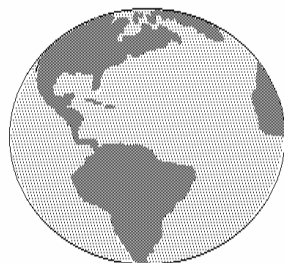


Summary

- This was an excellent quarter with most sectors producing attractive returns.
- The S&P 500 was up 6.3%. The Dow Jones Industrial Average was up 9.1%, zooming past its previous high set in 2000. The small company Russell 2000 Index was up 4.4%.
- International stocks did even better, with Europe posting gains of 8.3% in U.S. dollar terms. However, Japanese stock returns lagged with barely positive returns for U.S. investors.
- The outstanding sector, once again, was emerging markets. Latin America now has a 5-year average return of 41% and Asian countries (ex Japan) were close behind.
- Although non-U.S. REITs did well, U.S. Real Estate stocks declined by 8% this quarter (with virtually all of the decline occurring in June).
- On the bond side, interest rates rose substantially this quarter, causing intermediate and long-term bonds to fall in value. Short-term bonds returns, while small, were generally positive.



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The stock market rally that started at the end of the first quarter continued into April and May and pushed the market to frequent new highs. On May 30 the Dow Jones Industrial Average topped its prior all-time peak reached at the height of the market bubble in March 2000. But in June, the mood turned less positive driven by concerns that the slowing housing market, the sub-prime mortgage problems, the threat of rising inflation, and increasing interest rates and oil prices would combine to impact the broader financial markets. These concerns contributed to a June in which almost all major U.S. stock market indices were down.

Overall, the second quarter produced excellent returns for investors. The average U.S. diversified stock fund returned 6.4% in the second quarter (source: Lipper Inc.). This was slightly ahead of the S&P 500 which was up 6.3% (7.0% for the first six months of 2007). For the quarter, the Dow Jones Industrial Average enjoyed its best quarterly performance in three years, rising 9.1%. The Nasdaq Composite rose 7.5% in the second quarter and the small company Russell 2000 Index was up 4.4%. For the last twelve months, all major sectors of the U.S. market are up 17-23%.

Year-to-Date Market Returns



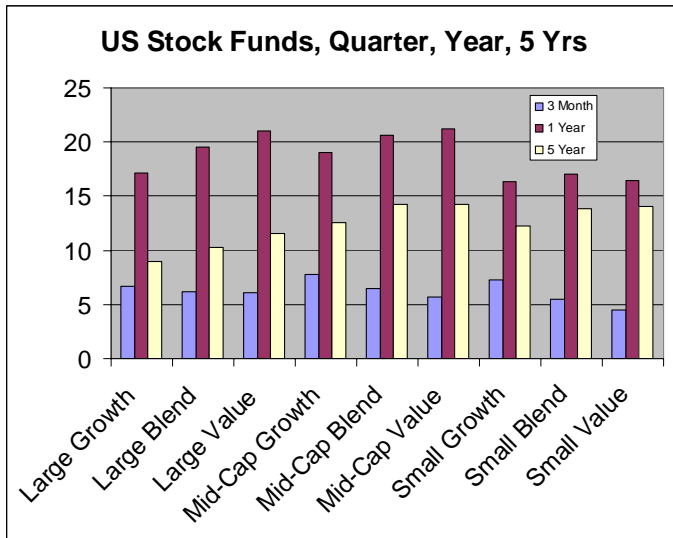
U.S. Markets

During the 2nd quarter, as the following chart shows, large U.S. stocks generally outperformed small stocks and growth outpaced value-oriented holdings. Large companies benefited from having more exposure overseas, where economic growth rates have been

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higher lately and currency exchange rates have added to overseas profitability. Regardless of size or investment style, returns for the last 12 months have been above 16% for all categories. Relative performance over the last five years shows smaller stocks outperforming large companies and value besting growth—but with strong positive annualized returns achieved across the board.



Despite the strong recent market performance, valuations remain within range of historical norms. The price-to-earnings ratio of stocks in the S&P 500 Index stood at roughly 18 on June 30 (i.e., investors were willing to pay about \$18 for every dollar of per share earnings). While the average P/E ratio since 1935 is a slightly more cautious 16, the current P/E is well below the levels of the late 1990's and 2000.

To offer some perspective on how the markets have performed lately, the following two charts show the cumulative returns of various segments of the U.S. stock market since the highs of the technology bubble and from the market low following the technology crash, 9/11 attack and corporate scandals (note that growth stocks still have not fully recovered).

