



2007 – 2ND QUARTER REVIEW



SURPRISING MARKET STRENGTH AS SUMMER ARRIVES

MARKET OVERVIEW

Investors shrugged off concerns about rising energy prices, a sluggish housing market and signs of trouble in the sub-prime mortgage industry, pushing stock prices higher in the second quarter. Corporate profits and stable interest rates helped maintain a favorable environment while a continued surge in corporate merger and buyout activity fueled additional gains.

Further indications by the Federal Reserve that it would not cut interest rates anytime soon discouraged bond investors, and credit markets lost ground during the quarter.

The market appears to be “**in balance**” through the first half of 2007. Profits are growing, albeit more slowly. Stocks appear to be fairly valued while bond yields and interest rates remain quite low by historical measures. Credit risk may be rising, but default rates have held steady. Continuation of this environment will probably be good news for investors in the second half of the year.

ECONOMY

THE 2ND QUARTER

Even with gas prices hovering around the \$3.00/gallon mark for much of the quarter, the economy managed to hold its own. Inflation remains modest, growing at a 2.3% rate. Low unemployment and healthy wage gains helped spur a 5.5% increase in consumer spending. Most expect GDP growth to improve on the 1st quarter’s minimal 0.7% gain.

The Federal Reserve kept short-term interest rates where they have been for a year. The Fed is balancing concerns about threats of higher inflation with a desire to keep struggling segments of the economy, like the housing market, moving forward. Home values continue to slide as housing inventories rise. Home equity loans, a contributor to growth in recent years are also lagging as interest rates move higher and homeowners in some markets see their equity shrinking.

Corporate profits have been one of the positive surprises so far in 2007. While earnings are growing at a slower rate than in recent years, leading indicators remain generally favorable for profits.

LOOKING AHEAD

The housing market is likely to struggle the rest of the year, due in part to problems that have surfaced in the sub-prime mortgage industry. The impact on the economy as a whole may be muted but bond investors could feel some effect. Business spending is expected to remain strong and exports could benefit from strong global demand and a weak dollar.

The Federal Reserve is likely to hold the line on the Fed Funds rate for the rest of 2007, and interest rates across the board should stabilize as a result. We anticipate that the economy will continue to create a positive environment for investors over the rest of the year.



BOB'S CORNER

Managing your portfolio to your specific level of risk requires both strategic and tactical asset allocation decisions. As is true to our value philosophy, we like to buy low (get in before anyone else) and sell high (leave the party early).

Over the past 15 months we have strategically taken chips off the table with our domestic small cap exposure to the point of no pure small stock exposure remaining. We tactically bought small cap in 2002 and in 2003, 2004 and 2005 that sector was up 16% per year! We started to strategically take chips off the table in early 2006 and saw large value, and now large growth, as better buys. As expected, they have now led the market the last year and a half. We strategically lowered your exposure to bonds since July 2004 and tactically stayed as short term as possible with rising interest rates. The change in international exposure is probably even more evident, as we have strategically more than doubled your exposure over the last 3 years and tactically added emerging market and a high dividend stock exposure to the mix.

When all is said and done, this is why we outperform the market from a risk adjusted perspective! We always strive for the least amount of risk with the highest, most efficient return as a result.



BOND MARKET

THE 2ND QUARTER

In contrast to the soaring stock market, bond investors faced a more tumultuous quarter. Consistent with the Lehman Aggregate Bond Index (down 0.52% for the quarter), the average bond fund lost ground over the three-month period. The yield on the benchmark 10-year Treasury bond rose significantly, from a low of 4.62% in April to a high of 5.25% in June, signifying a broad sell off in the Treasury market. As a result, long-term Treasury bonds, perceived as a relative “safe haven” for investors, lost 2.8% in the 2nd quarter. Ultra-short bonds performed much better, gaining 0.9%. By the end of June, the “inverted” yield curve disappeared, becoming steeper for the first time since 2005.

Higher-risk segments came through in better shape than the Treasury market, though not in a dramatic way. High-yield bonds and multi-sector bonds gained 0.3% while emerging market issues were up 0.4% during the quarter.

