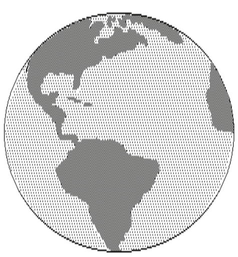
Market Watch
1st Quarter 2007

Summary

- Equity markets posted modest returns in Q1 following a strong run in the latter half of 2006.
- Economic growth moderates due to a weakening of the housing market.
- The economy continues to add jobs and the unemployment rate lowered to 4.5%.
- Corporate profits posted the 19th quarter of double digit earnings growth (year over year). Profit margins are strong.
- The Fed keeps interest rates at 5.25% while the yield curve once again is rising, although basically flat.
- Inflation is at 2.4%, but remains a concern as oil prices rise.
- Sub-prime mortgage delinquencies create concerns, but merger and buy-out activity remains robust.
- Despite a big drop in February, market volatility remains at relatively low levels.



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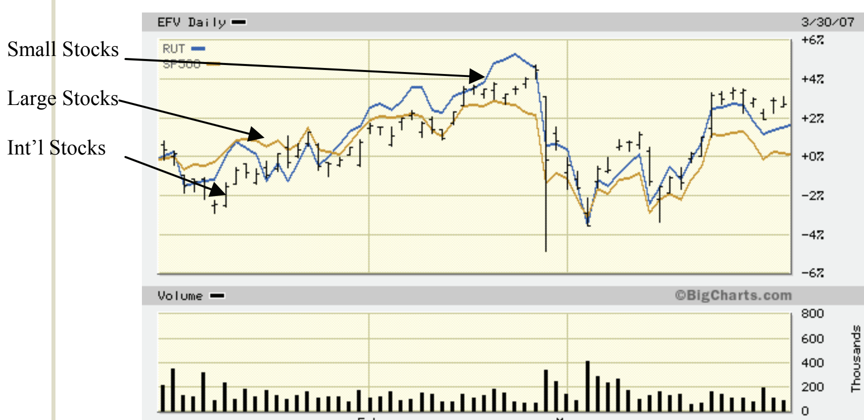
Overview

Starting last summer, the equity markets enjoyed seven months of solid growth, rising roughly 19%. In February, the Dow Jones Industrial Average, the best known benchmark for the U.S. stock market, hit an all-time high of 12786.64. The steady rise came to a sudden halt on the morning of February 27th when Americans awoke to discover that many Asian markets had plummeted roughly 9% while they were sleeping. This precipitated a downturn in the U.S. markets, which was quickly exacerbated by a spate of bankruptcies among mortgage lenders specializing in so-called sub-prime loans. U.S. stocks have since rallied off their lows, but ended mixed for the quarter.

The Dow Jones Industrial Average ended the quarter at 12354.35, down 108.80 points, losing 0.9%. The broader Standard & Poors 500 stock index ended the quarter at 1420.86, up 0.2%, or 2.56 points. The Nasdaq Composite ended the quarter at 2421.64, a rise of 0.3% for the three month period or 6.35 points. The small stock Russell 2000 index gained 1.7%, or 13.05 points, ending at 800.71. The average mutual fund gained 2.2%.



The Investment Environment

Besides needing a breather to digest the rise of the prior seven months, the choppy markets since late February have reflected concerns about the sub-prime mortgage market and how that will affect housing and consumer spending, the apparent slowing of the U.S. economy, the mixed signals the Fed has been providing on its direction for interest rates, corporate profit levels and productivity after several years of extraordinary growth, the recent rise in oil prices (oil rose to $65.87 per barrel, up 7.9% for the quarter) and the continuing threat of international conflict. On top of that, the Democratic-led Congress is discussing ways to change tax laws, the impact of which is unknown.

Federal Reserve Chairman Ben Bernanke told Congress the Central Bank expected the economy to keep expanding at a moderate pace with contained inflation. But at the same time, he warned that the expectation could be wrong and that inflation could turn out to be higher than forecasted, which would cause the Fed to raise rates. He, of course, needs to keep his options open, but the warning gave rise to investor caution.

The core personal consumption price index (CPI), which is said to be the Federal Reserve's preferred measure of inflation, showed the biggest gain in February since last August. On a year-over-year basis, inflation was up 2.4%, more than the Fed's comfort zone of around 2%.

