

January 2008

Dear Client,

The fourth quarter of 2007 provided a major test of nerves for investors and money managers alike. The story of the quarter was market volatility, with a steep sell off in the broad U.S. equity market beginning in October, followed by unsustained rallies in November and December.

Overall, investor concerns about the housing market, tightening credit and a potential slowdown in consumer spending saw most U.S. equity indexes in negative territory for the quarter. Yet despite these challenges, a review of the graph below shows that overall equity returns were reasonably positive for 2007.

#### **Fourth Quarter Markets**

There were several major market themes during the quarter. The “flight to quality” continued as investors favored high quality growth companies. Emerging markets also remained strong, setting the pace for the quarter and the year. Real estate, on the other hand, had the weakest returns for the quarter and the year. And while the dollar recovered somewhat toward the end of December, it fell against the Yen and the Euro for the quarter.

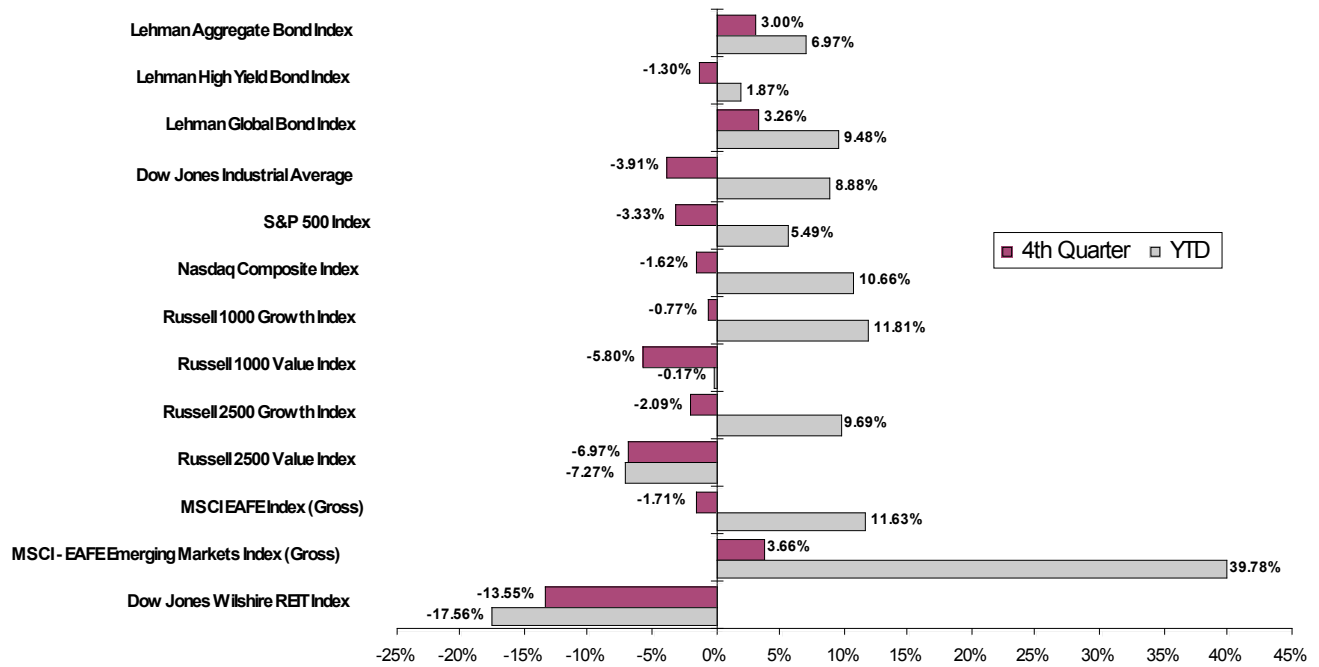
Among the trends and developments we found particularly noteworthy:

- Within the U.S. equity markets, large-cap stocks continued to outpace small-cap stocks, and growth stocks significantly outperformed value stocks.
- International markets outperformed the broad US equity markets as the weakness of the US dollar helped boost international returns. The differential between local currency and US dollar returns was at least 1% for the quarter and over 7% for the year.
- After fueling significant growth earlier in the year, China stumbled in the fourth quarter. India, Russia and Brazil, however, continued to provide strong returns and Emerging Markets was the leader for the quarter.
- Real estate, as measured by the Dow Jones Wilshire REIT Index, enjoyed a rebound in the third quarter, only to suffer a setback in the fourth. Consumer-related sectors such as hotels, residential and retail were the major sources of weakness for the index.
- The bond market yields continued to decline as the Federal Reserve Board reduced both the discount rate and Fed Funds Rate.
- According to Bloomberg, Treasury yields declined from the end of the third quarter to the end of the fourth across all durations as follows:
  - 30-day T-Bill yields from 3.46% to 2.92%
  - 10-year note yields from 4.59% to 4.02%
  - 30-year bond yields from 4.84% to 4.45%.

## U.S. Economic Report

Many of the themes present during the third quarter were also significant stories during the fourth. Causing concerns were market volatility, the slowdown in the housing market, and tightening credit markets. On a more positive note, employment figures remained strong, consumer spending was sustained and inflation appeared contained. Among new developments during the quarter were cuts in the Fed Funds rate at the October and December meetings of the Federal Reserve Board, bringing the rate to its current level of 4.25%. Oil prices ended the quarter at record highs, continuing an upward trend sparked by growing worldwide demand.

2007 Q4 Index Returns



An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged with no associated expenses, and investors cannot invest directly in an index. Past performance is no guarantee of future result. The index returns are all "Total Return" with dividends reinvested, which means the return includes not only the change in price for the securities in the index, but any income generated by those securities. Source: Bloomberg, Lehman Brothers, Wilshire Associates.

Overall, the U.S. Economy remained strong, sustained in part by solid consumer spending and continued demand for US goods abroad. Third quarter Gross Domestic Product (GDP) beat forecasts with a strong 4.9% growth rate. Despite the recent Fed rate cuts, expectations for the fourth quarter, according to a current Bloomberg survey, are for GDP to check in at a more modest 1.0%.

Analysts concerned about an economic slowdown will keep a close watch on inflation and unemployment rates. Nevertheless, the current consensus is that we will not enter a recession, although economic growth is expected to decelerate during the first half of 2008. Current forecasts are for consumer spending and the housing market to regain strength during the second half of the year. Analysts anticipate the Fed Funds rate to be at 4.0% for the year.

2008 is, of course, a Presidential election year. Analysts will monitor the markets closely as the markets build a consensus and respond to the upcoming change in the White House.

## **Staying on track**

While the major market indexes were in positive territory for the year, there was a wide range of returns, with pockets of great strength (such as emerging markets) as well as significant weakness (small cap value and real estate). This disparity reinforces the need for global diversification along with a focus on long-term objectives.

Nevertheless, the New Year is a time of new resolutions and gives us the opportunity to reassess our long-term plans. If you would like to reassess the level of risk in your portfolio, we welcome the opportunity to spend time with you reviewing your financial objectives and answering any questions you may have.

Sincerely,

Carreras Financial Services, Inc.

1 Source: Wilshire Associates. These figures represent "Total Return" with dividends reinvested, which means the return includes not only the change in price for the securities in the index, but any income generated by those securities

2 Source: Bloomberg as of 12/31/07

3 Source: Bloomberg. Ticker symbol CL1.

4 Bloomberg

5 Ibid

6 Ibid

7 Standard & Poors – Past performance is no guarantee of future results.