

2007 Year-End Market Review

Deflating bubbles in the credit and mortgage markets provided strong headwinds during the year as volatility shook the major indices. As an example, the DJIA rose or fell by one percent or more on 57 days during 2007, as compared to 25 days in 2006. Despite this instability, the leading stock indices recorded respectable gains as the S&P 500, DJIA, and NASDAQ returned 5.5%, 8.9%, and 10.7% for the year, respectively. [Please refer to the performance illustration below for complete year-end returns.]

Growth maintained its performance advantage over Value at all capitalization levels through year-end. Mid-cap Growth dominated all other categories, increasing 15.0% while Small-cap Value underperformed, falling 6.1% for the year.

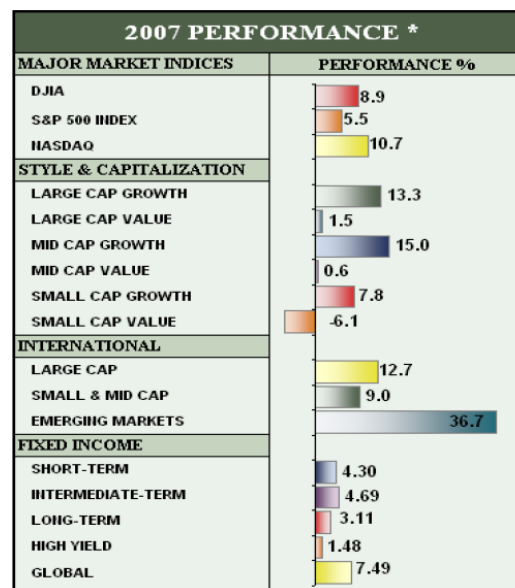
The Energy sector ended the year up 32.4% as terrorism issues, perceived global supply/demand imbalances, investor speculation, and the falling U.S. currency led to near \$100 per barrel oil and \$3 gasoline. The Materials sector, comprised of companies levered to commodities, agriculture, and chemicals climbed 20%, powered by increased demand globally. The Consumer Discretionary sector fell 14.3% as the consumer's ability to use their homes as a de facto ATM worsened. Financials dropped 20.8% as the sector was directly impacted by the housing and credit crunch.

Carry-over effects of the US' mortgage and credit problems plagued the international markets. However, these markets were able to eek out modest gains due to the falling US currency (International Large-caps gained 12.7% while International Small/Mid-caps rose 9.0%). For instance, the MSCI EAFE index gained 8.62% in US dollars but only 1.17% in local currency (price appreciation only). Emerging Markets, after overcoming a steep slide earlier in the year, proved to be the best international category

due to both currency and underlying asset price gains (up 36.7% for the year).

Cumulative 100 basis point ("bps") fed funds rate cuts since August led to a "steepened" yield curve which initially began the year inverted. The shorter, 2-year yield fell drastically from 4.81% to 3.05%, reflecting future implied fed funds cuts due to the slowing economy. The longer 10-year rate declined a more modest 67 bps to 4.03%. Two-year bond yields, which began the year 10 bps **higher** than the 10-year rate (an "inverted" yield curve), ended the year in a normalized and widened state, 100 bps **lower**. The unusually "steepened" yield curve reflects market fears of higher inflation as consumers face higher costs on everything from food to gasoline. As such, short and intermediate-term bonds returned 4.30% and 4.69%, respectively, while longterm bonds gained a more modest 3.11% (as shorter-term bonds appreciated more from falling short-term yields). High yield bonds returned a category low 1.48% as investors fled the sector in an all-out "flight to quality" from higher-risk investments. Global bonds led all fixed-income categories, returning 7.49%, benefiting from moderating global interest rates and the falling US dollar.

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Source Data: Morningstar, Inc. (investment category performance)
*Year-to-date as of 12/31/2007; Total return