



April 13th, 2007

Enclosed is our quarterly newsletter we send to clients.

Market Overview

Equities got off to a good start early in the year before the correction which started in late February. The correction took the major averages down about 5% from their highs. Equities rebounded in March, putting returns back on positive ground year to date. The large company S&P 500 index was up 0.6% in the first quarter, while the small company Russell 2000 index gained 1.9%. Foreign equities continued their momentum, posting a first-quarter return of almost 4%. On the fixed-income side, the Vanguard Total Bond Market Index Fund gained 1.4% for the quarter. Emerging markets short-term bonds and commodity futures also performed solidly in the first quarter. All our portfolio returns exceeded their benchmarks for the quarter.

Economic and Market Outlook

What spooked investors, albeit temporarily, in the first quarter? After enjoying a seven-month run of mostly climbing stock prices, U.S. stocks fell sharply in the wake of an even bigger drop in the Chinese stock market in late February. Investors are concerned that a slowing Chinese economy could foreshadow a slowdown in global growth. Another concern for investors is the housing market and associated problems in the sub prime lending market. The worry there is that the rising defaults could spread further weakness throughout the rest of the housing market, which in turn could hurt consumer spending, an important driver of the economy.

In our previous newsletter we discussed the outlook for continued weakness in the housing market and our view that this weakness should not by itself throw the economy into recession. However, we think concern over an eventual recession is warranted and the possibility of such an event should be considered. The only thing we know for sure is where the market is valued at this time and how that valuation compares to past valuations. Stocks are somewhat undervalued based on current valuation measures, but the real question is how much future risk is already priced in? A good way to assess this is to consider the impact of a slowdown in corporate earnings on stock prices. A research report from Advisors Intelligence analyzed several possible scenarios based on a range of earnings growth and P/E ratios going forward five years. A significantly bearish five-year scenario for corporate earnings could result in stock market returns in the low single digits. In scenarios that we

consider more likely, in which earnings growth still slows but not by levels that are historically rare, stock returns are much better-somewhere in the high single-digit range.

What this tells us is that although stock market valuations may not fully price in the less-likely possibility of a major slowdown in earnings over the next five years, they are probably still in a fair value range. Given this backdrop, we do not think it makes sense to be defensive, as we continue to expect equities to outperform bonds over the next five years.

The Successful Investor

Davis Advisors has another great paper that I have posted on my web site www.CompFinancial.com on the Documents page under Articles of Interest. In the "Engage in Healthy Investor Behavior" section of the paper they illustrate the findings from a Dalbar, Inc. study that calculated the average stock fund investor return at 3.9% annually over the last 20 years while the average stock fund returned 11.3%. Dalbar calculated these numbers right off the mutual fund annual reports. The difference in the two returns is due to the former being weighted for cash flows and the latter being a simple time-weighted average. The numbers quantify how most investors pour cash into stock funds that may have done well recently but subsequently perform poorly and at the same time get out of funds they should instead be buying.

Another interesting comparison they present is how low turnover ratios result in higher returns on average. This peaked my curiosity about how are funds compare to the average. I did a search on Morningstar's Principia mutual fund database and came up with average figures for the 12,915 stock funds in their data and came up with a comparison to the stock funds in our portfolios.

| | <u>Our Funds</u> | <u>All Stock Funds</u> |
|-------------------------------|------------------|------------------------|
| Turnover (ours dollar weight) | 31% | 81% |
| Alpha-3 yr | 1.2 | -1.2 |
| Beta-3 yr | 0.94 | 1.19 |
| Net Expenses | 1.0 | 1.46 |
| Manager Tenure | 8.4 | 3.7 |
| Stewardship Grade | 4.4 | 3.0 |

The Stewardship Grade is Morningstar's ranking based on how they believe the funds are looking out for the shareholder's interest. The grade runs from 1 to 5 with 5 being the highest score. As you can see our funds tend to have lower turnover, lower management fees, high stewardship grades, lower volatility and returns that beat their appropriate benchmark.

Portfolio Changes

In my continuous search to find new funds that can improve the performance of our portfolios going forward I've been following several hedge fund type mutual funds. These funds use many of the same strategies that hedge funds use but within the regulatory framework of a mutual fund. Unlike true hedge funds, this relatively new breed of mutual funds have all the disclosure requirements, limits on use of leverage and transparency of any other mutual fund.

I'm adding Diamond Hill Long-Short fund to our lineup. This fund invests in the stock market like any other fund except a portion of their portfolio (about 30% presently) is invested by shorting stocks that they believe to be overpriced. The main appeal of this fund is it has a low correlation to the rest of our mutual funds while also providing a long term return similar to the stock market. It probably won't do as well during strong bull market runs but will outperform during bear markets. The fund has been open almost 6 years and is co-managed by Ric Dillon and Charles Bath. Bath was a successful fund manager at Gartmore before joining Diamond Hill in 2002.

Since I don't want to increase the number of funds in our portfolios, the hardest decision to make when adding a fund to our lineup is deciding which fund to replace. Ron Baron has run the Baron Growth fund for over 12 years and returned over 17% annualized over that period. I have owned the fund personally for most of those years. A research service I use has recently downgraded this fund due to several recent troubling departures of key members at the firm. One of the issues that may have been a source of disagreement within the firm is their decision to reopen Baron Growth to new investors. The asset base for the fund has grown to over \$5 billion from around \$2.3 billion about 3 years ago when it was soft-closed. This huge increase in assets is also reflective of the general surge in the assets of small cap funds in general. Switching Diamond Hill Long-Short for Baron Growth will enable us to reduce the small cap weighting in our portfolios and add a fund unlike any other in our current lineup, thus improving the diversification in our portfolios. I'm already purchasing the fund for new clients and will transition current clients into the fund when appropriate. For those of you with Baron Growth in a taxable account, we should talk about the tax ramifications as there will be capital gains generated.

Book of the Quarter

Russell Olsen has written several books where he has shared his experience running Kodak's pension fund and several endowment funds. One, "The Handbook for Investment Committee Members" is written to those that are responsible for non-profit foundations and endowment funds. It's an easy read and is a great overview on investing for anyone. It is a must read for any director or board member of a non-profit. I'm also reading his book "Investing in Pension Funds and Endowments" which is written for the advisor engaged in managing funds in these institutional entities.

I look forward to meeting with you to discuss your financial situation. Thank you for your continued trust and confidence and don't keep me a secret. If you know anyone or any business or non-profit who could benefit from my services, please let me know.

Sincerely,

Stan Johnson, CFP(R)
Certified Financial Planner
Registered Investment Advisor
Comprehensive Financial Planning, Inc.