Bond investors were clearly influenced by signs that the Fed had no intention of lowering interest rates anytime soon. Most economic signals pointed to a pickup over the 1st quarter’s tepid growth rate. In addition, with central banks in Europe and elsewhere raising interest rates, money flowed away from U.S. Treasuries and into other global debt securities. All of this contributed to the setback for Treasuries.

LOOKING AHEAD

While short-term forecasts in the bond market are always a challenge, it appears that a better degree of balance is returning to the relationship between domestic and international bonds. We anticipate that central banks overseas will continue to raise interest rates while the Fed holds steady, at least in the near term. This could continue to cause investors to diversify away from U.S. bonds, a sharp turnaround from recent trends.

With very tight yield spreads existing between bonds of different credit quality, the high-yield bond market may face some risks. This is particularly true given the crisis in the sub-prime lending arena. Look for spreads to widen in the months ahead, resulting in more pressure in the credit sector. The safest harbor appears to be in short-term bonds.

DOMESTIC STOCK MARKET

THE 2ND QUARTER

A long anticipated recovery for large-cap growth stocks came to fruition in the 2nd quarter. The Russell 3000 Growth Index gained 8.2%, compared to a 6.0% return for the Russell 3000 Value Index. Large-cap stocks (represented by the Russell 1000 Index) rose 7.2%, outpacing the 6.5% return for small-cap stocks (the Russell 2000 Index). Mid-cap stocks outpaced both large and small stocks, as the Russell Mid Cap Index generated a 9.9% gain for the quarter.

Rising oil prices triggered a gain of 14.2% for energy stocks. Technology issues rebounded nicely with a 9.9% gain. Utilities represented the only industry to lose ground, declining 1.6%.

Merger and acquisition activity was a big driver of the market’s surge and Initial Public Offerings set a record for the 1st half of 2007, with \$132 billion in new offerings coming to market.

LOOKING AHEAD

A sense of **balance** is in full evidence in the stock market. The premium on growth stocks when compared to value issues is 1.5 times, below the historical average. By comparison, when the stock market peaked in 2000, the growth stock premium was 6 times that of value stocks.

The environment is ripe for a well-diversified portfolio, taking advantage of relatively “cheap” growth stocks and attractive dividends from value stocks. Investors are likely to benefit from an active stock selection process rather than settling for an indexing approach.

Large-cap stocks continue to be positioned to provide the best opportunities for long-term investors over the coming months, in line with historical trends when the economic cycle has reached a mature level.



LEE’S TAX TIDBIT

For cash contributions, regardless of amount, made in taxable years beginning after August 17, 2006 (i.e. January 1, 2007 for calendar year taxpayers), no charitable contribution is allowed unless the donor maintains as a record of such contribution: (1) a bank record or (2) a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution. The recordkeeping requirement cannot be satisfied by maintaining other written records. Therefore, when traveling to the lake or other destination, try to use a check instead of cash for your charitable contributions. Of course, if the contribution amount is \$250 or more you need additional substantiation, even if you write a check.

Give us a call with any of your tax questions or concerns. Next quarter we will focus on the gifting of IRA dollars.



Performance Update

Annualized Returns

Market Index	2 nd Qtr	YTD	1-Year	2-Year	3-Year
DJ Ind. Average	9.03	8.82	22.99	16.91	11.30
S&P 500	6.24	6.99	18.51	14.44	11.64
Russell 2000	4.42	6.45	16.43	15.50	13.45
S&P Mid-Cap 400	5.84	11.98	18.51	15.71	15.15
Russell 3000	5.77	7.11	20.07	14.69	12.44
MSCI EAFE	5.34	9.05	24.10	23.86	19.33
NASDAQ Comp.	7.50	7.78	19.85	12.50	8.33
Lehman High-Yield	.22	2.87	11.55	8.12	9.03
Lehman Agg. Bond	-.52	.98	6.12	2.60	3.98
Lehman Credit Idx.	-.73	.76	6.71	2.23	4.17
Lehman Gov. Bond	-.33	1.10	5.56	2.14	3.62

INTERNATIONAL STOCK MARKET

THE 2ND QUARTER

Economic growth remains robust in most overseas markets. Despite efforts to slow their red-hot economies, both China and India continue to grow at double-digit levels. Corporate profits are strong in Europe and rising in many Asian nations. Even Japan's long-struggling economy is showing modest improvement.