Measuring Inflation

CPI Components	Weight in CPI	3 year avg. change	12 month change
Food & Beverages	15.0%	2.8%	3.1%
Housing	42.7%	3.5%	3.3%
Apparel	3.7%	0.1%	2.1%
Transportation	17.2%	3.3%	-0.6%
Medical Care	6.3%	4.2%	4.3%
Recreation	5.6%	0.8%	0.9%
Education & Communication	6.0%	2.0%	2.0%
Other	3.5%	3.0%	3.6%
Headline CPI	**100.0%**	**3.0%**	**2.4%**
Less:			
Energy	8.7%	9.5%	-1.0%
Food	13.9%	2.8%	3.1%
Core CPI	**77.4%**	**2.4%**	**2.7%**

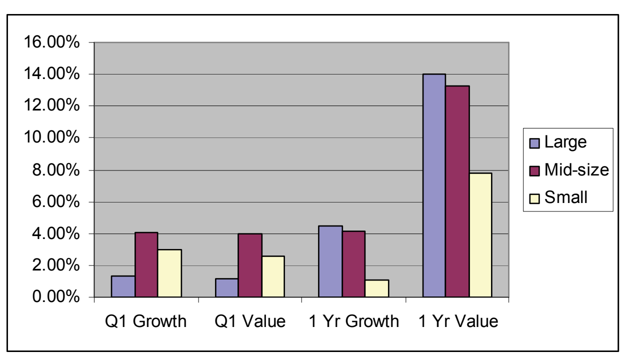
Corporate earnings have been growing at double digit rates for several years now, but the current reporting period is expected to break that string with good, but not great, single digit growth numbers.

Unemployment is now down to 4.5% and 4.7 million jobs have been created in the last 24 months. As a result, personal income data from the Commerce Department came in stronger than expected, as did consumer spending, construction growth was above expectation and purchasing managers indicated continued corporate growth was likely. At the same time, consumer sentiment surveys in March showed the lowest ratings in six months due to worries about rising prices. All of which could cause the Fed to continue to focus on the need to control inflation.

Markets hate uncertainty about where things are likely to go in the future and now seems to be a more uncertain time than we have faced in quite a while. With that in mind, and given the rapid recent growth in the markets, many observers believe that the markets are likely to decline for a few months before stabilizing. There is broad acceptance of the fundamental health of the economy, but in their jobs as market prognosticators, they have to make short-term predictions and, for some, a downward trend for a period of time gets them helpful attention.

U.S. Stocks

Overall, the markets advanced minimally this quarter, although some sectors did better than others, as always. The average U.S. stock fund was up 2.2% for the quarter and 8.11% for the last twelve months. For the first time in quite a while, this quarter "growth" stocks outpaced "value" for all sizes of companies, but only slightly. (Growth stocks are most typically those with fast rising earnings and typically identified with higher Price/Earnings ratios. Value stocks are generally those "on sale" where the cost of a dollar of earnings is less expensive due to either slower growth or difficulties the company may be experiencing.) For the last full year, value substantially outperformed growth. Company size mattered for both periods as well. For the first quarter, smaller stocks did better than large company stocks, but for the last twelve months, the reverse was true:



Among the sectors, real estate had a good quarter

(+3.49%) and it's one year returns remain outstanding (+21.53%). Utilities and Natural Resources had especially good quarters (7.79% and 5.85% respectively), each of which showed three year average returns, slightly above real estate. In our investment approach, we include these two sectors as part of a broader exposure to large stocks, rather than buy overlapping sector funds. Technology, overall, continued its flat performance.

For several years now, since the burst of the technology bubble, value has significantly outpaced growth. The following two charts show the differences since the top of the bubble in March of 2000 and those since the low point in the market in October of 2002. Clearly both growth and value have come back nicely since the bottom and especially so for the smaller stocks, but even for them, it has been important to have good exposure to value stocks.

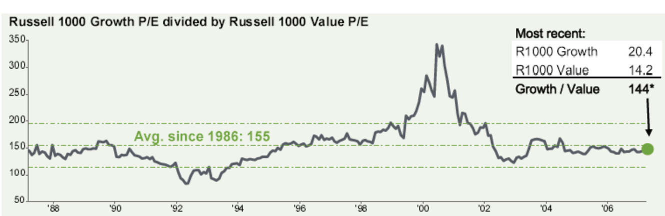
Growth Since Peak in 3/2000

	Value	Blend	Growth
Large	71.3	4.4	-35.5
Mid	169.1	73.7	-15.3
Small	176.6	52.4	-15.9

Growth Since Low in 10/2002

	Value	Blend	Growth
Large	136.8	98.4	77.0
Mid	186.7	167.8	146.9
Small	172.3	158.4	144.3

Based on relative Price Earnings ratios, Value stocks are slightly less attractive now compared to Growth stocks than they have been, on average, since 1988. Historically, the ratio of the Russell 1000 Growth was 155% of the Russell 1000 Value. Now the comparative relationship is 144% (20.4/14.2).



