July 15, 2008

Dear Client:

Clearly, the U.S. economy is not out of the woods yet and could deteriorate further before it regains forward momentum. However, there are valid reasons to believe that expectations of improvement later this year and in 2009 are realistic.

Despite a collapse in housing, a credit crisis that severely impacted many financial services companies and seriously undermined the mortgage market, plus severe weakness in autos, real GDP continues to be slightly positive and the overall economy has held up better than generally expected. Excluding the weak sectors mentioned above, corporate profits continue to rise with many industrial companies showing strong balance sheets and holding abundant amounts of cash.

Following four consecutive months of decline, U.S. manufacturing activity increased in June with the Institute for Supply Management (ISM) index of factory activity edging up to 50.2 from 49.6 a month earlier. Any reading over 50.0 indicates expansion. In view of the sharp drop in the automobile industry and in housing-related products (i.e. building materials, air conditioning equipment, appliances, furniture, etc.), the slight increase in the ISM index indicates that the rest of the economy is holding up relatively well. The 1% rise in real GDP in the first quarter was better than many expected and the second quarter results could also be positive.

Continuing strength in U.S. exports remains a major factor in offsetting much of the damage caused in other sectors of the economy. However, while still a strong contributor to the U.S. economy, export growth is moderating due to somewhat reduced economic expansion rates in Europe, China, India and some other developing countries.

Another cause for concern is that sharp increases in food prices and the cost of gasoline at the pump are affecting retail sales of general merchandise as well as consumer expenditures for such things as restaurant meals and travel. The government stimulus package is offsetting at least some of this weakness and, combined with continuing expansion in manufacturing, exports, healthcare and other service industries, real GDP growth may have remained moderately positive in the second quarter. This would be a notable performance, in our opinion, inasmuch as consumer spending accounts for roughly two-thirds of GDP and has been up against some serious headwinds in recent months.

Despite many serious current economic problems, corporate profits rose moderately in the first quarter of 2008 and may have increased again in the second quarter. In addition to exports, this would reflect strength in sectors unrelated to housing, finance and autos (i.e. information technology, telecommunications, pharmaceuticals, medical equipment, etc.). Profits have also been positively affected by dollar weakness. As we have mentioned in previous letters to our clients, a substantial portion of U.S. companies derive more than half of their revenues from foreign sources, both from exports and from facilities located abroad. With a weak dollar, these revenues convert into more U.S. dollars.

Earlier this year, the Federal Reserve and the Treasury Department jointly took aggressive action to avoid a financial crisis by injecting a massive infusion of liquidity into the banking system and by taking the unprecedented step of lending directly to a major securities firm. It seemed then that this could lead to greater government regulation and oversight of this industry.

This is now happening. Fed Chairman Bernanke has outlined proposals that could expand the Fed's ability to lend to the largest investment banking firms and would add regulatory authority that does not presently exist. Treasury Secretary Paulson has also advocated more regulation of the financial system beyond existing controls applicable to commercial banks.

As mentioned in our previous letters we have expanded our investment universe on a global basis and will continue to emphasize this strategy. Since it sometimes may not be feasible for us to invest in individual companies in certain foreign markets, particularly smaller-cap stocks which are more difficult to follow, we can implement this approach by using passive investments such as ETFs (Exchange Traded Funds). Our recent purchases can serve as illustrations.

NEW PURCHASES IN SECOND QUARTER OF 2008

SPDR S&P International Small Cap ETF (GWX)

GWX seeks to replicate the total return performance of the S&P/Citigroup World ex US Cap Range Under $2 billion Index, an equity index based upon the world (ex-U.S.) small cap composite market. GWX offers a good vehicle to participate in the expansion of developed economies outside of the U.S (currently weighted in Japan, Canada, U.K. and Australia) and adds some small cap diversification to our portfolio.

iShares MSCI Taiwan Index Fund (EWT)

EWT seeks to provide investment results that correspond to the price and yield performance of publicly traded securities in the Taiwanese market, as measured by the

MSCI Taiwan Index. In terms of valuation, Taiwan is one of the cheapest emerging markets. Taiwan's newly elected President Ying-Jeou Ma is expected to rebuild relations with mainland China which could substantially reduce geopolitical risk, create significant business opportunities across the Strait and thereby significantly increase market valuation. President Ma has also earmarked a $130 billion infrastructure project over four years offering a short-term boost to Taiwan's GDP growth.

<u>iPath MSCI India Index ETN (INP)</u>

INP is designed to provide cost effective exposure to Indian equity securities as measured by the performance of the MSCI India Total Return Index, an index currently comprised of the 68 largest companies by market capitalization listed on the National Stock Exchange of India. India's economic reform, initiated in 1991, trails China by approximately 13 years. We believe that India is still in the early stages of a sustained infrastructure investment boom with enormous growth potential.

FIXED INCOME UPDATE

The 3-month Treasury Bill ended the quarter at 1.90%, up from 1.38%, while the 10-year Treasury Note ended the quarter at 3.99%, up from 3.45%. As we noted, the Fed's response to the economic environment has been aggressive and unprecedented. In the past eight months, the Fed has reduced the Fed Funds rate to 2.0%. As a result, the real funds rate (adjusted for inflation) is actually negative and should be highly stimulative.

At their most recent meeting, the Fed held rates steady but adopted an inflation risk bias. Food and energy prices are increasing rapidly. For example, food prices have increased 6.3% so far this year and energy prices are up 16.5%. Because these segments are normally very volatile, Fed officials don't want to extrapolate their pricing trends too far in the future. Instead, they look at the core inflation rate and inflation expectations to get a better reading of long term inflation trends. The core rate is up only 2.0% this year, within the Fed's preferred range. However, inflation expectations, measured by the University of Michigan's Consumer Survey, have started to increase and consumers now expect a 5.2% inflation rate in the coming year, the highest reading since the early 1980's. This inflation scare is likely to be short term. It would be more problematic if there was evidence of a wage-price spiral, which currently does not exist.

We recently purchased Flaherty & Crumine Preferred Income Fund, a closed-end fund focused on preferred stock. This well diversified fund currently pays an annual dividend of $0.93 per share. As we expect preferred stock prices to rebound as the credit turmoil diminishes, this fund provides an opportunity for capital appreciation in addition to the attractive dividend yield of 8.9%.

We hope that everyone has an enjoyable summer. We are always available to discuss your portfolio and/or address any questions.

Sincerely,

Richard M. Brown, CFA
Chief Investment Strategist

Our most recent Form ADV, Part II is available upon request

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