ALL STAR QUARTERLY

THIRD QUARTER 2007 VOLUME 13 ISSUE 3

2007 – 3RD QUARTER REVIEW AND PREVIEW

BOB'S CORNER

As predicted, we are experiencing an extreme amount of volatility in the market. This volatility is due to the fact that in this part of the economic cycle (going from mature growth to contraction with the potential of going into a recession) uncertainty is what makes the market go crazy.

A common question asked by clients these days is "How are you dealing with this crazy market?" My response is that we have already done what we needed to do. As mentioned in our second quarter review and preview, we took 20 - 25% of our domestic equity exposure off the table in late '06 and early '07 and kept predominately a large cap exposure, which do better in a falling market. We then took 10 – 18% of that and added it to our international exposure (totally outperforming domestic). Then we took the remaining 7 – 10% and added it to our short term bond exposure.

Looking forward, do not be surprised if we add a financial sector allocation to your portfolio. This is a true value driven play, after the financial stocks have gotten beat up!

MARKETS MANAGE GAINS DESPITE HOUSING CREDIT WOES

MARKET OVERVIEW

What many hoped would be an easily contained problem limited to the subprime mortgage market turned into a full-scale credit crisis in the 3rd quarter of 2007. It also created an untimely setback for the already struggling housing market. As mortgage delinquencies and foreclosures reached record levels, credit markets froze up. The result was a "flight to quality" in the bond market and an escape from any asset perceived to have exposure to the subprime market.

From mid-July to mid-August, stocks lost nearly 10% and corporate bonds declined dramatically. Central banks took swift action to infuse liquidity into the markets. Most notably the Federal Reserve cut the discount rate in August, and then shaved the Fed Funds rate by 0.50% at its September 18th meeting.

The Fed's actions triggered a positive response from investors and the economy. At least for now we avoided slipping into a recession. All of these factors contributed to a market recovery from the middle of August through the end of the 3rd quarter. Beware, more challenges (opportunities) lie ahead!

ECONOMY

THE 3RD QUARTER

On the heels of a strong 2nd quarter with an annualized Gross Domestic Product growth rate of 3.8%, the economy was decidedly weaker in the 3rd quarter. The sudden emergence of a widespread credit crunch in the wake of the subprime mess completely changed the environment.

New home sales declined 8% in July and another 21% in August, and the supply of existing homes for sale on the market expanded to a 10-month inventory. Mortgage delinquency rates jumped and foreclosure rates doubled among borrowers with adjustable rate mortgages (ARMs).

Severe weakness in the housing sector heightened concerns that the pain would spread to other parts of the economy. Measures of consumer and investor confidence hit one-year lows, and unemployment rose slightly. The biggest impact was credit markets dried up almost overnight! This affected financing for consumers and corporations, even sidetracking what had been a very active mergers and acquisitions market.

Once the Federal Reserve took steps to improve the liquidity situation, some of the concerns were eased, but questions linger as to whether the negative impact seen in the subprime arena will spread further.

LOOKING AHEAD

Financial services companies coping with subprime losses appear most susceptible in the current environment. This leads some to fear that problems related to the housing market will, in fact, trigger a widespread recession. On the other hand, the Fed and others have indicated an expectation that most of the damage can be contained.

INSIDE…THIRD QUARTER REVIEW AND PREVIEW CONTINUED…PERFORMANCE SUMMARY…LEE'S TAX TIDBIT

There is support for the contention that the economy can continue positive, albeit slower growth. The Institute of Supply Management's survey of manufacturing and service sectors shows continued economic expansion. With inflation staying at modest levels, the Fed should have the flexibility it needs to further lower interest rates if economic conditions require it. Corporate profits remain solid and continued dollar weakness benefits U.S. companies that sell overseas. Still, the general consensus is for less robust economic growth in the coming year.

BOND MARKET

THE 3RD QUARTER

The bond market endured a significant shakeup in the 3rd quarter, due to the onset of the credit crunch. The subprime problems that first stung U.S. financial companies also triggered losses in financial institutions in Europe, Australia and China. That news quickly drove investors out of virtually all bonds that had any association with risk, favoring instead the perceived safety of U.S. Treasury bonds.

Most other segments of the market paid a price, with bonds in the high-yield, emerging markets, commercial and bank loans sectors all suffering significant losses prior to intervention by central banks. Commercial paper (short-term corporate borrowing) was hit particularly hard, and even credit worthy corporations had to shift borrowing to long-term (and typically more costly) loans.

Long-term government bonds, by contrast, gained 5.3% for the quarter. Global bonds rose 4.5% and inflation-protected (TIPS) bonds were up 4.1%. Most other sectors of the bond market recovered their losses by the end of the quarter, except for high-yield and bank loan funds.

