John Guarino
President
(908) 879-4090

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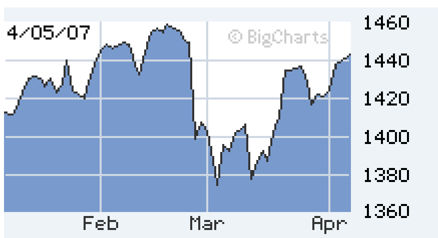
Investment Outlook Second Quarter 2007

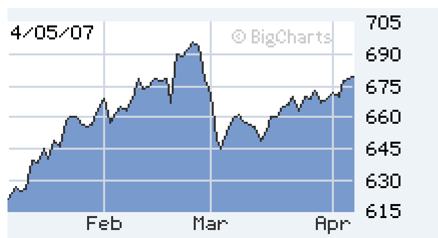
First Quarter Review

Most asset classes experienced a roller-coaster ride during the first quarter of 2007. Oil prices, commodities, interest rates and stock prices all witnessed increased volatility as seen in the following charts:

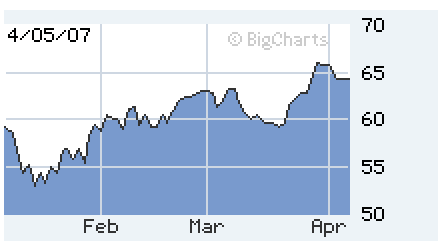
S&P 500



Gold



Oil



10 Year US Treasury Yield

The stock market began 2007 much like it ended 2006 with nearly daily new 5 year highs being set by the S&P 500 and Nasdaq and all-time highs marking the DJIA advancement. Then on February 27, worldwide markets plummeted after the Japanese central bank raised short-term interest rates, provoking worries that the carry trade (where investors borrow low yielding Japanese yen and invest in higher yielding or more speculative investments in other markets) would begin to unravel and global liquidity would begin to dry up. Asian markets began the tumble on these concerns and the fear that the Chinese stock market was forming a bubble at a time when its economy was beginning to slow. Ten year US Treasury Note rates declined to a 52 week low at under 4.40% as investors sought a safe haven for their money. After several weeks of nervousness and calls for a deeper correction, stock prices began to firm and interest rates ascended back above 4.70%. Oil prices, which began the year near $50/barrel rose steadily during the first quarter on news of tightening supplies and geopolitical concerns. On the economic front, moderating employment and GDP growth provide solid evidence that the economy has officially settled into a soft landing.

2007 Economic Outlook

Economic activity cooled substantially during the last nine months of 2006 and there is every indication that softening demand has continued into this year's first quarter. Precipitous weakness in housing shaved approximately 1% from real GDP growth last year and continued sluggishness should persist to be a drag on the economy through at least the first half of this year. New fears within the housing industry have arisen as delinquency rates and loan losses have mounted in the sub-prime lending sector and a number of high profile companies in this field have either suspended sub-prime lending or declared bankruptcy. To date however, there is no indication that softness in housing has spilled over into other sectors of the economy.

The labor market remains tight with monthly job growth averaging approximately 150,000 net new jobs and unemployment at a five year low of 4.4%. With employment gains and wage growth healthy, households have maintained the income needed to sustain spending growth. However, these gains were strengthened by a decline in energy costs during the early winter months. Now that crude oil and gasoline prices have rebounded, consumer spending may come under additional pressure in the months ahead.

At the most recent FOMC meeting, the Fed kept interest rates steady while releasing a statement which most observers read as moving to a neutral monetary policy position. We are still of the belief that economic growth is self sustaining and no fiscal or monetary stimulus is necessary or likely anytime soon. In fact, the Fed will surely remain vigilant in keeping inflation at bay and is just as likely to maintain or even raise the discount rate in the face of a weakening dollar and rising commodity prices. Look for real GDP growth for the first half approximately in line with the fourth quarter at 2-2.5% with faster growth in the second half as the economic drag from the housing market begins to wane.

Capital Markets Analysis

The key question for the financial markets is whether the Chinese sell-off and sub-prime lending scare has run its course or whether a second leg down is still ahead. With all markets becoming increasingly global, an economic slowdown in China would ultimately have ramifications in Europe and the US. Similarly, any signs of weakening demand by the US consumer will affect exports in China, Japan and other developing economies around the world. Recently, markets have been gyrating with every new piece of economic data. With the data clearly mixed, it is easy for buyers and sellers to alternate in gaining the upper hand. Now that first quarter earnings reports have begun, stock prices have additional data points in which to react. With earnings expectations muted, it won't take much in the way of positive reports or comments to drive prices higher. And with Fed officials remaining vocal concerning inflation, bond yields are likely to trend toward the upper end of their recent range.

Risks

The US dollar has recently slid to two-year low. A weak currency could portend difficulties for the US economy by raising inflation fears as imports become more expensive and potentially forcing the Fed to increase interest rates to prevent jittery foreigners from dumping our money. The rapid rebound in oil prices is another concern as consumers are forced to spend more on their transportation and energy needs. The housing market decline and any additional economic fallout must also continue to be monitored. And unfortunately, our world has become increasingly dangerous with geopolitics remaining at the forefront of the list of risks to the economy and our financial markets.

Strategy

Diversification across asset classes continues to be foremost in our minds. While real estate and energy markets have become more volatile thus far in 2007, international stock markets have maintained their market leadership. We are gratified to see that many of the stocks that lagged last year have rebounded and are once again outperforming the major market indices. We still believe this year should bode well for the equity markets and are positioning our client portfolios accordingly. With money market rates near 5% and our expectation for a continued inversion of the yield curve, our inclination is to keep fixed income purchases on the shorter term.