The average international stock fund gained 9.4% in the 2nd quarter. Emerging markets continued to sizzle as a group, up 16.4% even with sharp, short-term sell offs during the quarter. Latin American stock funds soared 21.2%, thanks in large part to gains by materials and energy stocks. Pacific Asia ex-Japan rose 20.7%.

Developed nations performed well too, though not at the rapid pace seen in emerging markets. European funds were up 7.9% and Japanese stock funds gained 3.4%. Performance was fairly consistent across market capitalization (large-, mid- and small-cap stocks) and investment style (growth and value).

LOOKING AHEAD

Foreign markets remain attractive, though we anticipate more volatility in emerging markets. Much of this is due to the hard-charging Chinese and Indian economies and the high valuations stocks have achieved there. In the long run, volatility can work to the benefit of investors who are positioned to take advantage of it, particularly given our expectation that overseas growth rates are likely to be twice those seen in the U.S. economy.

European stocks remain attractive as companies there are expanding profits and margins. Japan should continue to perform reasonably well, though probably not at the pace of its European counterparts. Favorable demographic trends and debt rating upgrades should continue to propel Latin American markets, but gains may be muted compared to the sizzling returns of recent years.

SUMMARY

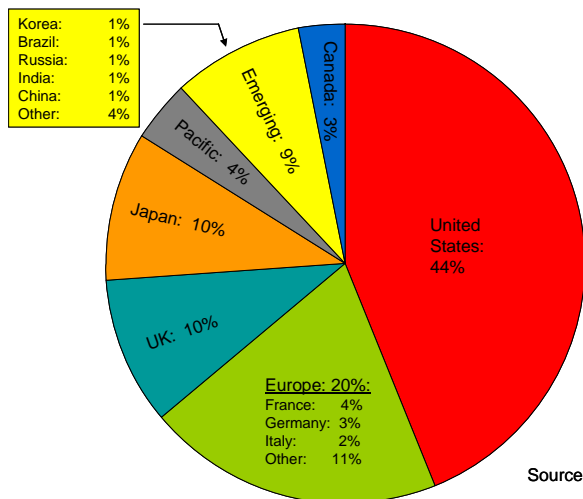
We appear to be entering a new era for investors, where the distinction between different types of assets (i.e., growth and value stocks; investment grade and high-yield bonds) appears to be blurred. In this type of **"balanced"** environment, positioning your portfolio in a broadly diversified manner is more important than ever.

As an investor with All Star Financial, you benefit from a portfolio that is designed for your level of risk tolerance, one that includes a mix of quality growth and value stocks, a healthy offering of foreign stocks and a high quality bond portfolio. Choices ranging from traditional, actively managed mutual funds to exchanged-traded funds (ETFs) are among your many options. In other words, you have the ability to take advantage of the best today's vast global markets have to offer today in order to build an appropriately-diversified portfolio that fits your needs. Thank you again for allowing us to help navigate your investments through the first half of 2007!



Why Use More International Stocks in Your Portfolio?

Weights in MSCI All Country World Index



Source JP Morgan 3-31-07



“The World is Flat,” is the title of a recent best-selling book. The title refers to the increasingly intertwined relationship between the world’s economies. More global trade allows many nations to expand their economies, provides lower-cost goods for the U.S. and helps finance our nation’s burgeoning federal deficit.

The global nature of stock markets is more evident than ever, with non-U.S. stocks now representing more than half of the value of the world’s equity value. This trend is likely to continue in the future as developed markets in the U.S., Europe and Japan age while emerging economies such as Brazil, Russia, India and China are expected to grow more rapidly.

Traditionally, arguments promoting international investing focused on the benefits of diversification. But there are other advantages to consider. For example, there is a wider range of stocks to choose from. Today’s foreign markets include an expanded set of small-cap stocks. In addition, representation of emerging market stocks is becoming more common in international stock portfolios.

These trends indicate the need for investors to be more aggressive about allocating assets to foreign stocks. For this reason, we have strategically increased your allocations to global stock funds while tactically adding more emerging market stocks and high dividend-paying stocks at the same time.

The result is a portfolio offering the increased potential to capture attractive returns from fast-growing global economies (enhancing prospects for your investment results) while taking approximately the same level of risk.

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