Cumulative Returns in the U.S. markets Since Market Peak (March 2000)

	Value	Blend	Growth
Large	79.7	10.9	-31.1
Mid	179.0	82.9	-9.6
Small	182.9	59.1	-10.3

Cumulative Returns in the U.S. Markets Since Market Low (October 2002)

	Value	Blend	Growth
Large	148.5	110.8	89.1
Mid	197.2	182.0	163.6
Small	178.6	169.9	160.7

Real Estate

After an extended run of positive returns, REIT investments (Real Estate Investment Trusts — companies that own office buildings, hotels, shopping centers, apartment complexes, warehouses, storage facilities, etc.) declined significantly in June. As a result, this was the only major U.S. equity sector to fall in value during the quarter (down 8.0% for the quarter but up 13.0% over the last twelve months). However, as the following chart reflects, since 1992, REITs have produced returns comparable to the broader stock market (as represented by the S&P 500 Index). In a contrast to domestic REITs, international real estate generated positive returns for the quarter.



One of the comments we often hear is that homeowners have enjoyed significant returns on their real estate. On the following page is an analysis from JP Morgan that compares residential real estate returns with the returns homeowners would have achieved investing in the market as a whole. While the chart is based on national statistics, it suggests that over longer periods of time (20

(Continued on page 3)

years in this case), the returns of the stock market (the S&P 500 Index) significantly exceeded the returns of residential real estate, especially after inflation. Note that \$100 invested in a home in 1986 nearly tripled in that 20 years (to \$274) but over the same period the stock market produced substantially greater value increases. The power of compounding works its magic over time, and even modest returns can produce large gains over many years.

	20-year Return	Inflation (CPI)	Real Return	1986 Value	2006 Value
S&P 500 Index	11.8%	3.0%	8.8%	\$100	\$931
Residential Real Estate	5.2%	3.0%	2.2%	\$100	\$274

Global focus—*Europe surprises, Japan disappoints.*

In local currency, European markets rose 5.3% during the quarter (21.7% for the last 12 months). But because international returns reflect not only market movement but also the impact of currency movements (and lately the dollar has been weakening) for U.S. investors, the returns from European markets were even better (8.3% for the quarter, 32.4% for the last 12 months).

The world's economies are generally booming, thanks in no small part to the current taming of inflation. Europe is being led in its revival by the region's biggest economy (and its biggest laggard in the past) Germany. Europe's proximity to emerging market countries, especially those in Eastern Europe, is also helping. Countries like Germany, Austria and France are actively making acquisitions in emerging eastern Europe — opening operations, relocating factories and setting up joint ventures. Developed Europe is also finding in eastern Europe ready sources of labor and agriculture productivity as well as markets where they can sell goods and services — a relationship that seems to be setting the stage for continued growth in both parts of the world.

On the other side of the equation, in the second quarter, funds invested in Japan experienced the lowest returns in the international sector. Japan's slow growth economy caused the Japanese markets to fall slightly for the quarter (-0.6%). With currency differences factored in, U.S. investors enjoyed better news (+3.9% and 14.6% for the last quarter and 12 months). This was still well behind Europe. Japan's population is not

growing nor are they importing labor. In this circumstance, it is nearly impossible to grow the economy.

Smaller international companies have outperformed their larger brethren over the last three and five year periods, but slightly underperformed in more recent periods, including this quarter.

The real investment stars for the last quarter and for the last few years have been the emerging markets (up 14.8% for the quarter and 46% for the last 12 months). Latin American stocks led the emerging markets with gains of 20.3% for the quarter (they are up an average of 41.1% per year over the last FIVE years!). Latin America was closely followed by Pacific/Asia stocks (excluding Japan). As a group, the category was up 19.6% (and 57.8% for the last year). Much of Asia is being driven by China's rapid economic growth. Should China falter, the region and much of the world could be badly impacted. Most observers believe a slowdown in China is unlikely at least through 2008's Beijing Olympics.

Population growth and demographics are helping fuel the emerging economies. The middle-class in China is expected to exceed 550 million people by 2025. Some forecast that by 2025, India will have a middle class that surpasses that in the U.S. three times over. Economic growth in these countries is likely to be driven by their increasing consumer demands.

