2007 Third Quarter Update

October, 2007

Review: Stocks had a strong finish to the quarter, rising 2.0% despite being down 3% in July. For the year to date, the increase was 9.1%. Bonds rose by 2.8%, and gained 4.4% for the year to date.

	3Q07	***2Q07***	***1Q07***	***4Q06***	***3Q06***
S&P 500 Index	***2.0***	6.3%	0.6%	6.6%	5.7%
Merrill Lynch Intermediate Bond Index	***2.8***	-0.1%	1.6%	1.0%	3.2%

The Economy: The job picture turned somewhat less favorable. Monthly new jobs averaged 97,000 compared to 126,000 in the second quarter. The downturn has not yet been confirmed by the trend of weekly unemployment claims, which are still indicating good economic growth.

The housing slump has worsened as mortgage delinquencies and foreclosures have surged. New home permits and sales are both running at a 20% lower rate than last year, while inventories of unsold homes remain at record levels. Most observers think the market will not bottom until at least mid-year 2008.

Energy costs remain a drag. Gasoline and heating oil prices are stubbornly high, despite signs of slower US growth, because of strong demand outside the US.

The relative bright spot continues to be retail sales, especially at upscale stores. A strong stock market has offset the impact of weak housing market for upper income people. However, lower income households have pulled back because high gasoline and heating oil prices have crimped their discretionary spending.

Our outlook for the economy reflects the mixed trends of the data discussed above. We see slowing activity into next year as shown in the table below.

	2006	***2007E***	***2008E***
GDP	+2.9%	+2.0%	+1.8%
Consumer Spending	+3.2%	+2.2%	+1.8%

Global growth trends are becoming more mixed. Emerging economies continue to be strong, but developed economies, such as the euro area and Japan, have seen growth estimates decline somewhat, largely due to lackluster consumer spending.

The weak dollar has benefited many US companies. Exports by domestic companies to still strongly growing emerging economies have been an important source of earnings, helping to offset domestic consumer sluggishness. If the US and other developed economies have a soft landing, we believe this trend can continue. However, if the developed world experiences a sharp recession, emerging economies will certainly be hurt because of the interdependence of the world. We are keeping careful watch on these trends.

Stock Market: The stock market started the quarter on a strong note, as second quarter earnings reports were generally good, despite the weakness in housing. Turmoil in the credit markets caused stocks to fall in August, but they rebounded sharply in September as the Federal Reserve cut rates and pumped money into the financial markets to ease the credit contraction.

Bond Market: The turmoil in the sub-prime mortgage market spilled over into the credit markets, causing investors to flee risky bonds and bidding up the prices of US Treasury bonds. The outlook for interest rates is unusually murky because the Fed is hemmed in between two concerns. They have eased monetary conditions aggressively, pumping hundreds of billions of dollars into the financial markets, in order to counteract the lack of credit for all but the most secure borrowers. On the other hand, they do not want to be seen as bailing out those lenders who took excessive risk. Also, they risk igniting inflation which would be contrary to the Fed's primary charter to control inflation. The dollar is at record lows against the euro, a strong indication that international investors are already concerned about the risk of higher US inflation. If domestic markets also become concerned about inflationary pressure, long-term interest rates may rise in spite of the Fed's actions, further slowing the economy. We currently believe that this will be the case, and that long-term rates will trend higher over the next 6 to 9 months.

Strategy: The key driving factor for the stock market is the outlook for corporate profits. It appears that profit growth will slow from the 16% pace of last year to a 6-7% gain for this year and next. While not robust, we believe that the trend is "good enough" to allow further gains in stocks, because the valuation of stocks is reasonable by historical standards. However, we will maintain defensive portfolios of high quality stocks that are able to prosper in a low-growth environment. Our bond portfolios will be equally defensive, emphasizing high quality and shorter maturities.