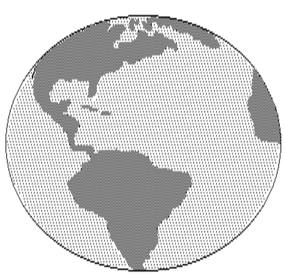
MOSAIC FINANCIAL PARTNERS, INC.
a Wealth Advisory firm

Market Watch
3rd Quarter 2007

Summary

- Market volatility was extremely high this quarter. The Dow Jones Industrial Average saw a 10% correction in before bouncing back to finish with a gain of 3.6% gain, a good gain for this traditionally slow quarter. Small stocks declined in the quarter.
- Thanks to the impact of the falling dollar, international investments enjoyed a good quarter in dollar terms — despite returns that in local currency terms were, in many cases, negative.
- Emerging markets once again produced the best quarterly returns.
- Real estate suffered during June and July but recovered to end the quarter with positive returns.
- The Federal Reserve cut both its Federal Funds and discount rates by ½ a point, helping to boost bond returns.
- Sub-prime mortgages are a concern as defaults continue at a high rate causing some institutional investors to take larger losses than expected.
- Consumer confidence declined during the 3rd quarter.



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Uncertainty was the prevailing feeling throughout the 3rd quarter of 2007 as the financial markets faced a turbulent summer with issues in housing, mortgage, and credit sectors. The stock market (the Dow Jones Industrial Average) fell by nearly 10% during the middle of the quarter, hitting a low of 12517 on August 16 before rallying to finish the quarter with a positive return. The Dow gained 3.6% for the quarter — closing within points of 14,000 (and setting new record highs in early October). The tech heavy NASDAQ rebounded with a gain of more than 8% and the S&P 500 saw a small gain, its fifth consecutive quarter with positive returns.

The summer drop in the U.S. stock market was driven, in part, by inaccurate Department of Labor employment estimates but more significantly, by rising fears about mortgage-related problems in the financial sector. These problems centered primarily on loan repayment uncertainties faced by lenders in the trillion dollar sub-prime mortgage market. As investors grew increasingly more cautious, they required a greater premium to invest in these riskier assets or in many cases, there was simply a "flight to safety." Lenders and investors alike exited those segments of the market that were seen to be excessively risky, or where the outcomes were unpredictable.

The Sub-Prime Credit Crisis

Over the last decade or so, financial instruments have been created that enable lenders to package and sell loans to financial buyers throughout the world. Packaged into financial products called collateralized debt obligations (CDOs), mortgage loans have been resold to banks, hedge funds, mutual funds, and other large investors. Increasingly during the housing boom, mortgage lenders relaxed their lending standards for borrowers with blemished (less than "prime") credit records. Often, these "sub-prime" loans were structured with low initial interest rates that would reset at higher levels after a few years. As interest rates (and defaults) began to rise, the formerly hidden risks associated with sub-prime loans began to come to light.

As the housing boom drove home prices higher, borrowers increasingly needed ever larger loans to finance their purchases. Lending practices became particularly aggressive and sub-prime loans came to represent a larger percentage of all mortgage loan originations. Unfortunately, the packaging of these loans disguised the level of risk loan buyers were taking on. As interest rates and loan defaults rose, it became clear that the extent of non -payment risk was much greater than thought.

The sub-prime crisis was a global crisis. The French Banc Paribas issued the initial warning by refusing to return investor funds that had been invested in such packaged loans. Paribas was not confident they could value the underlying loan investments and so they could not determine the appropriate sums to distribute. While the loans were of U.S. origin, global investment banks like Goldman Sachs had aggressively sold these loan packages (CDO's) to investors around the world. As liquidity problems began to emerge, central banks around the world had to step in to ensure the liquidity needed by the financial markets as they adjusted.

With liquidity in the credit markets virtually dried up, lending for housing essentially halted. New home purchases fell by 8.3%, as people without perfect credit found it hard (or at least very expensive) to get loans. Related market sectors such as mortgage lenders and home construction companies were hit especially hard.

In part, to ease concerns over the credit crisis, the Fed cut interest rates on August 17th by half a point to 4.75%, somewhat more than the consensus expectation. This action calmed jittery markets and signaled the Fed's intention to be supportive of economic growth. While the market would like to see further rate cuts, given a weak dollar and continued growth of the economy, the prospects for further rate reductions are uncertain.

GDP is generally considered the best overall economic indicator for the health of an economy. The U.S. economy as a whole slowed slightly as the quarter saw an annualized GDP growth rate of 2%. This was down from the previous quarter's growth rate of 3.8%.

The number of jobs created in the quarter took a surprise turn up, posting 292,000 new jobs, as the Labor Department reported that it had mistakenly reported job losses for August and under-reported job growth for July. Despite the growth in jobs, the unemployment rate rose to 4.7% (the highest rate in more than a year) as more job seekers entered the market place. From a longer term perspective, this rate is still historically low.

