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The stock market rally continued through the fourth quarter of 2006, closing out a good year for stocks. On the year, the S&P 500 Index returned 15.8% and the NASDAQ Composite Index gained 10.4%. For the third year in a row, foreign stocks (thanks in large part to a weak U.S. dollar) were the standout performers as the MSCI EAFE Index rose 27.0%. Bonds, on the other hand, generated rather subdued returns of 4.6% (as measured by the Lehman Aggregate Bond Index) as the ten year U.S. Treasury yield ended the year modestly higher than when the year began. Our portfolios were well positioned during the year and performance was strong. Generally speaking, our portfolios began the year with equity allocations in line with their investment policy targets, and we increased the allocations just ahead of the second half rally and then maintained them through the end of the year. Furthermore, within our equity allocations we benefited from our healthy and long-standing allocations to foreign stock funds. Finally, our ongoing strategic allocation to a precious metals fund boosted our returns for the third straight year.

Despite the fine returns of our portfolios, there were some disappointments. The relative performance of our stock funds versus their peers was mixed after two previous years of strong relative returns. Also, our increasing emphasis on more growth-oriented stock funds (after many years of focusing on value funds) was a drag on our performance as value managers stayed at the top of the performance charts. Finally, our strategic allocation to commodities was our one losing position last year, as the Pimco Commodity Real Return Strategy Fund lost 3.0%. We did cut this position in half across all portfolios in August, but should have sold the position in total. Since the start of the New Year, we have sold the remaining holdings of this fund for all accounts. While we still like commodities as an investment over the long-term, in the interim we think they are less attractive given our outlook for a weaker than expected economy.

Looking forward, we think that 2007 will be a challenging year for investors. It should be noted that the S&P 500 Index has not experienced a 10% decline since 2003, which represents the second longest such stretch in this index's history. Similarly, we have also enjoyed the longest period in 107 years without a 2% intraday decline in the Dow Jones Industrial Average. The stock market is overdue for a correction. We suspect that this correction will materialize later this year as stocks discount lower corporate profits and an increasing risk of an economic recession, precipitated in large part by a continued slide in housing activity.

As we explained in our last letter, our focus will soon shift toward reducing the risk in our portfolios given our outlook. This process will involve a lowering of equity allocation (relative to each client's Investment Policy and asset allocation targets) and a corresponding increase in our bond allocations. Within each of those asset classes, our growing emphasis on higher quality and less risky securities will also stand us in good stead. Finally, as I meet with each of you in the coming months, we will review your Investment Policy, specifically, the analysis of possible downside risk if stock prices begin to fall. In some cases, we may choose to amend your target asset allocations to further minimize your risk of loss.

Sincerely,

A handwritten signature in black ink, appearing to read "David B. Ackerman". The signature is fluid and cursive, with a long horizontal stroke at the end.

David B. Ackerman, CFA, CFP
Partner