One final item about the U.S. markets: based on Price Earnings ratios, the market today is substantially more attractive than it was at it's last peak in 2000 as well as when it was at it's low point in 2002. That does not mean that the market will go up, but it does point out that where it sits today, given the high level of corporate earnings, it is reasonable to be optimistic.

Source: Standard & Poor's, First Call, Compustat, FactSet, JPMorgan Asset Management

Foreign Markets

International markets have led the charge since the year 2000. On average, international stock funds were up 3.28% this quarter and are up 17.44% for the last twelve months. Latin American stocks (4.41%) and smaller company international stocks (5.95%) led the quarter.

Emerging Market stocks averaged a gain of 2.39% this quarter, not nearly as strong as their performance over the past few years. Some analysts are beginning to wonder whether emerging market prices are becoming excessive. The 9% drop in the Shanghai Index on February 27th served as a wake-up call.

Emerging market indices fell 10.6% between February 22nd and March 5th, but they gained slightly over the full quarter. The strongest markets generally benefited from good commodity prices including Peru (up 33%), Brazil (up 3%), and Malaysia (up 13.7%). Vietnam has been an especially attractive market; it was up 42.5% this quarter after rising 145% last year. Indian stocks fell 5.2% as a result of concern over their growing trade deficit and a possibly over-heating economy. Despite it's huge one day decline, China's markets (the Dow Jones China Broad Market Index) still surged 45.4% for the quarter.

Japan's markets suffered very badly in sympathy with the Chinese market decline. The Nikkei Stock Average of 225 Japanese companies fell 9% that week. Japanese stock funds were up 0.94% this quarter but fell 5.48% over the last twelve months.

World Market Returns by Region

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	1Q07
MSCI UK 27.4%	S&P 500 33.4%	MSCI Europe Ex-UK 34.0%	MSCI EME 66.4%	MSCI Europe Ex-UK -7.1%	MSCI EME -2.4%	MSCI EME -6.0%	MSCI EME 56.3%	MSCI EME 26.0%	MSCI EME 34.5%	MSCI Europe Ex-UK 36.4%	Pacific Ex-Japan 7.6%
S&P 500 23.0%	MSCI Europe Ex-UK 25.0%	S&P 500 28.6%	Pacific Ex-Japan 64.7%	S&P 500 -9.1%	Pacific Ex-Japan -3.8%	Pacific Ex-Japan -8.3%	Pacific Ex-Japan 47.0%	MSCI Europe Ex-UK 22.4%	MSCI Japan 25.6%	Pacific Ex-Japan 33.2%	MSCI Europe Ex-UK 4.4%
MSCI Europe Ex-UK 18.7%	MSCI UK 22.6%	MSCI UK 17.8%	MSCI Japan 61.8%	MSCI UK -11.5%	S&P 500 -11.9%	MSCI Japan -10.1%	MSCI Europe Ex-UK 43.6%	MSCI UK 19.6%	Pacific Ex-Japan 23.2%	MSCI EME 32.6%	MSCI Japan 3.6%
Pacific Ex-Japan 10.0%	MSCI EME -11.6%	MSCI Japan 5.3%	S&P 500 21.0%	MSCI EME -30.6%	MSCI UK -14.1%	MSCI UK -15.2%	MSCI Japan 36.2%	Pacific Ex-Japan 17.7%	MSCI Europe Ex-UK 11.3%	MSCI UK 30.7%	MSCI UK 3.0%
MSCI EME 6.0%	MSCI Japan -23.6%	Pacific Ex-Japan -7.8%	MSCI Europe Ex-UK 17.8%	MSCI Japan -28.1%	MSCI Europe Ex-UK -22.0%	MSCI Europe Ex-UK -19.9%	MSCI UK 32.1%	MSCI Japan 16.0%	MSCI UK 7.4%	S&P 500 15.8%	MSCI EME 2.3%
MSCI Japan -15.4%	Pacific Ex-Japan -40.3%	MSCI EME -25.3%	MSCI UK 12.5%	Pacific Ex-Japan -35.2%	MSCI Japan -29.3%	S&P 500 -22.1%	S&P 500 28.7%	S&P 500 10.9%	S&P 500 4.9%	MSCI Japan 6.3%	S&P 500 0.6%

Source: MSCI, Standard & Poor's, FactSet, JPMorgan

MSCI = Morgan Stanley Capital Index. UK = Britain, S&P 500 = U.S., Europe Ex-UK = continental Europe, Pacific Ex-Japan = Asia & Australia without Japan, EME = Emerging Markets.

