INVESTMENT UPDATE

July 2007

Economic Conditions & Market Outlook

Despite the mid-year performance of the Standard & Poor's 500 Index (+6.00%YTD) and Dow Jones Industrial Average (+7.59%YTD), the first six months of 2007 was definitely a tale of two quarters.

After closing out 2006 on a high note, the stock market began the first quarter by experiencing a bad case of winter blahs as Wall Street's mood started to mirror January's cold, dark nights. The market's increasing preoccupation with the potential negative fallout from sub-prime lending problems was eclipsed only by the ongoing hand-wringing related to woes in the housing and homebuilding sectors.

Adding to this somewhat dour disposition was a February rise in crude oil prices to a seven-month high (long since history) that was at least partially fueled by Hugo Chavez's decree to takeover all oil projects run by non-Venezuelan companies. Unfriendly leaders of foreign countries making grand socialistic gestures often makes the markets nervous, particularly so when the country is a major petroleum producer.

On the economic front, an up-tick in core inflation was also reported and former Federal Reserve Chairman Alan Greenspan was, for some reason, prompted to return from retirement, again, just long enough to roil the markets, again, with public utterances about recessionary concerns.

Still, most economic data for the period was more neutral than negative. There was lingering market uncertainty as to whether the so-called 'Goldilocks' economy could continue to successfully sustain the moderate growth trend that had been experienced since the Federal Reserve halted their rate rising campaign.

This skepticism was directly reflected in the tepid corporate earnings estimates posited by most equity analysts for the first quarter of 2007. For example, aggregate profits for S & P 500 companies were projected by Thomson Financial to improve by only 3.8%, which would have been the smallest quarterly increase of this measure since the second quarter of 2002. Reflecting this air of uncertainty was lackluster year-to-date market performance through the end of March; with the S & P 500 Index barely inching up +0.18% for the period and the DJIA remaining slightly underwater at -0.87%.

What contributed to the impressive stock market turnaround of the three months that followed? In our opinion, the most important factor was the surprising increase in corporate earnings over analyst expectations when those numbers were actually reported at March quarter-end. For example, first quarter operating earnings for companies comprising the S & P 500 far surpassed earlier estimates and finished 8.2% above their 2006 first quarter totals.

This surprise in corporate earnings was fairly broad-based and provided the catalyst for the markets to surge in April and May, while ending June 30th with the year-to-date numbers outlined above. Fundamental factors contributing to this earnings boost included top-line strength via continued sales growth in foreign markets for many U.S. based, but globally operating, firms; the effective execution of cost-containment and efficient operating strategies; and lower than predicted corporate spending on capital expenditures. While this last factor resulted in favorable bottom-line impact at present, it can potentially be interpreted as a negative moving forward.

Other events during the second quarter also contributed to the notable stock appreciation and optimistic turn of the markets. In particular, the excess cash in many corporate coffers resulted in a number of share buyback programs that boosted both stock price and shareholder value. Likewise, deep-pocket investors jockeyed with each other in taking some publicly-traded firms private and fueled speculation as to which company might next be in the crosshairs for a buyout.

However, the recent volatility in the equity markets reminded investors that the forecast for the rest of the summer might not be quite so rosy. The largest contributor to the jitters that plagued most of June came from the other half of the asset allocation equation – bonds.

While fixed income investments are often viewed by the general public as being the safe and stable side of their investment portfolio, bonds can also experience significant short-term pricing volatility. Such was the case as the second quarter came to a close when the yield on 10-year U.S. Treasuries surged, finally resulting in the biggest daily Treasury price decline in more than two years.

This potentially impacts the stock market in several ways. First, rising bond yields affect the overall economy by making all forms of debt more expensive. The result is less borrowing, which can slow personal/corporate spending, which in turn hinders economic growth, etc. The 'Goldilocks' economy that was referenced previously can quickly turn from being 'just right' to 'too cold'. Second, higher borrowing costs have an even more direct effect on the current market environment where readily-available and relatively inexpensive debt has been used to fund the leveraged corporate buyouts mentioned earlier as a key driver in the stock market's recent upward move. Finally, as yields rise, bonds start to become more attractive to investors than their equity counterparts on a relative risk versus return basis, putting additional downward pressure on stock prices.

