

July 17, 2007

## 2<sup>nd</sup> Quarter 2007 Review

Dear clients and friends,

I hope you are enjoying your summer. As I write this letter rain is falling throughout the neighborhood and much of the city. Thankfully, it has rained every day for a few weeks now, a welcome relief for Atlantans.

While the Southeast may have suffered through a drought for much of the second quarter, the stock market surely did not. Here are the results for several market indices:

### Second Quarter 2007 Market Performance

Index	Quarter	1 Year
S&P 500	6.3%	20.6%
Russell 1000 Growth (Large Cap)	6.9%	19.0%
Russell 1000 Value (Large Cap)	4.9%	21.9%
Russell Mid Cap	5.3%	20.8%
Russell 2000 (Small Cap)	4.4%	16.4%
Russell Micro Cap	3.3%	14.2%
EAFE (International) in US \$	5.3%	24.1%
MSCI Emerging Markets in US \$	14.1%	41.8%
Lehman Aggregate Bonds	-0.5%	6.1%
Dow Jones Wilshire REIT (Real Estate)	-9.4	11.7

Source: PSN

### World Economy

If an investor were a surfer during the period it would have been a great time to go to the beach. Any beach. There were clear skies and rolling waves of global economic prosperity to surf upon. June was down a bit, but equated to only a small tumble off the board.

The global economy expanded at a healthy pace during the second quarter. So much so that some central banks have had to raise interest rates slightly in order to temper enthusiasm. Also worth noting, the overall global economy is becoming a bit less dependent on the U.S. and more balanced among all of the world's trading partners.

## **The U.S.**

The U.S. economy perked up after a sluggish first quarter. Overall GDP is expected to rise at the comfortable annual rate of about 3% (vs. 0.6% in the first quarter). Some experts had feared a much poorer showing because of higher food and energy prices, sub-prime lending concerns and the ripple effects of a housing downturn. Despite these drags, strong job creation has accounted for some heavy lifting. Unemployment remained at a low 4.5% level. Better still, wages rose at a faster rate than inflation (3.9% vs. about 2.7%). This resulted in more disposable income for U.S. consumers – which helped both overall economic growth and corporate profits. Corporate profits have been surprising on the upside.

## **International**

The Euroland (those nations that adopted the euro as their currency) economy continues to grow strongly. Business spending has been particularly strong – more so than consumer spending – and has been the driving force behind the growth. Meanwhile, the employment situation continues to improve. Unemployment in the Euro-zone is now almost 7%, which is the lowest rate seen in a decade. The European Central Bank (ECB) has a low inflation tolerance of only 2%. Somewhat concerned with inflation, the ECB has been inching up interest rates and is expected to take them to the 4.5% range (vs. the current 5.25% U.S. Fed Funds rate).

The U.K. (not a part of the Eurozone) is similarly inflation conscious and the Bank of England has now raised their rates 100 basis points over the past year.

Asian economies such as Japan, China and Taiwan continue to have strong fundamentals such as net exports. They also have higher personal savings rates to support further expansion. Importantly, as a percent of overall exports, exports to the U.S. have been declining in recent years. This means that Asian countries are trading more with one another as well as with their European trading partners. Many economists regard this increase in intraregional trade and correspondingly less reliance on the U.S. as a positive.

## **Portfolio Commentary**

During the second quarter we continued to stay slightly overweighted to equities, which helped give an added boost to performance. International exposure – especially to emerging markets – was a plus. Our overweighting to large-cap growth stocks also added value, as large-cap growth outperformed large-cap value for the period. Regarding bonds, we maintained our emphasis on shorter-term maturities.

Although there are many positives that we have already mentioned, there are also a few concerns. These include continued weakness in the U.S. dollar (the dollar is trading at a 26-year low vs. the British pound) and high energy prices. Also, the full effects of the housing downturn have yet to be determined. Taken in combination with the strong run-up in equities over the past year and other factors, we will likely be making some appropriate adjustments to client portfolios sometime in the third quarter.

Thank you for your business and for your interest in our firm. If there is any change in your investment objectives or your financial situation, please let us know.

Best regards,

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