LOOKING AHEAD

The direction of the bond market for the remainder of the year will likely be driven by economic signals. If housing remains weak and consumer spending is muted, the Fed is likely to trim interest rates even further. In that environment, expect bond yields to fall. Signs of a stronger recovery in housing will, on the contrary, likely keep the Fed in check and eliminate further rate cuts for the current cycle.

LEE'S TAX TIDBIT

Generally a taxpayer is taxed on distributions from his IRA. However, for tax year 2007, for individuals 70-1/2 years or older, an exception applies to distributions made directly to a charity or donor advised fund, up to $100,000. The exclusion does not apply to employer sponsored IRAs such as SEPs and SIMPLEs.

Although the check must be paid out of the IRA account directly to a charitable organization, it may be delivered by the IRA owner. An added benefit is the distributions are taken into account and "count" toward your required minimum distribution, to the same extent as if the payments were made to the IRA owner. The charitable contribution substantiation rules must be followed, or the exclusion is not allowed for any part of the distribution. The exclusion is also not allowed if the deductible amount is reduced because of a benefit received. These distributions are not subject to withholding because IRA owners that request charitable distribution are deemed to have opted out.

The above is not intended to be all inclusive, but to bring your attention to some of the main points.

Please give me a call if you are in need of any tax planning. Now is the time to plan. It is too late when you are starting to think about getting your taxes done!

DOMESTIC STOCK MARKET

THE 3RD QUARTER

It was a topsy-turvy quarter for stocks. After a rapid start built on encouraging economic signs, market sentiment shifted rapidly in light of mounting credit woes and their potential fallout. Stocks, as measured by the broad Russell 3000 Index, lost 9.9% from the peak on July 13 to the low on August 15. At that point, the Federal Reserve began to take steps to boost liquidity, sending signs of encouragement to the markets. Bargain hunters took over and stocks quickly recovered. When the quarter came to an end, the Russell 3000 had regained much of the ground it lost and finished with a gain of 1.6%.

Investors focused on high-quality large-cap stocks, which logged a 2.0% return for the period. Many of these companies have significant export business, which benefited from the weaker dollar. Mid-cap stocks were down 0.4%, and small-cap stocks trailed, losing 3.1% for the quarter. From a style perspective, growth stocks profited, with a gain of 3.9% versus a loss of 0.8% for value stocks.

As commodity prices rose through much of the quarter, energy and material stocks benefited, rising 8.1% and 6.7% respectively. Technology continued its comeback with a 5.6% gain and industrial stocks returned 4.4%. By contrast, financial stocks lost 5.0% and consumer discretionary issues declined 7.0%, as consumer spending slowed for major purchases.

LOOKING AHEAD

Despite the third quarter's uncertainty and volatility, the general outlook for most companies remains positive. Profits should grow modestly in coming months with an improved profit picture forecast by the 2nd quarter of 2008. Technology, telecommunications and

Performance Update

Annualized Returns

Market Index	3rd Qtr	YTD	1-Year	2-Year	3-Year
DJ Ind. Average	4.18	13.37	21.65	17.30	13.94
S&P 500	2.02	9.15	16.43	13.56	13.13
Russell 2000	-3.09	3.16	12.34	11.13	13.36
S&P Mid-Cap 400	-.87	11.01	18.76	12.50	15.63
Russell 3000	**1.55**	**8.77**	**16.52**	**13.33**	**13.74**
MSCI EAFE	1.69	10.89	22.02	19.21	20.66
NASDAQ Comp.	3.77	11.85	19.62	12.05	12.51
Lehman High-Yield	.33	3.21	7.54	7.81	7.44
Lehman Agg. Bond	2.84	3.85	5.14	4.40	3.86
Lehman Credit Idx.	2.08	2.86	4.23	3.81	3.45
Lehman Gov. Bond	3.61	4.75	5.63	4.46	3.78

consumer sectors may be best positioned to drive earnings growth. The ability of consumers to spend in light of the housing crunch remains a big question mark.

Large-company stocks will continue to benefit if, as expected, dollar weakness remains. The environment going forward is likely to favor large-cap growth stocks.

INTERNATIONAL STOCK MARKET

THE 3RD QUARTER

International stocks continued to outperform domestic equities in the 3rd quarter. While the credit crunch was felt in overseas markets, foreign stocks, particularly those from emerging economies performed well. Pacific Asia (ex Japan) rose 22.3%, led by a blistering hot Chinese stock market that gained 42% in the 3rd quarter alone. Latin American stocks rose 10.8% and diversified emerging market stocks rose 11.9%.

Among "developed" markets, gains were more muted. Europe felt some direct pain from the U.S. subprime problem, but still registered a 1.8% return. Japan lost 2.9% amid another political crisis. International large-cap growth funds enjoyed a 5.1% gain while small- to mid-cap value stocks lost 0.5%.