Most major European markets posted modest gains for the quarter. On average, European stocks gained 4.16% this quarter and were up 23.06% for the last year. In specific markets this quarter, Britain was up 1.4%, France was up 1.7% and Germany rose 4.9%, all reflecting the continued expansion of the European economies and the relative value available there versus the U.S. corporate restructuring and cost cutting suggest a continuation of improved profitability. At the same time, the Euro appreciated against the dollar 1.3%, on top of the 11.5% gain of last year, making European goods more expensive (and also boosting foreign stocks for American investors).

Bonds and Bond-Replacements

Mortgage loans to poorly qualified borrowers became a concern this quarter as more borrowers failed to keep up with their payments. These "sub-prime loans" were a major concern of investors when the markets dropped so much in late February. An index called the ABX that tracks sub-prime bonds fell more than 30% during the quarter, but so far that has had a limited effect on broader credit markets.

Bond buyers ran to safety after the late February shock in the stock markets. Riskier assets with higher yields like "junk" bonds and emerging market debt enjoyed early price gains in the quarter. But the 8.8% drop in the Chinese stock market on February 27th amid the concern over expected losses in the subprime mortgage market caused a significant movement toward the safety of U.S. Treasury securities. That caused prices of the 10-year note to rise and the yield to fall to a 12-week low of 4.52% in early March. It ended the quarter at 4.65%, well below the 4.71% at the end of 2006. The spread between yields on junk bonds and treasuries ended the quarter at a sizable 2.85%, indicating that bond investors were still being cautious.

Taxable bonds, on average, gained 1.66% this quarter and 6.62% over the last twelve months, reflecting a relatively steadier market during these periods. Tax-free bond funds gained 0.67% and 4.59% respectively. Higher returns were had from the higher risk bond sectors. Emerging market bonds gained 2.27% and 10.87% for the 3 and 12 month periods while High Yield "junk" Bonds were up 2.64% and 10.12%. Short-term bonds gain 1.29% and 5.01% while Intermediate-term bonds were up 1.43% and 6.13% respectively. Inflation-protected bonds gained 2.24% and 4.50% over the same periods. Three month T-bills returned 1.30% this quarter.

Sector	Yield			
	3/31/2007	12/31/2006	12/31/2005	12/31/2004
Broad Market	5.3%	5.3%	5.1%	4.4%
MBS	5.6%	5.6%	5.5%	4.9%
Corporates	5.6%	5.7%	5.4%	4.7%
Municipals	4.0%	3.9%	3.9%	3.6%
Emerging Debt	6.1%	5.9%	6.0%	6.4%
High Yield	7.6%	7.7%	8.3%	6.8%

A key driver to the health of the bond market is the direction of interest rates as set by the Federal Reserve Bank. Early in the year, investors generally expected the Fed to lower interest rates, but at its March 21st meeting the Federal Reserve described inflation as "slightly elevated" and indicated its concern, suggesting no near-term decline in interest rates. For the first time in months, the 10-year yield edged above the two-year yield, returning to the more normal and comforting "normal yield curve."

Building Portfolios Properly

At The Lubitz Financial Group we pride ourselves on offering investment management that is thoughtful and disciplined. Client portfolios are diversified with an intention of realizing a needed rate of return (on average, over several years) while exposing the portfolio to the smallest degree of volatility possible. We don't always achieve that goal but we never stop trying. One primary consideration in what goes into your portfolio is how the different investments work together—ideally when something is going down, something else is rising in value. The statistical concept is known as "correlation." If one segment is going up "x" percent, what is the likelihood that the other segment is also going up and how closely will it be to "x" percent? If it went down, then the two would be negatively correlated. If it could just as likely be going up or down, then the two are non-correlated. The ideal portfolio would be largely made up of non-correlated asset classes.

