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Weekly Market Wrap June 18, 2007

Review - Week Ending 06/15/2007

Stocks staged a broad rally last week on the strength of strong retail sales and relatively mild core inflation data. Bonds remained weak early but had stabilized by the end of the week. This week brings a light economic and earnings calendar and merger deals will remain the headline market drivers.

Commentary/Highlights

- The market was impressed by milder than expected “core” (ex-energy and food) inflation data last week, but headline **inflation numbers remain worrisome**. A sharp rise in energy prices for the month raised May CPI inflation +0.7%, up 2.7% year/year, and up 7.0% annualized over the last three months. Energy remains the chief culprit.
- Merrill Lynch seized \$400 million in assets of a Bear Stearns managed hedge-fund that specialized in sub-prime mortgage backed banks. **The Bear Stearns fund used leverage and had been scrambling to sell \$4 billion in sub-prime related bonds last week**. Bear Stearns had the weakest earnings of the major investment banks last week due largely to sub-prime exposure. In a related story, Moody’s slashed ratings on 131 bonds back by sub-prime mortgages last week.
- **WSJ editorial highlights possibility of the sub-prime risk spreading to the high-yield markets**. Evidence cited includes: 1) 21% of new issuance last year to CCC or less credits; 2) Spreads remain tight at 263bps, less than half of 542 bps historical average; 3) defaults are likely at cyclical low of 0.8%, well below average of 3.4%.
- **Highlights from PIMCO’s 2007 Secular Outlook for next 3-5 years:**
 - 1) Real global growth of 5% for the next several years;
 - 2) U.S. and other mature economies mired at 2% growth due to demographics;
 - 3) Property market has yet to bottom, influence on consumption still to be realized;
 - 4) Global inflation slightly higher;
 - 5) Interest rates to remain low;
 - 6) Accelerating returns to capital, diminishing returns to labor

Index/Portfolio Returns	% Change Week	% Change QTD	% Change YTD
Lehman Aggregate Bond	-0.05%	-1.21%	+0.28%
Lehman High Yield	-0.12%	+1.04%	+3.70%
Dow Jones Industrial	+1.64%	+10.82%	+10.61%
S&P 500 Index	+1.67%	+8.26%	+9.02%
Russell 3000	+1.63%	+7.86%	+9.23%
MSCI EAFE Index	+2.48%	+5.44%	+9.15%
MSCI EAFE Small Cap	+1.26%	+3.83%	+11.30%
NASDAQ Composite	+2.07%	+8.47%	+8.75%
Russell 2000	+1.58%	+6.15%	+8.22%