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Investors will remember 2007 as the year the housing bubble burst and the sub-prime mortgage industry imploded. We correctly predicted such turmoil, but were certainly surprised by the contagion effect this had on the entire financial industry. Fannie Mae, Freddie Mac, Citigroup, Merrill Lynch, Bear Stearns, Washington Mutual, and Countrywide Financial were among the many respected companies in the industry whose fortunes were dramatically reversed. The eventual effect of this debacle was a “credit crunch” – lending standards tightened significantly, liquidity dried up, and consumer spending began to slow. The recession that we predicted is now almost a certainty.

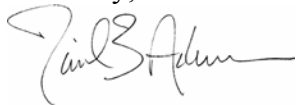
Despite the upheaval in the housing market and financial industry, the stock market still managed to finish the year with a positive return. The S&P 500 Index rose 5.5%, but volatility was high. We expected a correction of at least 10% in 2007, and in fact, there were two such corrections. Foreign stocks fared better, thanks in large part to a continued decline in the U.S. dollar. For the sixth consecutive year, the MSCI EAFE Index bested U.S. market indices with an 11.7% return. Interest rates, meanwhile, moved significantly lower in the second half of the year, as they began to discount the economic slowdown. As a result, the Lehman Brother Aggregate Bond Index returned a respectable 7%. Municipal bonds, however, were negatively affected by a “flight to quality” and concerns about the viability of the country’s largest mortgage bond insurers. The Lehman Municipal Bond Index returned a fairly meager 3.4%.

Our portfolios performed very well in this difficult environment. With regard to U.S. stocks, our emphasis on high-quality, large-capitalization stocks with a decisive tilt towards growth and multinational companies was well placed. Meanwhile our long-standing and generous allocation to foreign stocks continued to enhance the performance of our portfolios. Finally, our strategic allocation to gold stocks, via the American Century Gold fund, further boosted our returns for the fourth consecutive year. In bonds, our focus on funds with low costs and high credit quality served us well. Finally, with regard to asset allocation, our tactical moves were well-timed. Generally speaking, our portfolios entered 2007 with above-target equity allocation (relative to each client’s investment policy). Equity allocations were reduced to target levels in June, just ahead of the July/August correction. We used the ensuing rally to further reduce allocations to below-target levels, which helped to insulate our portfolios as stocks resumed their descent in the fourth quarter. All in all, this was a year in which our diversified,

contrarian, and risk averse investment philosophy truly shined, and the relative performance of our portfolios was indeed strong.

Looking forward to this year, we believe that the stock market has not fully discounted the slowing economy. If we are not already in a recession, then we likely will be in one soon. Assuming this is the case, stocks could fall further during the first half the year, and our conservatively positioned portfolios will help us limit our downside. Eventually, though, this year should present us with an excellent opportunity to again add to our equity exposure at attractive levels, once investor sentiment turns decidedly negative. Regardless, we believe that we will continue to benefit from our tilt towards large stocks, growth stocks, and foreign stocks. We will also continue to look for new opportunities to make additional strategic investments, as we have successfully done in recent years in commodities, gold, and technology stocks.

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