FINANCIAL SERVICES ADVISORY
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Rockville, MD 20850 800.235.4567 www.fsainvest.com

Market Begins Year on a Modest Note
January Market Review From Your Portfolio Management Team—February 6, 2007

January has a reputation as being one of the strongest months out of the year. According to research from Yale Hirsch, as reported in the *Stock Trader's Almanac*, January has been positive in 36 of the past 57 years, with an average gain of 1.7%. In addition, you may have heard of the so-called 'January Effect' which maintains that the direction of the market in the month of January often predicts the general direction of the market for the entire year. Going back to 1950, January has correctly predicted the direction of the market for the entire year in 51 out of 57 years (again according to the *Stock Trader's Almanac*).

For 2007, the S&P index finished January with a gain of 1.4%. So, according to the January effect, we should expect a positive year for 2007. On the other hand, since the return for 2007 was below the average gain for January (1.7%), we should put less weight on this indicator than otherwise might be the case.

At FSA, we are moderately positive about market prospects at the moment. Most areas of the market seem a bit stretched to us, but there is no reason they could not extend even higher. Only energy and commodities have been hit in recent months; although, those two areas have been among the strongest for the past several years. It's not surprising to see those areas take a breather. The FSA portfolios generally include large-cap funds, with some allocation to international funds. We have reduced, and in some cases, eliminated the long-term bond positions in our portfolios. Even though we believe this area could do just fine in 2007, they hit our safety nets, so we have reduced our investment and look for a better opportunity down the road.

To give you a flavor of how the different portfolios are constructed, below we list the ten largest holdings within the various FSA objectives:

- *US Equity Funds*
  Rydex Large-Cap Value—focuses on companies that are undervalued relative to the broad market. These stocks tend to be a bit more conservative than the average stock.
  Schwab Premier Equity—buys large-cap stocks according to a rating system developed by Schwab. A good, solid fund that moves as the broad market moves.
  Mutual Shares (and Mutual Qualified)—these funds are excellent funds that focus on undervalued companies, both in the U.S. and abroad. They will tend to lag in strong market rallies, but tend to hold up better in down markets.

Rydex NOVA—a fund that mimics the return of the S&P 500 index, but has a beta of 1.5 times the S&P index. That means it will go up more than the S&P index on positive days, but it will fall more than the S&P index on down days.
DireXion OTC Plus—an aggressive fund that mimics the return of Nasdaq OTC 100 index, an index which tracks the 100 largest companies in the Nasdaq Stock Market.
iShares NYSE Composite—an exchange-traded fund (ETF) that mimics the return of all the stocks that trade on the New York Stock Exchange (NYSE). Basically, it provides a broad exposure to the U.S. stock market and will tend to move as the S&P 500 index moves.

- *Core Funds (tend to exhibit consistent returns in rising markets and offer good downside protection)*
  Schwab Hedged Equity—one of our favorite core funds because it tends to give nice participation in rising markets, while offering good downside protection in down markets. They do this by shorting stocks they believe will fall in value (that is, the portfolio can make money if those stocks they are shorting actually do fall in price). This makes the overall portfolio more conservative than the broad market.
  Merger Fund—a long time favorite of FSA, this portfolio is managed in a very conservative fashion and usually holds up very well in down markets. While it cannot keep up in a strong bull market, over most of its history, it has provided very consistent returns.

- *International Funds*
  DireXion Developed Market Bull—a fund that attempts to mimic the return of the MSCI EAFE index, but goes up or down at twice the rate of the general index. That is, if the EAFE index rise (falls) 1% in a single day, this fund expects to rise (fall) 2% in that same day. By using this fund, even though we may have only 5% or 10% invested in the fund, the portfolios will behave as though there was twice as much in the fund.
  iShares EAFE Index—an exchange-traded fund (ETF) that mimics the return of the MSCI EAFE index of foreign stocks.

In our opinion, the key factors that will push the market this year will no doubt be:

a) Direction of oil prices
b) Earnings growth from companies
c) Direction of interest rates

If the economy can maintain a growth track for 2007, without interest rates rising too much, and with oil prices remaining in a tolerable range (no higher than $65), stocks should generate enough earnings to keep the markets moving higher in 2007. Of course, we will constantly monitor the health of the overall market, as well as the individual funds in your portfolios, and be ready to take whatever action is necessary to help these strategies continue to deliver solid returns with moderate levels of risk.