Market Watch

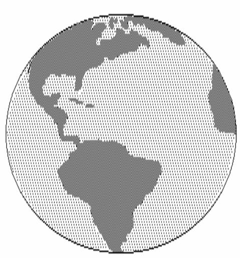
Q3 2006

MOSAIC FINANCIAL PARTNERS, INC.

a Wealth Advisory firm

Summary

- Quarterly returns were positive in virtually all market categories.
- Large U.S. stocks led the way, with the S&P 500 returning nearly 5.7% for the quarter. Value stocks continued to outperform growth stocks.
- International stocks had another good quarter, led by the emerging markets. The Japanese markets experienced a modest decline.
- Real Estate stocks led all sectors held in our portfolios.
- Thanks to a slight decline in interest rates, bonds enjoyed the first strongly positive quarter in a while. Long-term government bonds led the major bond sectors. High yield and emerging market bonds bond also enjoyed strong results.
- "Experts" who seek to predict market direction were surprised by the robust quarterly results. Maintaining a steady hand on the diversified portfolio tiller continues to benefit your portfolio.



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Following the second quarter's negative results, the third quarter began with U.S. market returns essentially flat on a year-to-date basis. But during the third quarter, particularly in August and September, the markets rebounded with surprising strength. The Standard & Poor's 500 U.S. Stock Index rose nearly 5.7% for the quarter and has increased 8.5% for the year. This trend continued into early October when the Dow Jones Industrial Average set an all-time high — surpassing the record that had been set in the year 2000 (though it must be noted that both the S&P 500 and the NASDAQ indexes remain well below their all time highs).

The markets surged despite macroeconomic uncertainty. After 17 straight increases in the short-term lending rate, the Federal Reserve chose to hold rates steady early in the quarter. This helped send stocks upward. Toward the end of the quarter, the economy and the markets were further encouraged by falling commodity prices. Crude oil futures dropped from over $75 per barrel to below $60. Other commodity prices, including natural gas, tumbled as well. Perhaps as important from a psychological standpoint, we are the midst of one of the longest boom periods in corporate earnings in the post-war era.

While falling commodity prices helped the broader markets, they did cause trouble in some quarters. Amaranth Advisors, a hedge fund, reportedly lost some $6 billion misjudging the direction of natural-gas prices. As hedge funds have increasingly garnered the attention of wealthy investors and institutions, it is important to remember their risks. While these "alternative investments" can have a place in a diversified portfolio, we remain cautious. These investments are often illiquid and, in many cases, offer more sizzle than steak.

The bond markets saw traders buying longer-term bonds throughout much of the quarter. This demand sent the yield on the 10-year U.S. Treasury Note down to 4.6% as of the end of September — defying the Fed's earlier rate-raising efforts. The yield curve (the plot of bond yields based on their maturities) is again inverted (longer bond yields are lower than those of shorter-term bonds). This may indicate that investors are anticipating a weaker economy and an eventual lowering of interest rates.

While the residential real estate market has shown continued weakness, other real estate sectors have continued to show positive growth. Real estate investment trusts (REITs) have again confounded the experts and enjoyed solid gains during the quarter — spurred, at least in part, by private acquisitions of public companies.

Stocks

As has been the case for much of the last six years, during the quarter, value oriented mutual funds outperformed growth funds in all size categories. Large company stock funds were the best performers in the quarter.

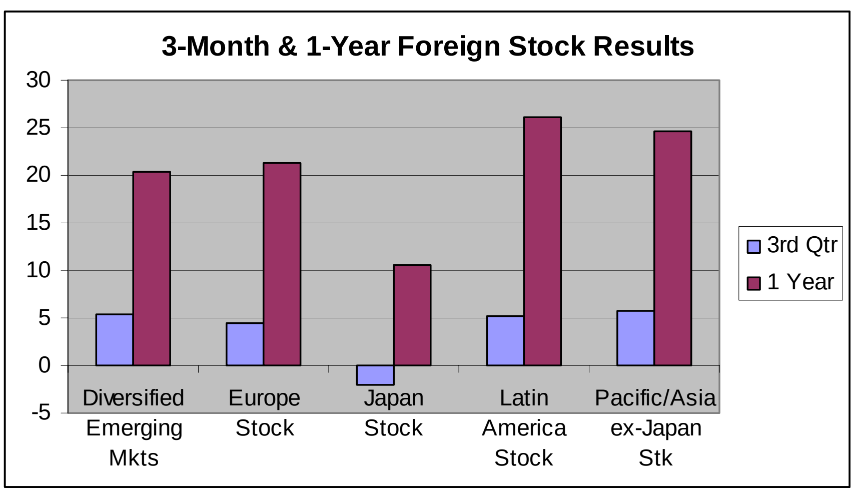
Morningstar Mutual Fund Category Returns 3rd Quarter, 2006			
	Growth	**Blend**	**Value**
Large	2.54	4.36	5.16
Mid-Size	-0.86	1.16	2.30
Small	-2.43	-0.75	0.27

In the chart in the next column, we look at the same comparison but over the last five years. As you can see, value has significantly outperformed growth since October, 2001. However, in contrast to this most recent quarter, small stocks have outperformed their larger brethren over the longer five-year period.

