INVESTMENT LETTER

A PUBLICATION OF CALDWELL TRUST COMPANY

MARKET SNAPSHOT: JULY 31, 2007 | DJIA: 13,211.99 | NASDAQ: 2,546.27 | S&P 500: 1,468.35 | 10 YEAR TREASURY NOTE: 4.77%

DOW 15,000?

In spite of the recent market pullback, major U.S. public companies are still selling at significant discounts and well below the values that are "warranted," based on company financials today. The Dow rose nearly 40% since it hovered around 10,000 for about four years, and the financials of these companies have improved over this same period—in some cases quite dramatically. As a result, based on these fundamentals, prices still remain below where they should be.

This leaves investors with two questions: why this discount remains, and how high share prices can go before stocks are no longer bargains as they are today. This Letter attempts to deal with these questions by looking at a few new factors that seem to be uniquely impacting stock levels today, versus the usual ones that historically have supported share prices.

Pressure For a Quicker Return

All know about the U.S. Economy's excellent expansion over the past decade. However, many lay investors do not realize that few, if any, companies today are willing to put money to work in a venture project without a realistic chance that it will quickly earn attractive profit margins. A decade or so ago, companies pursued numerous opportunities to invest excess capital. Now, many of the old means are less attractive to managers. If doing a new project would jeopardize a company's own very high margins, most company managers would decline.

Rather, major public companies today often make their larger investments by buying existing companies that fit into their own business plans and that are absolutely necessary if companies are to continue meeting the demands of their own product lines or services.

Charter a Safer Course

Another burgeoning course of action that is "safe" and stockholder-friendly is simply to use excess cash to buy back a company's own shares. These buybacks not only reduce the number of outstanding shares, to the benefit of stockholders who do not sell; they also simultaneously increase reported earnings per share, even during years when operating profits are growing at only a modest annual rate. It is a win-win situation for all.

This trend, new to the equity markets, was not a factor just a few years ago, at least not at its current level. Recent announcements by major Dow companies have gone so far as to give the price range that the company would be willing to pay for its shares. This is tantamount to what analysts and forecasters used to call a "support" level for the company's shares. To the extent that more companies adopt this practice, it might be called a support level for the market itself.

A New Plateau of Confidence

If that is what is happening, the picture looks something like this:

(a) So long as consumers continue to earn paychecks and spend, companies are able to closely control their own marketplace position; and

(b) companies, if they are able,

CONTACTS

R. G. "Kelly" Caldwell, Jr., kelly@ctrust.com
H. Lee Thacker, Jr., thacker@ctrust.com
Jan Miller, jan@ctrust.com
Wendy Fishman, wendy@ctrust.com
Phone: 800-338-9476
Internet: www.ctrust.com

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are forced by professionals managing dominant share positions to control their profit margins better then ever before; and

(c) if these same companies then use excess cash flows to reduce the size of their own shareholder base on a regular and sustained basis; and

(d) most of the major companies are now employing the buyback ploy . . .

then, investors in major U.S. stocks have indeed reached a new plateau of confidence and security unlike any other period in our history.

CONCLUSION

Recent market volatility aside, these fundamentals still hold true today:

- **corporate earnings continue to show gains;**
- **interest rates remain low;**
- **public companies are using excess cash to buy back their shares, thereby increasing earnings per share; and**
- **core inflation remains in check.**

Therefore the challenge facing today's investors is to determine whether they have indeed reached a new "plateau" unlike any other period in our history.

If public companies are really headed for smaller and more exclusive shareholder ownership, continuing to hold stocks seems the logical conclusion.

Given these factors, Caldwell Trust Company continues to believe that common stocks are the investment of choice for investors, and that stock prices at or well above 15,000 on the DJIA seem fully warranted.

Now if we can just keep the politicians held at bay regarding any negative changes in tax, fiscal, or monetary policies . . . .

Venice
201 Center Road, Suite 2, Venice, Florida 34285
Voice: 941-493-3600 Fax: 941-496-4660
Toll Free: 800-338-9476 Web: http://www.ctrust.com

Sarasota
8592 Potter Park Drive, Suite 150, Sarasota, Florida 34238
Voice: 941-926-9336 Fax: 941-926-9335
Toll Free: 877-926-9336

Punta Gorda
133 West Marion Avenue, Punta Gorda, Florida 33950
Voice: 941-505-8500
Fax: 941-525-8501