

DouglasBradley LLC – 3rd Quarter 2007

Quarterly Economic and Market Assessment

DOMESTIC ECONOMY

- The economy remains surprisingly resilient and employment remains strong in the face of significant disruptions in the credit markets stemming from the subprime loans fallout
- The Federal Reserve Board surprised many by lowering the Fed Funds rate .50% (vs. an expected .25%)
- Profit margins remain at the upper levels of historical averages
- Liquidity continues to be added to the US economy at high rates in order to boost economic activity
- The US Dollar Index continues its slide against foreign currencies (compounded by the rate cut)
- Real estate prices continue to weaken and the first signs are appearing that this is spilling over to retail sales
- Fears over sub-prime mortgages and collateralized debt obligations (CDOs) are tightening credit standards and increasing risk premiums

INTERNATIONAL ECONOMY

- China's economy continues to grow and is driving economic activity throughout Asia economies
- Foreign markets, especially in Asia, are having a greater impact on the world economy
- The decline in the US dollar will make foreign produced goods more expensive to buy in the US, forcing foreign manufacturers to broaden their sales to other countries in Europe, the Americas (ex. US), and Asia
- Brazil, Russia and India are investing in education and infrastructure needed to compete internationally
- Economies supported by the production of energy, commodities, and agriculture continue to outperform

DOMESTIC STOCK MARKET

- It appears the major US stock indices may have peaked in mid-October as the many financial issues facing the US economy and stock markets are starting to raise concerns
- Credit standards for borrowers continue to tighten as credit markets remain constrained
- Among the best performing sectors continue to be basic materials, energy, commodities, and technology

INTERNATIONAL STOCK MARKETS

- Until recently, emerging country stock markets continue to advance on strength in energy, commodities, and telecommunications/Internet companies

FIXED INCOME (BOND) MARKET

- Declining interest rates have rallied short- and long-term bond markets
- Despite the Fed easing interest rates, long-term interest rates have not followed short-term rates down as investors fear a return of inflation
- Historical spreads between interest rates on high-quality bonds and “junk” bonds are returning as risk is again being priced into the bond markets – a healthy sign

DouglasBradley's View Looking Ahead

- The US economy is likely to feel additional impacts from slowing residential real estate sales, layoffs in real estate/construction and the financial industries, defaults stemming from sub-prime mortgages
- Global stock markets can be expected to continue to correct along with the US and efforts by the world's Central Bankers will have only minimal impact and possible unintended consequences
- We believe inflation is currently above what is being reported, driven in large part by increases in energy and food costs, and the recent decision to lower rates to head off a recession will only compound inflationary problems in the future
- Given the lengthy decline in the price of the US dollar relative to other currencies and a “flight to safety” as global financial markets start to falter, we may see a rebound in the value of the US dollar
- US companies with meaningful international sales exposure should outperform those that do not as foreign consumers continue to be attracted to American-made goods and services

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Quarterly Assessment and Discussion

Discussion of Selected Portfolio Holdings

The third quarter of 2007 was punctuated by yet another sharp decline in the major US stock market indices. The sell-off occurred over a period of approximately 30 days beginning in mid-July and ending in mid-August. And, like most of the recent corrections, it stopped just short of a 10% loss on a closing basis – an unhealthy situation in our opinion as we would like to see some additional stock market excesses purged.

The long-term impact of these corrections, followed by quick rebounds to new stock market highs, is that investors are being conditioned to look at them as buying opportunities instead of considering the underlying causes. In the most recent occurrence, the issue was the realization that very large numbers of subprime mortgage loans were in danger of default. In simple terms, loans were issued to borrowers who did not have the means to repay them and the pricing of these loans did not represent this risk. When these loans were “re-priced”, lenders decided that they needed to stop lending money – period – until they understood the ramifications and tightened their lending guidelines. This caused the bankruptcy of several lenders, fear in the financial community, and a severe stock market sell-off.

Since this Assessment and Discussion is focused on your portfolio holdings, it is appropriate that we evaluate how your portfolio performed, how DouglasBradley reacted, and what we see for the future. We have gone into detail in earlier reports about our allocation between “Growth” holdings and “Protection” holdings. Just as in the past, your “Protection” positions cushioned the decline and those holdings that are designed to rise in value during a decline did so. As to be expected, the “Growth” positions participated in the correction by declining to varying degrees.

As more information came to light on the severity of the subprime problems and the future impacts, we evaluated the inherent risk in your portfolio in light of the new information. Our conclusion was that if the markets dropped further, the time to recover from further losses in the portfolio would be greater than we felt was acceptable. Since markets typically rebound temporarily before the next leg down, we would use that as an opportunity to lower your risk exposure. This is consistent with our goal of protecting principal.

When the markets did rebound, we stayed disciplined and reluctantly sold our long-held position in gold stocks. This was not an easy decision for us because gold has been a favored investment of ours for many years – and continues to be for the future. However, gold is also our most volatile holding and is therefore a meaningful driver of portfolio performance (both up and down). We plan to own this fund again.

Despite selling the gold fund, our overall strategy has served us well as the markets continued their rebound. Citing a recent purchase, technology stocks have materially outperformed both the Dow and the S&P 500 since it was added to your portfolio early this year. Our initial investment was in growth-oriented stocks. Around mid-year, after an internal analyses, we fine-tuned the investment and narrowed it to just large technology company stocks by exchanging your Rydex Large Cap Growth Fund for the Rydex Technology Fund. The ensuing relative performance has validated our decision. We were very early to recognize the value of US technology stocks, particularly those with significant overseas sales, relative to other investment options. This is because investors still have not forgotten the major losses experienced in technology earlier this decade and tended to favor foreign stocks during the past several years. In our mind, these circumstances create a buying opportunity that offers reasonable risk with an outsized potential for returns. If we are correct (and we believe we are), you can expect to see us adding to this position in your portfolio.