Moving forward, it is likely that increasing volatility will continue to haunt the stock market for the next several months. A lack of clear direction often is the beginning of notable day-to-day price swings, like the spinning needle of a compass trying to find true North. Additionally, many market observers have been suggesting some form of price correction is long overdue after a rather prolonged period of not having one. Are current prices out of line with fundamentals…we don't think so. But the market often has the ability to create its own self-fulfilling prophecy, particularly when feeling a bit nervous and jumpy. Like the proverbial pig in a python, don't be surprised if the market has periods of discomfort until the reach and impact of the sub-prime problems are better digested.

<u>Our Tactical Investment Stance</u>

Roof Advisory Group's disciplined investment approach emphasizes adding value to client portfolios while controlling downside risk. Strategies include clearly defining investment policy ranges based on each client's specific investment objectives/risk tolerance, monitoring portfolio adherence to established benchmark parameters, and the ongoing evaluation of relative portfolio return.

Within this strategic context, the firm makes tactical shifts with changing market conditions to optimize client portfolio performance. While every client situation is unique, outlined below are a few of the tactics we are using in the current market:

- For the majority of clientele, we ***increased target equity exposure in early February*** to a ***maximum equity allocation*** as defined by each client's individual investment policy and ***phased in*** the change over a two month period. This targeted allocation level was maintained but then ***recently reduced to one-step under maximum at the end of June***.

- The firm continues its ***leaning toward large-cap stocks*** with solid management, consistent earnings, low P/E ratios (18 or below), higher dividend yields (2.5%+) and annual growth potential (10%+). Stocks outside these parameters are also used when unique pricing or appreciation opportunities exist. Throughout the first half of the year, ***several positions were pared*** that had either ***reached price appreciation potential or did not perform per expectation.*** Additionally, as notable market appreciation occurred during the second quarter, ***several concentrations and positions were rebalanced to maintain target levels***.

- ***Diversification remains a priority*** in both equity and fixed income portfolios. Equity exposure is regularly evaluated for diversification based on style and industry sector while fixed income assets are diversified by issuer, industry and, in the case of municipal bonds, geographic region. While the firm does not make deliberate industry sector bets, concentrations above the benchmark can result from our equity selection process. As a result, currently the industry sectors of ***Energy & Utilities remain over-weighted*** versus S&P 500 benchmark averages; while the areas of ***Consumer Services, Healthcare & Technology are under benchmark level.***

- ***International equity exposure*** is maintained through investing in ***large-cap multinational firms that operate globally*** and by ***utilizing asset managers that focus on fundamental foreign investment opportunities in stable countries***. The target level for ***direct foreign exposure was increased*** in most of our portfolios during the first half of the year.

- Per usual, new account balances and large cash deposits are phased into targeted investment levels. The rapidity of investment of new cash additions to build to target equity exposure ***was accelerated in the appreciating market*** but now ***remains at standard,*** while ***individual fixed income purchases remain paced*** based on opportunity and availability.

- Individual bonds are always used for larger fixed income portfolios to control quality, maturity, and yield. Overall bond quality is never sacrificed in the pursuit of higher yield and a client's tax bracket/account determines whether taxable or tax-free bonds are more advantageous. We continue to maintain a ***notably shortened average maturity*** in the bond portion of our client's portfolios due to market conditions, with most having ***aggregate bond durations of 2.5 years or less***. Similarly, we continue to ***selectively purchase short to intermediate tax-free municipal bonds*** in the taxable accounts of our high tax bracket clientele. ***As mid-term interest rates improve***, we will ***increase the average duration*** of our bond portfolios to capture any yield advantage.

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