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No Santa Claus Rally For 2008 As Market Stumbles Through Year-end

Fourth Quarter Market Review From Your Portfolio Management Team—January 14, 2007

The stock markets continued their volatile ways in the fourth quarter, ultimately ending on a down note, which is somewhat unusual as the stock market (at least as measured by the S&P 500 index) is seldom negative in the fourth quarter. In 2007, the market finished down over 3%, which was the worst performance for the fourth quarter since 2000.

At this point, market participants continue to be concerned about the ongoing declines in housing and sub-prime mortgages, as well as oil prices that have already touched $100 a barrel. The concern, of course, is that these issues will help cause a recession in the U.S. At the same time, there is also concern about a return of inflation, with gold prices back above $800 an ounce, as well as soaring commodity prices. So, the Federal Reserve Board is caught between wanting to cut interest rates to help spur the economy along, and needing to keep interest rates high enough to prevent inflation from picking up steam. The stock market hates all the uncertainty, so volatility remains high.

As we entered the final quarter of the year, we had moderate levels of money markets (about 45%), plus about 7% in bond funds, so we were in a decent position to weather the volatility that occurred from October through December. Across all strategies, FSA was down less than 2% for the quarter.

For the year as a whole, it was quite a challenging year for FSA, and in some ways reminiscent of 2005, another year of modest returns from the broad U.S. stock market.

Index	*Q4 Return*
S&P 500	-3.3%
EAFE	-3.0%
Lehman Bond	3.0%
90-Day T-bills	0.9%

Source: Ned Davis Research
Note: EAFE represents the MSCI index of foreign stocks; Lehman Bond represents the Lehman Aggregate Bond Index. Returns cover the period from 9/30/07 – 12/31/07.

Here is a brief review of the major FSA strategies during the fourth quarter (Full performance data for all objectives will be available at the end of January, upon request):

Conservative Growth
These portfolios weathered the volatility pretty well in the fourth quarter, falling about half the loss of the S&P 500 index. By the end of December, the bulk of the assets in *Conservative Growth* was in the safety of a Treasury money market fund, with a modest amount of fixed income (10%) and a few conservative to moderate equity funds.

For the year as a whole, most *Conservative Growth* accounts performed behind our expectations. Nevertheless, we believe our safety-first focus in these portfolios will serve them well in 2008 and beyond.

Core Equity
For the fourth quarter, *Core Equity* accounts fared about as expected, falling in line with (in some cases slightly less than) the broad market. We believe the shift from value-oriented funds to growth-oriented funds was the right move in the longer run, as growth-oriented stocks (such as health care and technology) will do well in the coming years, but the market volatility at the end of the year forced us to reduce or even eliminate some of these positions. For now, we will maintain high money market positions until the skies clear up a bit.

It was a very difficult year for most *Core Equity* accounts. The high market volatility coupled with a sideways market created a challenging environment for our all-equity strategy. We are hopeful for a better environment in 2008 and a better result for our clients. The onset of a bear market or a sustained recovery would serve our investment approach just fine. We have been through these types of market environments in the past, and have always successfully weathered them, as new trending environments emerge that play to our investment approach more favorably.

Tactical Growth
Tactical Growth fared quite well during the fourth quarter, falling a small fraction of the return of the broad market. As was the case in the third quarter, this was accomplished through the use of growth-oriented sector funds, along with an inverse real estate fund (that goes up in value as real estate funds fall) and a long-term government bond fund.

For the year as a whole, this strategy posted a decent result, finishing in line with the broad market. Choppy, volatile years such as 2007 can be good environments for a strategy that has total flexibility to go into any market segment or asset class.

Income & Growth
Income & Growth portfolios also held up quite well in the fourth quarter, down a fraction of the return of the broad market. As one of the more conservative strategies at FSA, they avoided many of the choppiest parts of the market in 2007. With a balance of stock funds and bond funds, they seem to offer a great sleep-at-night risk profile—a particularly nice feature for clients making regular and sizable withdrawals from their portfolios. For the year, *Income & Growth* portfolios finished just slightly behind the returns of the broad market.

Income
As you might expect from our most conservative strategy, volatility in the equity market had only a minor impact on these portfolios, and they fell only slightly for the quarter. As the quarter came to a close, these portfolios were primarily in money markets, with an allocation to a bond fund, as well as a high yield fund.

For the year, *Income* portfolios finished essentially flat. This was behind our objective of exceeding the return of a money market fund. We tend to use high yield funds frequently in this strategy, and high yield bonds experienced some of the same volatility as their equity counterparts in 2007, finishing the year up less than 2% on average.

The Future
We believe the uncertainty in the markets from 2007 will get resolved in 2008. At that time, the market should resume a trend. That trend may be upward, if the U.S. can manage a soft landing and avoid a recession, or a downward trend if the U.S. does slip into a recession (in all likelihood, the stock market will be in a downtrend before the experts officially determine we are in a recession). We ask for your patience during this choppy period of transition, as the market digests news on the economy and the housing market. We have experienced these types of markets in past years, and in all prior cases, the market environment did migrate into an environment more conducive to our investment style.

Increased market volatility is often a precursor to a more challenging market, and we believe that 2008 will be a year fraught with peril. As happened nearly ten years ago, clients who had the patience to remain with us during a frustrating environment for conservative managers (1998 – 2000) were glad they had an experienced hand to guide them through the difficult market that followed (2001 – 2002). We believe that your patience during these flat choppy past few years will be rewarded in the years to follow as the market transitions into a more trending market.

We are not pleased with the results for 2007, particularly for most of our Core Equity accounts; however, we remained true to our discipline and investment philosophy during the year. We added to our equity positions as the market rallied during the year, and built up our money market allocation during the sell-offs. Years like 2007 will always be challenging for our approach to managing money, but we are willing to struggle through these kinds of years since our approach works well in protecting portfolios from sustained market declines. Since inception in 1997, Core Equity has performed ahead of the S&P 500 index, with less risk, even though there are years when these accounts finish well behind the broad market. This is possible because Core Equity accounts have done a good job in avoiding much of the losses from the negative years in the market. We remain committed to helping clients reach their goals through conservative money management. Making money in bull markets is only successful if you can keep most of those gains in bear markets.

Please let us know if there is anything we can add to these monthly reports that would help you better understand what is happening in your accounts.