The U.S. Markets

The Morningstar U.S. Market index finished the third quarter with a modest 1.44% gain. Natural resources funds produced the best quarterly returns at 7.79%. As the following chart shows, the market (the S&P 500) is up 9.1% year to date. Energy and materials enjoyed particular success while financial services companies and discretionary consumer products are down year-to-date. In just the last quarter, lenders like Countrywide and most homebuilders dropped significantly.

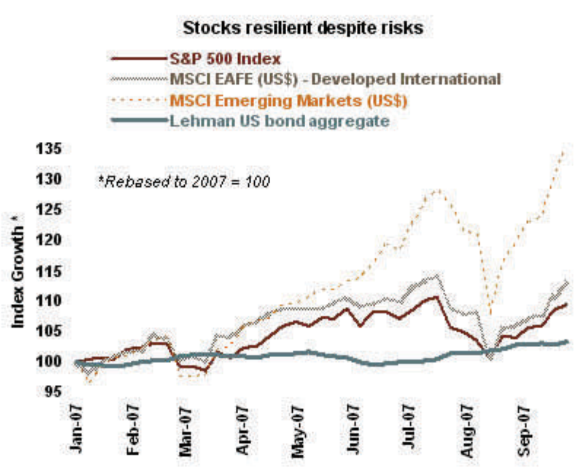
Large blend funds gained 1.64% for the quarter, which reflected positive returns from large growth stocks and slightly negative returns for large value stocks. Small stocks under-performed large stocks this quarter, as they have year-to-date. Smaller stocks declined as the small-cap Russell 2000, the general index for smaller companies, fell by 3.1% for the quarter. Small growth stocks were essentially flat while the small-cap Russell 2000 Value Index lost 6.26%.

Food and gas prices rose again during the quarter. This would normally be cause for alarm about inflation; however, prices other than energy and food have been constant or even slightly deflationary. Inflation usually is caused by an overheated economy that pushes wages up. This in turn pushes consumer prices higher since higher labor costs make it more expensive to produce goods and services. So far, we've been able to avoid high inflation. In part, the availability of low cost foreign goods has helped keep prices reined in. And, while job growth has occurred, the unemployment rate also risen (helping to control wages). Factory utilization has remained within acceptable limits and the economy is generally healthy — not overheated. As a result, core inflation for August was measured at only 2.21% while the increase in the consumer price index was also very tolerable at 2.36%.

The quarter's U.S. fixed income market was characterized by a flight to quality. Corporate bonds and commercial paper were seen as excessively risky due to the concerns over sub-prime mortgage loans. Yields increased and the issuance of new bonds slowed. Many investors moved funds from short-term money market accounts into US short-term treasury bonds. All of this demand for quality led to the best quarter for US treasury bonds since the third quarter of 2002. Similarly, municipal bonds had a great quarter with a gain of 2.2%. The demand for quality in the bond market pushed the spread between AAA and BBB rated bonds to a three year high of 1.53%. Foreign bonds also saw an increase in the desire for quality but this spread narrowed after the Fed cut its rate.

International

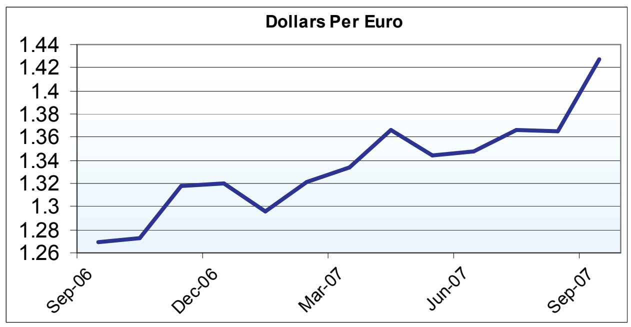
As a group, international funds did very well — outpacing U.S. funds with a growth rate of 4.93%. In many cases, this performance was attributable to currency. Many international indices were down in local currency terms but showed gains in dollar terms. The MSCI Asia/Pacific Index (excluding Japan) rose 13% in dollar terms during the quarter (9.8% local) . The Emerging Markets Index gained 14.5%. (12.6% local). Latin American stocks also grew at double-digit rates



Source: Datastream, Morgan Stanley Capital International, Lehman

this quarter. The only major foreign index to lose ground in dollar terms was Japan's Nikkei Stock Index (an average of 225 large companies). The Nikkei lost 7.6% in local currency (though less than 1% in dollar terms). Japan's market decline was driven by concerns about the viability of the Japanese economic expansion.

As in the U.S., markets around the world had a tumultuous roller coaster ride during the third quarter. In local currency terms, returns were negative in most EU countries. The MSCI Europe Index (excluding the UK) was down 2.7% for the quarter but provided a dollar based return of +2.5%. As a region, Asia did well during the quarter. China in particular enjoyed continued strong growth.