As can be seen in the following chart provided by JP Morgan, bonds are negatively correlated with the other asset classes, whereas hedge funds and real estate tend to be minimally correlated with most equity assets. ("EME" represents emerging market equities while "EAFE" stands for Europe, Australia Far East.) As a result, we like to see real estate and what we call "Alternative" assets in every portfolio. We are continuously looking for effective ways to invest in such Alternative assets because of their minimal correlation to other equities—you'll almost certainly be seeing more suggestions from us out of this sector in the future. Due to their current popularity, a lot of new "product" is coming onto the market, but we will be using our normal cautious approach before jumping onto any bandwagon.

Correlation

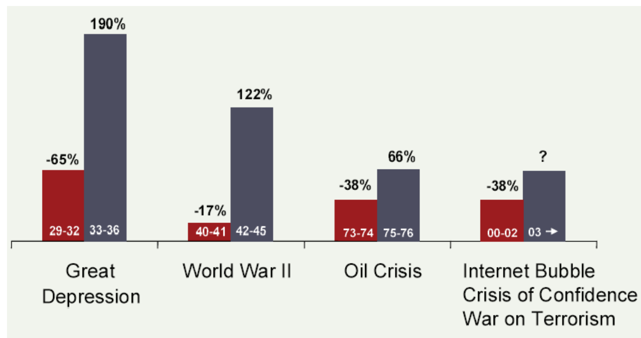
	Large Cap	Small Cap	Value	Growth	EAFE	Bonds	EME	Hedge Funds	Real Estate
Large Cap	1.00	0.87	0.91	0.95	0.86	-0.41	0.83	0.25	0.18
Small Cap		1.00	0.86	0.81	0.81	-0.40	0.88	0.24	0.03
Value			1.00	0.74	0.79	-0.30	0.86	0.15	0.19
Growth				1.00	0.80	-0.43	0.79	0.29	0.15
EAFE					1.00	-0.46	0.89	0.28	0.19
Bonds						1.00	-0.20	-0.08	-0.04
EME							1.00	0.67	0.22
Hedge Funds								1.00	0.14
Real Estate									1.00

Source: Standard & Poor's, Russell, Lehman Brothers, MSCI, CSFB, NCREIF, JPMorgan Asset Management.

Indices used: Large Cap: S&P 500, Small Cap: Russell 2000, Value: Russell 1000 Value, Growth: Russell 1000 Growth, EAFE: MSCI EAFE, Bonds: Lehman Aggregate, EME: MSCE Emerging Markets, Hedge Funds: CSFB Tremont Multi-Strategy Index World, Real Estate: NCREIF National Property Index. All correlation values calculated based on quarterly return data for period 12/31/96 to 12/31/06 with the exception of MSCI EME which reflects 5-year correlations due to data limitations. This chart is for illustrative purposes only.

One of the other key ingredients to successful investing is keeping an appropriate perspective, especially during turbulent periods. As the following chart shows, historically the market has always righted itself after downturns, even the worst of them. While it is tempting to get out once things start downward and jump back in when it starts upward, few people have actually been able to accomplish that dual decision-making successfully. Many have done it once and some have twice, but over time, almost all investors who try to "time" the market lose out to those who suffered through the bad times in full anticipation of the market coming back. Here's why (each column represents that respective period from peak to trough, or trough to peak):

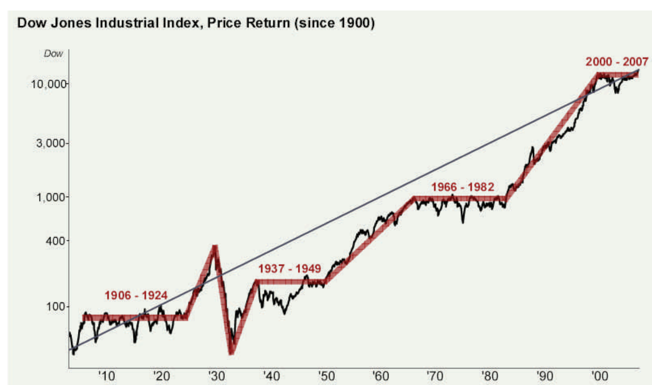
Market Returns after Consecutive Down Years



Source: JPMorgan Asset Management, Standard & Poor's

Another way to look at that issue is to take a long-term perspective. Here's how the Dow Jones Industrial Average has performed since 1900. Patient investors almost always win out.

The DJIA since 1900



Source: IDC, FactSet, JPMorgan Asset Management

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Sources: Reuters, Morningstar, Wall Street Journal, MarketWatch.com, Business Week