



2007 – 1ST QUARTER REVIEW



MARKET RIDES A 1ST QUARTER ROLLER COASTER

MARKET OVERVIEW

What began as a steady ride upward in the opening weeks of 2007 quickly turned into a thrill ride the likes of which investors haven't experienced in some time. Stocks gained 3.7% by Feb. 20 before a sudden correction, triggered in part by a major setback for the red-hot Chinese stock market. In a matter of days, the market sell-off sent stocks reeling 6.3%, and at their low point in mid-March, the market was down 2.4% for the year. Despite another decline in the closing days of March, -1.1% in 4 days, a steady recovery allowed stocks to get back into positive territory.

While the Chinese correction came and went, it was replaced on the domestic front by a focus on problems in the subprime mortgage market. Rising default rates (due to a combination of lax lending standards and even some cases of fraud) contributed to an ongoing recession in the housing market. Investors remain concerned that this could have a damaging impact on the U.S. economy as a whole, affecting consumer and business spending.

As a result, risk and volatility have returned to the markets after a four-year hiatus. It is likely that the roller coaster ride will continue throughout 2007 and probably beyond that point. The current environment has put the Federal Reserve (the Fed) in a difficult position, balancing the desire to keep inflation in check (as prices for gasoline and other goods and services rise) while maintaining economic growth (in the face of slowing corporate profits and the weak housing market).

ECONOMY

THE 1ST QUARTER

While a number of threats continue to challenge the economy, it has managed to grow at a slow but steady rate. Fourth quarter Gross Domestic Product figures were bumped from the original estimate of 2.2% to 2.5% on an annual basis. A weaker dollar has boosted export growth 11% and government spending is up 3.4%. Consumers remain a player in the economy's stability as well, with personal spending rising at a rate of 5.6%.

The struggling housing market continues to present the greatest immediate threat to the economy's growth. Residential sales are off 20% and housing prices are down 2 to 5%, and in some parts of the U.S. even more. The collapse in the subprime market has driven a number of lenders out of the business, a factor that could play a significant role in keeping the housing market in the doldrums for the rest of 2007. Layoffs in the construction, real estate and mortgage industries have been widespread. On the other hand, the service sector is demonstrating solid growth, and there has been a modest uptick in hiring among struggling manufacturers.

LOOKING AHEAD

The economy remains on solid footing and seems positioned to maintain a modest level of growth. Continued challenges in the housing market and potential oil price spikes remain points of sensitivity. The consensus of economists is that the rate of growth will slow this year, but remain in positive territory.



BOB'S CORNER

Welcome to two new team members, Valerie Moorhead and Diana Turk. Valerie's title is Executive Assistant, and will work closely with me and you to take some of the pressure off of Maren, Nick and I with client service. Valerie was born and raised in Minneapolis and brings a ready to serve attitude to All Star Financial.

Diana's title is Office Manager, but I prefer to introduce her as the President of first impressions. Diana is the voice you first hear when you call. She has already brought a huge amount of computer skills to the table that will make all of us that much more efficient.

Last, but not least, thank you for your continued support of All Star Financial and the steady stream of referrals that came in from you. I tease people and say, "Do not keep us a secret", but I sincerely appreciate you being the best sales force in the world. Look for more of our TELL A FRIEND outings this summer and fall.



An important factor we will be monitoring is whether consumer spending and business investment can hold up despite the drag caused by the housing slowdown. At this point, economists anticipate that both will show solid growth. Exports are also anticipated to rise as the dollar remains weak compared to other major currencies. Unemployment and inflation should remain in a modest range.

The influential website, Moody's Economy.com has increased the risk of recession in its forecast, to a chance of 22%. However, with key leading economic indicators that are not housing related still pointing in a positive direction, the economy is likely to follow suit.

BOND MARKET

THE 1ST QUARTER

On a day-to-day basis, bonds generally moved in an opposite direction from stocks for much of the quarter. Through mid-February, bonds struggled as interest rates steadily rose amid general optimism about the economy. When the stock market changed course suddenly in late February, the bond market's fortunes improved. For the first three months of the year, the Lehman Bros. Aggregate Bond Index gained 1.5%, slightly better than the stock market.

As was the case through much of 2006, risk was rewarded in the bond market. High-yield bonds gained 2.6% while emerging market bonds rose 2.3%. Treasury-Inflation Protected (TIPS) bonds also finished among the leaders, rising 2.2% for the quarter.