Morningstar Mutual Fund Category Returns Five Years Ending 9/30/06			
	Growth	**Blend**	**Value**
Large	4.47	6.57	8.62
Mid-Size	8.86	12.40	13.16
Small	9.10	13.70	15.66

For an interesting perspective, we can view stock returns over the last ten years — which includes the go-go years of the late 1990's, the three-year market crash, and the economic recovery since that time. Most U.S. stock categories are in the high single digits. The outstanding U.S. stock category is small value stocks, which have averaged 12.40% over the last ten years. At the other end of the spectrum, large growth stocks have averaged 6.03% over this period. Of the domestic investment categories, real estate has been the best performer with an average return of 15.52% over the period (technology, like real estate, a specialized investment category, returned 7.27% over the ten year period).

On the international side, diversified emerging markets have continued to be an outstanding performer (for the quarter and over the longer term). Japan was the only region experiencing a negative return in the quarter. Still, Japan's markets are up nicely over the last twelve months. Large foreign stocks modestly outperformed small foreign stocks this quarter while underperforming them slightly over the last year. Over the last five years, all foreign stock categories have generated double digits returns with emerging markets, and specifically, Latin America leading the way.



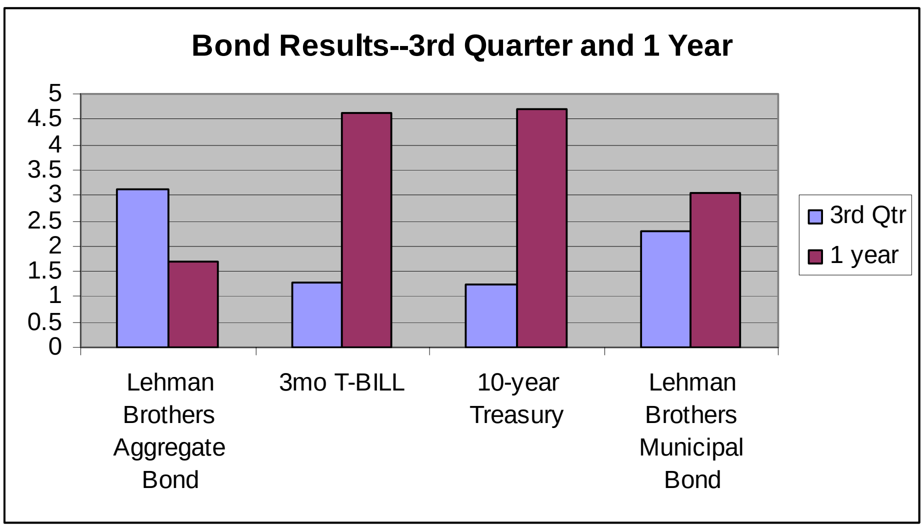
Source: Morningstar as of 9/30/06

Bonds

Bonds benefited from an environment of falling interest rates this quarter. When the Fed announced it would not increase rates for the 18th straight time, rates stabilized and then fell slightly — particularly rates for bonds with longer maturities (10 years and longer). All bond categories were in positive territory this quarter, ranging from long-term government bonds (+6.75%) to ultra short bonds (+1.46%).

Bond values and interest rates move in opposite directions — when interest rates fall, bond prices rise. And this effect increases as bond maturity lengthens (i.e. prices rise or fall more steeply). In this quarter's environment of declining rates, the best performers were long-term government bonds. Emerging market bonds (+6.11%) also performed well benefiting from improved credit quality as the world economy strengthened.

One year results are better than the recent quarterly performance numbers for shorter-term maturity bonds and bonds with a higher risk profile (high yield and emerging markets bonds). This relationship is reversed for bonds of longer maturities (where the recent results are more favorable).



For municipal bonds, as shown above, the Lehman Brothers Index achieved average results of 2.30% for the third quarter and 3.03% for the last twelve months. Understandably, variations in individual state credit quality along with variations in bond maturities can produce results quiet different from those noted.

Another perspective on the markets ...

David Swensen has been managing the highly successful Yale Endowment for over 20 years and is one of the pioneers of modern portfolio construction. He recently spoke to a JP Morgan/Chase conference, offering the following key messages:

- Diversification by market and by manager allows you to take more risk with individual managers or investments.
- Maintain a 3 to 5 year horizon for evaluating active managers, as long as they are adhering to the investment approach that prompted their inclusion in the portfolio.
- In today's markets, there are fewer pockets of under-investment, but valuations are reasonable, so stay invested.
- The fundamentals and pricing of commercial real estate are still attractive.
- If an economic or geopolitical driven crisis hits, stay invested, contrary to the majority of investors that often unwisely exit positions at market lows.
- Try to minimize the impact of individual commodity prices or other macro variables on the portfolio (i.e. use a diversified approach).
- Swensen's forward-looking portfolio return target is inflation plus 5%-6%. This is a target that matches up reasonably well with our expected returns on equity growth oriented portfolios.

In other words, we continue to believe our positioning for your portfolio is appropriate and forward-looking. There will inevitably be bumps in the road, but the fundamentals continue to serve you well.

Sources: WSJ, Morningstar, JP Morgan/Chase