curve is unlikely to normalize anytime soon continuing the pressure on net interest margins. Technology, after underperforming for much of this decade is showing renewed signs of leadership. And if consumer spending rebounds, retailers may also enjoy a healthy bounce. With regard to Growth vs. Value styles, Growth should be favored in 2007. Factors pointing to a rebound in Growth stocks include last year's dramatic underperformance, the recent leadership change away from energy and commodities, the expected deceleration of overall corporate earnings growth, and still low inflation and interest rates. Our expectations for the bond market this year is similar to last year with interest rates staying in a range of 4.5% to 5.5% for the ten-year US Treasury Note and the yield curve remaining inverted for much of the first half.

Risks



Clearly our projections would be undermined if the U.S. economy falters unexpectedly. A more sustained downturn in housing would be the most logical cause for misperceived weakness. Geopolitical upheavals could also sidetrack financial markets and economic confidence, derailing our forecasts. Also, any perception of an attack on capital market forces by the new Democratic controlled Congress could create market dislocations. These attacks could take the form of a more restrictive regulatory environment, attempts to increase marginal income tax rates or capital gains or dividend tax rates, or movements to restrict free-trade which may be interpreted as protectionism. Finally, if the Fed begins to signal renewed concerns over inflation, the markets may begin to anticipate less favorable monetary policy and both bonds and stock would likely weaken in preparation for expected Fed rate hikes.

Investment Strategy

The extreme disparity of returns based upon style differences these past two years has chastened us as we move into a new year. After riding high in 2005, growth stocks fell on hard times relative to other styles last year with the Lipper Values Indices outperforming their Growth brethren by roughly 10 percentage points in 2006. While we still favor growth as the best strategy for producing excess after-tax returns over the long-term, we have come to believe that a tighter standard deviation around market returns may also be beneficial. In our flagship Equity Growth Model, we have set a goal to migrate toward a core growth stock portfolio encompassing approximately two-thirds of the portfolio value, thereby limiting to one-third the amount allocated to smaller, more rapidly growing companies, those of which invariably generate more volatility. It is our expectation that this refocused strategy, strictly adhered to, will produce similar long-term investment results while reducing year-to-year volatility. Our forecast of improved conditions for growth stocks should also improve the probability of better relative performance in 2007. Philosophically, our approach to fixed income investing and other asset classes remains largely unchanged. When structuring a bond portfolio, we advocate an intermediate-term laddered approach concentrated in high-grade securities. REITs, preferred stocks and high-yield bond funds are added to the fixed income mix to enhance yields. In most cases, depending upon individual investment objectives, we also recommend some international equity exposure via no-load mutual funds or exchange-traded funds (ETFs).

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