LOOKING AHEAD

The Federal Reserve has held the line on interest rates since June 2006. Bond investors seem to be split on when or if the Fed will cut interest rates. The anticipated likelihood of a rate cut seems to continually be pushed back on the calendar. Our expectation is that the Fed will stay on the sidelines with any short-term interest rate changes for the rest of 2007.

Although high-yield markets started off the year well, we believe further gains from this point may be limited. Our focus instead is on high quality, investment-grade bonds and short-term cash equivalent investments that offer attractive yields with limited risk.

DOMESTIC STOCK MARKET

THE 1ST QUARTER

Thanks to a comeback late in the quarter that was strong enough to offset the market's sudden downturn that began at the end of February, stocks managed a 1.28% total return for the quarter (as measured by the Russell 3000 Index). Investors took a more cautious view after the year's rapid-fire start, as the stock sell-off in China, the nation's housing woes and slowing corporate profits tempered enthusiasm.

Growth and value styles generated comparable gains. However, mid-cap stocks enjoyed a huge advantage, rising 4.4% for the month compared to 2.0% for small-cap stocks and 1.2% for large-cap issues. From an industry perspective, materials companies gained a stunning 9.1% for the quarter and utilities followed close behind at 7.6%. On the negative side, driven by the subprime mortgage crisis, financial stocks lost more than 3% for the quarter.

Another factor continuing to work in the market's favor is the pickup in merger-and-acquisition (M&A) activity. M&A transactions rose 32% in 2006 and are on a similar trajectory so far in 2007.

LOOKING AHEAD

The stock market remains attractively valued as corporate earnings are holding up well. This is particularly true when compared to current values in the bond and real estate markets.

Corporate earnings have proven to be solid, though we anticipate a drop off from the double-digit profits generated in the past few years. The earnings growth forecast for the S&P 500 this year is 7.6%. Still, given current valuations, there is every reason to expect the stock market to generate good performance in the months ahead, with a fair amount of volatility likely to be thrown into the mix.

The majority of investment managers surveyed in the Russell Investment Management Quarterly Outlook anticipate large-cap growth stocks to lead the pack this year. This group has been out of favor since 2000, and it seems likely that they will eventually find their way



Performance Update

Annualized Returns

Market Index	1st Qtr	1-Year	2-Year	3-Year
DJ Ind. Average	-.19	13.80	10.93	8.56
S&P 500	.70	11.82	11.79	10.04
Russell 2000	1.95	5.91	15.45	12.00
S&P Mid-Cap 400	5.80	8.44	14.85	13.35
Russell 3000	1.28	11.28	12.77	10.84
MSCI EAFE	3.52	17.50	19.80	17.45
NASDAQ Comp.	.26	3.50	10.06	6.69
Lehman High-Yield	2.64	11.58	9.48	8.59
Lehman Agg. Bond	1.50	6.59	4.40	3.31
Lehman Credit Idx.	1.51	7.08	4.43	3.21
Lehman Gov. Bond	1.44	5.93	4.02	2.70

back to the top spot. The investment managers also expect technology and health care issues to perform particularly well during the rest of 2007.

INTERNATIONAL STOCK MARKET

THE 1ST QUARTER

Overseas stocks led the pack again in the 1st quarter as improving economic trends in Europe and Japan buoyed investors. Markets bounced back from the impact of the short-lived Chinese sell off. The average foreign stock fund gained 3.3% for the quarter.

The best investment category in overseas stocks was the small- and mid-cap sector, where a 6% gain was registered. Regionally, Europe and Latin America returned more than 4%. Emerging markets were hardest hit by the Chinese correction, with India and Russia losing about 5%. However, given the stratospheric gains each of these markets have generated in recent times, a brief cooling off period may be warranted, and prove to be a healthy development for continued long-term success of those markets.

LOOKING AHEAD

Emerging markets have been on a roll for three years, and we anticipate that they will continue their positive ride. Most emerging market economies can boast surplus foreign reserves, trade surpluses and a generally sound financial footing. Growth rates in China, India, Latin America and Eastern Europe are forecast to be above average for the rest of 2007. In addition, capital flows to these markets remain strong.

Developed markets in Europe, along with Japan, also appear to be well positioned for the rest of the year. European economies are showing improved employment levels and most companies are

generating solid earnings. Europe in particular seems poised for more upside surprises.

One cautionary note – foreign small-cap stocks have enjoyed enormous gains over the past three years and the sector is no longer considered “undervalued.” Additional gains may result in some shakeout of stocks within this sector by mid-year.

SUMMARY

Some tried-and-true lessons of investing were fully visible during the 1st quarter of 2007.