LOOKING AHEAD

The weak dollar has put upward pressure on oil prices, a trend that generally benefits emerging market stocks tied to natural resources. That factor, along with expectations that economic growth in global markets will outpace domestic growth through 2008, continues to make the case for global exposure.

Valuations are attractive in Europe and to a lesser extent in Japan. Chinese stocks are ripe for a correction even with the country's dramatic economic growth rates. After suffering a severe drop in February, the Dow Jones Shanghai Index has gained more than 136%. As is often the case, some risk to overseas investors is tied to political uncertainties. Recent events like a government crackdown in Burma and leadership struggles in Pakistan are among the issues worth monitoring.

SUMMARY

We commented in recent letters about the level of balance the market had achieved in past months, with many asset classes generating similar returns. The environment changed abruptly in the 3rd quarter, as markets "re-priced" risk. Some of the themes we anticipated earlier in the year began to play out. High-yield bonds, which we saw as expensive, fell out of favor. Large-cap stocks appeared to have more to offer compared to the previously red-hot small-cap market. Growth stocks, long due for a recovery, outpaced value stocks during the quarter.

This is a good time for investors to be reminded of an old lesson once stated by industrialist J. Paul Getty. He said, **"Buy when prices are low and hold on to your securities. People seem unable to grasp these simple principles. They are fearful of bargains." We continue to put an emphasis on identifying investments that offer fundamental value and solid long-term performance prospects.**

Remember: "Buy low and sell high. It's not how much you make, its how much you keep!"

Don't Fight the Fed

There is an old Wall Street saying that goes, "Don't Fight the Fed". When the Fed is raising rates you want to reduce your stock holdings, and when the Fed is lowering interest rates you should increase your stock holdings. Actually, the Federal Reserve's main goals are maintaining price stability (inflation), employment, and economic growth. The stock market really is not a main concern of the central bankers.

But Wall Street normally reacts positively whenever the Federal Reserve embarks on a new round of interest rate cuts. The Fed has cut interest rates 11 times since 1945 and the S&P 500 has advanced an average of 12.3% in the first six-months following the first cut. Since 1984, stock market returns have tended to favor large-cap stocks and growth stocks in early stages of monetary easing. Technology, industrial, and consumer sector stocks have all outperformed the market during these periods.

STOCKS RISE ON FED RATE CUTS

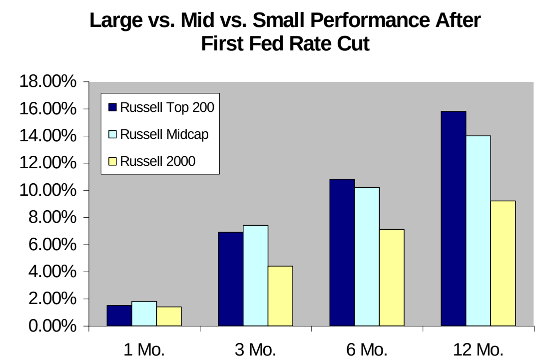
Since 1945, the S&P 500 has gained 7 of 11 times in the six months after a rate cut*

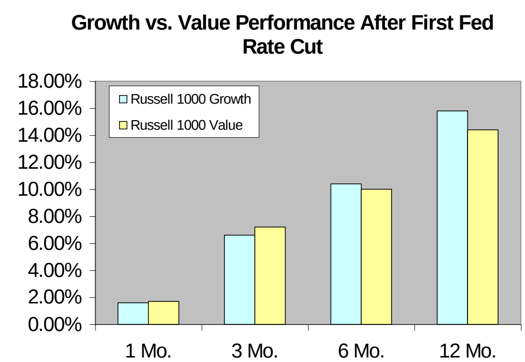
Period Analyzed	S&P 6 mos. later
Feb '54 – Aug – '54	+17.9%
Nov '57 – May '58	+9.3%
Jun '60 - Dec '60	-2.3%
Nov '70 – May '71	+22.3%
Dec '74 – Jun ' 75	+42.3%
May '80 – Nov '80	+27.4%
Nov '81 – May '82	-4.5%
Jul '90 – Jan '91	-13.7%
Jun '95 – Dec '95	+15.3%
Sep '98 – Mar '99	+24.9%
Jan '01 – Jul '01	-3.6%
Average	+12.3%
Average since 1980	+7.6%

**DISCOUNT RATES WERE USED FROM 1945 – 1982. THE FED FUNDS RATE WAS USED AFTER THAT

*SOURCE: SAM STOVALL, STANDARD & POOR'S

Returns Historically Favor Large Cap Equities After First Fed Cut





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