The GDP picture was mixed. Germany saw slow GDP growth of only one 1%, while Italy's GDP grew at only half a point. The United Kingdom had the most robust EU economy with a GDP growth rate of 3.3%. The relatively slow growth rate in Europe reflected, in part, the increased difficulty of European manufacturers to export their goods to the U.S. due to the appreciation of the Euro relative to the dollar.

The US dollar has continued to fall against most of the world's major currencies. As the above chart shows, the quarter finished with the dollar to Euro exchange rate at just over 1.4. The dollar has suffered the most against the major world currencies (e.g., the Euro and the Yen), where the trade-weighted dollar is down 33% from its highs. Against the currencies of the rest of the world (which account for 45% of U.S. trade), the U.S. currency is down only 6% on average. For example, the Canadian dollar gained only 6.9% versus the U.S. — but even this created parity with the US dollar for the first time since 1976.

When the Federal Reserve lowers interest rates the dollar's relative value declines. Higher interest rates attract foreign currency and lead to an appreciation of the dollar. Falling interest rates have the opposite effect.

The dollar's drop in value will make trips overseas and foreign goods more expensive for U.S. consumers. At the same time, exported American goods are now cheaper for foreign markets. As a result, the U.S. trade deficit narrowed recently, with exports rising 2.7%—the largest rise in more than three years. More exports are also likely to mean more American jobs.

Also of note in the discussion of the falling dollar, your non-U.S. investments are benefiting significantly. For example, if the dollar were to drop 20%, then, even if stock prices were flat in in local currency, the value of your investment in dollar terms would rise by that same 20%. That can help pay for your next overseas trip!

Positive returns of note around the globe included China whose Shanghai Composite Index gained a remarkable 45% last quarter. Part of this gain can be attributed to the closure of the Chinese market to foreign investors. This creates an artificial demand for the scarce stocks still available. However, mainland Asia as a whole did well with Hong Kong's Hang Seng Index jumping 25%, South Korea's Korea Composite Stock Price index rising 12% and India's Sensex up 18%.

As a whole, the pattern of returns in the international markets paralleled those in the U.S.— bottoming out in mid-quarter before rebounding. In the global economy, oil prices continued to climb and hit new highs late in the quarter. Although OPEC decided in September to increase their production by 500,000 barrels a day, oil prices still hit record levels at $83.90. The rising price of oil has pushed prices at the pump up by 48 cents per gallon over the last year.

Foreign bond holders enjoyed a good quarter, thanks largely to foreign currency appreciation relative to the dollar. On average, U.S. investors in foreign bonds earned a six percent return from foreign bonds just in currency appreciation.

Commodities as a whole did well, as represented by Dow Jones/ AIG Commodity Index which gained 5.1% in the quarter. Wheat rose to an all-time high of $9.53 per bushel. Gold and silver gained 14.7% and 11.4%, respectively. During the quarter gold hit a 27 year high of $742/ounce.

Real Estate Investment Trusts (REITs) have been stellar performers for the last seven years. After enjoying an annualized return of over 20% the last 5 years, REIT growth has slowed this year. According to the National Association of REITs, equity REITs were down 3.46% for the first nine months of 2007. Almost all of that decline occurred in June and July. August and September showed positive returns, resulting in a gain of 2.59% for equity REITs in the third quarter. Reflecting the problems of the credit markets, mortgage REITs (which are not in your portfolio) have fallen 42.5% year-to-date with over half of that occurring this summer.

Consumer attitudes strongly influence the economy's direction as consumers account for nearly two-thirds of all U.S. economic activity. Consumer confidence fell this quarter as slumping home prices and borrowing restrictions worried consumers. For first time in nearly two years, the U.S. Michigan Confidence Index found that American consumers are openly pessimistic. Expectations for the future, which were already low, declined further with nearly 12%of households surveyed expecting economic conditions to worsen in the next six months. Consumer concerns about the cost of energy, gas, and food prices remain high.

Conclusion/Looking Forward

With the continued uncertainty in the U.S. housing market, most observers expect the economy to continue to be volatile in the near term. According to a recent Wall Street Journal poll, recession risks have grown in the past 3 months. According to the economic survey, the odds that the U.S. will experience a recession in the next year have increased to 36%, up from 23% earlier this summer (of course, it's been said that economists have predicted ten out of the last three recessions...☺) The outcome of this tug-of-war will be determined either by, on the downside, a further decline in the housing market and continued depreciation of the dollar or, on the upside, an increase in domestic jobs and additional interest rate cuts by the Federal Reserve.

Foreign markets should continue to look attractive as the dollar is expected to remain weak. Emerging markets should continue to grow — although caution is in order as these markets are pushing against record highs.

We appreciate the opportunity to serve you.

Sources: Wall Street Journal, Morningstar, JP Morgan, Schwab Public Research, Deutsche Bank, Bureau of Labor Statistics