

SMITH & HOWARD FINANCIAL GROUP

Comprehensive Wealth Management

April 10, 2007

Dear Clients and Friends,

We hope this letter finds you off to a great start in the New Year. Following is a review of recent activity in the financial markets.

First Quarter 2007 Review

Market Performance

Everyone knows the shortest distance between two points is a straight line. Everyone except the stock market, that is. Most of the major stock market indices (save the Dow) ended slightly positive for the quarter, but not before enduring the most volatility we've seen in several months. The markets were generally in strong positive territory until the end of February, when a confluence of factors caused the biggest one day percentage drop in the Dow in nearly four years. International stocks had a strong quarter. Their influence, along with fixed income and alternative investments, combined to give our clients a smoother ride during the quarter than that experienced by the overall market.

Bond prices were also more turbulent than normal, but the broad market averages turned in a positive performance as well. Bonds rallied nicely on the days of the biggest declines for stocks, again validating their place in most portfolios, not only for income production, but for dampening volatility.

Most alternative investments fared well for the quarter also. Following are the returns for the quarter and past twelve months for many of the asset classes we actively track:

First Quarter 2007 Market Performance

Index	Quarter	1 Year
S&P 500	0.6%	11.8%
Russell 1000 Growth (Large Cap)	1.2%	7.1%
Russell 1000 Value (Large Cap)	1.2%	16.8%
Russell Mid Cap	4.4%	11.8%
Russell 2000 (Small Cap)	2.0%	5.9%
Russell Micro Cap	1.0%	3.1%
EAFE (International) in US \$	3.5%	17.5%
MSCI Emerging Markets in US \$	2.3%	21.0%
Lehman 1-5 Year Government/Credit	1.6%	5.7%
Lehman Aggregate	1.5%	6.6%
Lehman High Yield	2.6%	11.6%
Dow Jones Wilshire REIT (Real Estate)	3.7%	21.9%
HFRX Global Hedge Fund Index	3.3%	6.9%

Source: PSN

Economic Review

The government's last revision to GDP shows that the U.S. economy grew 3.3% in 2006, as compared to 3.2% in 2005 and 3.9% in 2004. The Fed officially expects 2.5 – 3.0% growth this year, and about the same next year.

After the prolonged rate hike campaign by the Fed over the past couple of years, an economic slowdown should not come as a surprise. Fortunately, so far, the increased rates have had the desired effect of cooling off the red-hot real estate market and some of the resultant inflation, without ending the expansion.

Market participants had much other news to digest during the quarter. Along with continued strained relations with Iran, a number of items combined to cause the aforementioned volatility in the stock market. Non-Chairman Greenspan uttered the “R” word in a speech, although upon closer examination he merely suggested it was a possibility, as we are late in the current economic cycle.

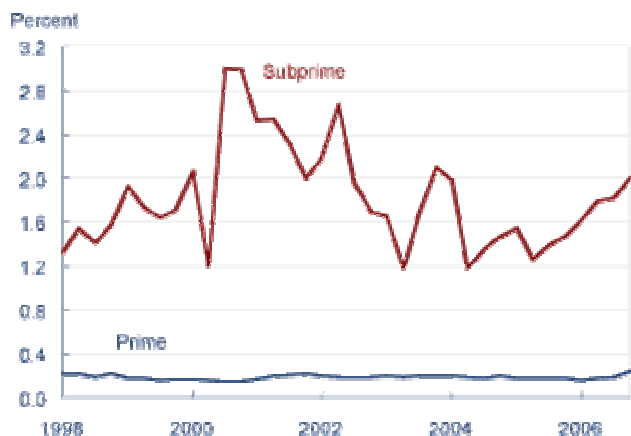
Daddy, What's a Sub Prime Loan?

When the ten year old son of a friend in the real estate business asked this question, I knew this was a frequently addressed, but perhaps little understood topic du jour.

The markets were abuzz in the first quarter about the fallout in the so-called “sub prime” mortgage market. I venture to guess most people had never heard the term before 2007. These are loans generally made to people with less than stellar credit histories, thus they do not qualify for “prime” rates. They are considered to be more risky, and their default rate is naturally higher than for prime loans. Many of these loans are made with little or even no equity, and this time around, the problem was exacerbated by artificially low interest rates, and even lower “teaser” rates – rates that eventually reset higher.

This, combined with real estate prices that in many areas rose too much too fast, created a volatile cocktail, the hangover from which has resulted in some borrowers with monthly payments that have doubled. Indeed, sub-prime foreclosures have risen dramatically. Despite predictions of more trouble ahead, as with anything, some context is necessary.

Foreclosures Started



Source: Mortgage Bankers Association.

While sub-prime loans increased to about 14% of all mortgages outstanding, the vastly bigger prime market appears to be in fine shape. According to research firm Litman Gregory, even if the combined sub-prime/FHA sector hit higher than average default rates, fewer than 5% of all outstanding loans would be impacted.

While we are carefully monitoring this situation for any potential spread to other sectors of the economy, at this time we don't expect any real problems.

Inflation Update

We have mentioned several times in recent letters our concern over trends in inflation. The past twelve months' average of 2.8% increase in overall prices does not sound particularly alarming on its own. However, several underlying trends are worrisome. For example, readers may be surprised to learn the price of corn has doubled in the past two years, driven by increased demand for ethanol and other alternative fuel sources. This has translated into higher prices for corn syrup, livestock feeds, and eventually will cause increases in retail food and restaurant prices. The ripple effects from seemingly insignificant beginnings are often what cause the market to be surprised down the road.

We continue to view inflation as a greater threat than a recession, at this point. Most clients have several positions in their portfolio designed to combat inflation.

Evidently the masses disagree. The bond market is currently pricing in a reduction in the Fed Funds Rate by early summer. While this is possible, given the possibility of continued inflationary pressures and the overall strength of the economy, we view significant rate cuts as unlikely in the near term.

Asset Allocation

Equities

The equity-only component of our client portfolios performed relatively well in the first quarter¹. Returns were helped by mid-cap and international stocks. With the Dow again flirting with all-time highs, we are taking the opportunity to rebalance portfolios that may have gotten a little heavy in stocks.

We made one change recently in some portfolios, replacing a large-cap growth fund whose performance had fallen behind our standards. This either occurred in December or after January 1st, depending on which was more advantageous from a tax standpoint for each client.

Fixed Income

With U.S. Treasuries yielding five percent or less across the board, we continue to favor short-term maturities. Given our economic outlook and inflation expectations, we also still view stocks as more attractive than bonds. There were no changes to the fixed income portfolio during the quarter.

Alternative Investments

Where appropriate, this quarter we added a mutual fund that is invested with several managers that use hedge-fund-like techniques to attempt to achieve attractive returns with less volatility than the stock market. Unlike hedge funds, however, this fund has daily liquidity, less than average expenses and no complicated tax filings.

Thank you for your continued trust and interest in our firm. As always, if there has been a change in your financial situation or your investment objectives please let us know.

Sincerely yours,

Michael R. DeWitt, CFA
Director of Research

¹ Performance references are derived from a composite calculation of the equity, fixed income and alternatives portion of fee-paying client accounts, and are net of all fees and expenses incurred by the accounts. Not all clients are invested the same, and performance varies accordingly. Complete information about the composite is available upon request.