The first is to avoid “chasing” returns – investing in the hottest markets or sectors simply with the expectation that they will remain hot. The setbacks suffered by markets in China, India and Russia are good examples of the risks associated with that approach.

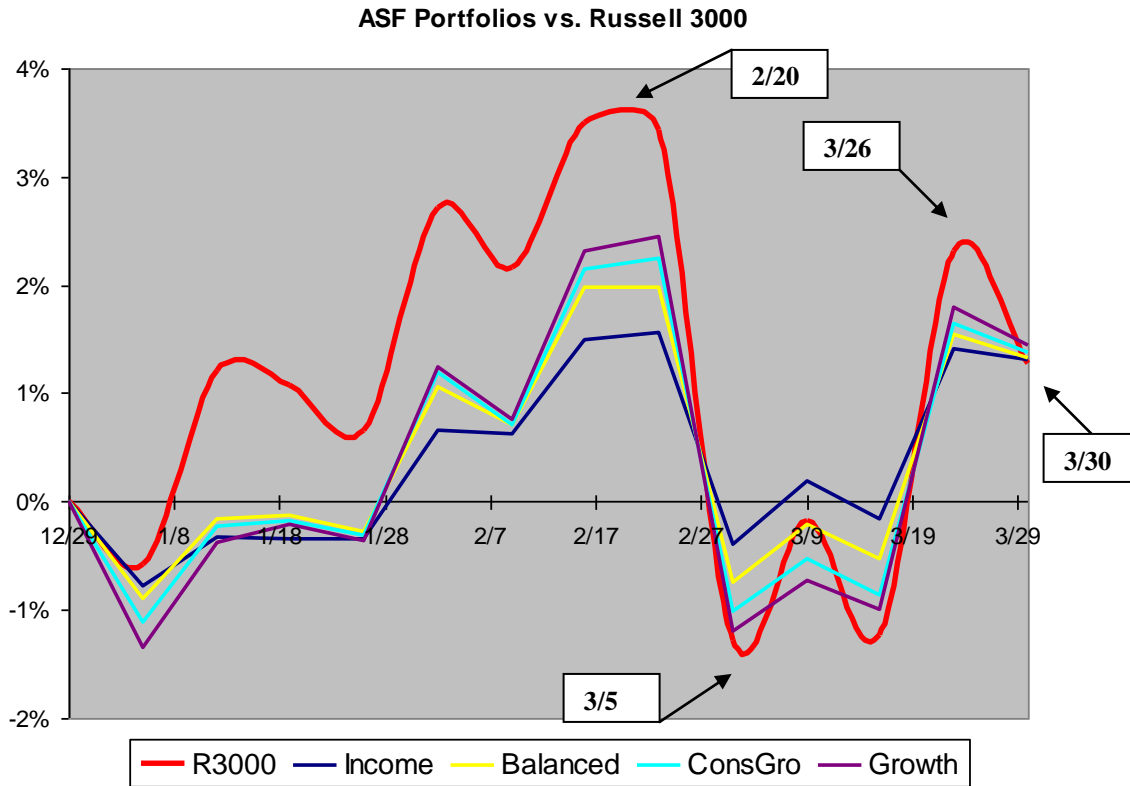
The second is to stick with your long-term investment plan. The sell-off in China ignited a global decline that scared some investors into selling their positions. Those who did missed out on the market’s recovery in the last several weeks of the quarter.

While the volatility we experienced in the 1st quarter is a reminder of what can happen to markets in the short run, we appreciate your continued trust and appreciation of our long-term approach, and look forward to continuing to provide you with *all-star* investment choices and guidance for many quarters to come.



“It’s not how much you make - it’s how much you KEEP!”

Bob Klefsaas



Even with the very emotional reaction to the Chinese correction, when all asset categories lost ground, All Star Financials four portfolios all lost significantly less than the market. From 2-20-07 to 3-5-07, the Russell 3000 lost -6.3% while our Income, Balanced, Conservative Growth and Growth portfolios all lost less, -2.7, -4.3, -5.3 and -6.0 respectively. Then the second drop occurred late in the quarter (3-26-07 to 3-30-07) and the Russell 3000 lost -1.1% and our Income portfolio lost only -0.11%, Balanced -0.22, Conservative Growth -0.35% and Growth -0.39%. **For the quarter, all four portfolios outperformed the market, 1.31%, 1.33%, 1.37% and 1.45% vs. the market up 1.28%. We did this with 7% to 53% less risk!!**

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