Country / Region	Q2 2007		YTD 2007	
	Local	US Dollars	Local	US Dollars
Regions / Broad Indexes				
USA (S&P 500)	-	6.3	-	7.0
EAFE	6.2	6.7	9.8	11.1
Europe ex-UK	7.8	9.2	11.9	14.0
Pacific ex-Japan	6.1	9.7	12.2	18.0
Emerging Markets	12.6	15.1	15.3	17.7
MSCI: Selected Countries				
United Kingdom	5.2	7.6	8.1	10.8
France	8.9	10.5	10.9	13.6
Germany	15.1	16.7	21.8	24.7
Japan	3.9	-0.6	6.6	2.9
China	24.5	24.5	22.2	21.6
India	13.2	20.8	7.5	16.8
Brazil	16.6	23.9	18.7	31.5
Russia	0.3	0.5	-2.9	-2.5

Source: JP Morgan

Bonds

The yield on the 10-year Treasury note ended the 2nd quarter at 5.03%, up from 4.65% at the end of March. When interest rates rise, bond values fall, so this was not a good quarter for bonds— particularly intermediate and long-term bonds. Short-term bond and money market rates remained relatively steady this quarter and thus managed to produce small positive returns. In the aggregate, for the quarter, the average taxable bond fell 0.04% while the average municipal bond fell 0.58%. Here's a look at bond results in more detail:

Fixed-Income Funds	3 Month	1 Year
LB US Aggregate Bond Index	-0.52	6.12
High Yield Bond	0.36	10.57
Emerging Markets Bond	0.20	13.99
Short-Term Bond	0.39	4.96
Inflation-Protected Bond	-0.97	3.15
Intermediate-Term Bond	-0.71	5.68
Long-Term Bond	-1.11	7.31
LB Municipal Bond Index	-0.67	4.70
US Treasury T-Bill 3 Month	1.29	5.27
Muni National Short	0.23	3.19
High Yield Muni	-0.40	5.51
Muni National Intern	-0.65	3.69

Source: Morningstar

Problems on the Horizon

Investors can always find something to worry about and today is no different. We thought it might be useful to review some of the primary areas of concern that seem to be worrying the markets these days:

Interest rates: If interest rates move higher, corporate profits could be hurt and retail borrowers pinched. Higher rates would also make bonds and money market offerings relatively more attractive when compared to stocks. So long as global demand for U.S. debt continues and inflation stays under control, interest rates are unlikely to rise significantly from their current levels.

Sub-prime mortgages: Sub-prime loans are those issued to less credit-worthy borrowers. As interest rates rise, holders of variable-rate mortgage are required to make increasingly higher payments. Since many sub-prime borrowers could only marginally afford the loan payments at their initial (often below market) mortgage rates, rising loan defaults are a risk. Troubles affecting the sub-prime mortgage market led to the near collapse this quarter of two hedge funds owned by Bear Stearns

as well as several others with significant investments in sub-prime loan investments. According to a Credit Suisse report, those lending to sub-prime borrowers or to the hedge funds and other investors who bought these loans may lose as much as \$52 billion. While a fairly narrow segment of the economy is impacted directly, a greater concern arises from the possibility that rising defaults and loan failures could reduce the availability of credit and have a slowing impact on broader parts of the market. It is not yet clear how this might play out but it is entirely possible that there could be more fall out — particularly if interest rates rise substantially or the economy slows further.

A continuing housing slowdown: Housing impacts the economy in numerous ways — from jobs, to consumer purchases of new furnishings and appliances, to being able to borrow against rising equity to make investments or finance lifestyle. Rising interest rates have slowed housing activity. An oversupply of new housing in a number of markets has further contributed to falling prices. Some forecast that the housing slowdown could slow the U.S. economy for another year or two.

Slowing corporate earnings: Without continued growth in corporate earnings, there is little to move market valuations higher. With the economy slowing and corporate profit growth falling below 10% for the first time in 14 quarters, some economists worry that this cycle of rising earnings growth might be ending.

Rising energy prices: Although oil and gas prices are up significantly, higher prices have not spooked the rest of the economy so far. The economy, although slowing, remains reasonably strong.

Legislative Risk: Legislation to increase tax rates, increase corporate regulation or restrict global trade could all have impacts on the markets. While no such legislation is pending, it is always possible.

Terrorism: These days, this has to make the list of concerns for the economy and the markets. We all hope the U.S. is able to avoid any major future events.

It always pays to be aware of what could go wrong, but fundamentally, we continue to be optimistic about the U.S. and global economies.

Thank you for allowing us to be of service to you.

Sources: Morningstar.com, MarketWatch.com, Wall Street Journal, JP Morgan, NY Times