



MW INVESTMENT
STRATEGY GROUP

APRIL 2007

After a volatile three months, the US stock market ended fractionally higher for the first quarter of 2007. The EAFE index gained 4% for the period, as foreign stocks continued to outperform US equities. Bonds rose 1.5%, as measured by the Lehman Brothers bond market index.

Model Portfolio Performance

Our four portfolio models managed gains of between 1.2-1.4% for the quarter. These returns surpassed that of the S&P 500 index, and the performance of each model matched its risk benchmark for the three months. For the trailing twelve months, our portfolio models continue to lag the S&P and their respective benchmarks, a consequence of the simultaneous underperformance by several of our larger cap stock funds during the third quarter of 2006. In the longer run, our models have significantly outperformed the broad US stock market averages and their portfolio benchmarks.

MUTUAL FUND MODEL PORTFOLIOS CURRENT PERFORMANCE ¹				
MODEL	RISK BENCHMARK	TRAILING CUMULATIVE		
		1 ST QTR	12 MONTHS	SINCE JAN 99
All Equity	100% Stocks	1.3%	8.8%	103.5%
Growth	80% Stocks 20% Fixed Income	1.3%	8.9%	90.3%
Balanced	65% Stocks 35% Fixed Income	1.4%	8.6%	89.8%
Conservative	40% Stocks 60% Fixed Income	1.3%	7.3%	74.0%
S&P 500		0.6%	11.7%	30.8%

Standout mutual fund performances during the first quarter were largely among our foreign and global stock fund holdings. Of these, Oakmark Global Value, managed by Clyde MacGregor and Robert Taylor, returned 5% for the first three months of the year. Bond funds showed renewed life during the quarter, as did our commodity and newly-added international real estate fund holdings.

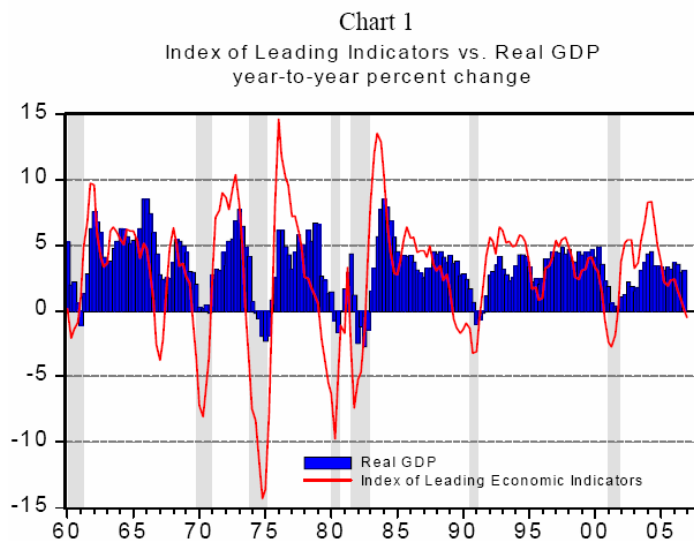
Clouds on the economic horizon

As the year began, disappointment befell those anticipating a continuation of the second-half 2006 market rally. A sudden sell-off in the Chinese stock market sparked a sharp US market decline in February. This decline briefly brought to the fore worries about global markets in general, leveraged risk at hedge funds, and the slow collapse of what is termed the “sub-prime” mortgage market. The event was a reminder that investment markets can be much more volatile than the past few years would suggest. By quarter’s end though, prices had largely recovered. Investors breathed a sigh of relief, but were left to wonder just what had happened.

We usually view market turbulence as more of an opportunity, than as a cause for worry. Volatility is often a sign that conflicting views are fighting for the “soul” of investors. Today’s conventional view holds that the economy is slowing, but will do so at a measured pace, allowing the Federal Reserve to lower interest rates. This is the “Goldilocks” scenario and when it is in the ascendant, the

markets rise. The contrasting view holds that the economy and/or inflation trends are stronger than the markets believe, that the Fed will not lower rates and may even raise rates. When this view is commanding investor attention, markets decline. On balance, this back and forth, up and down, has the effect of “pricing into the market” these various risks.

One risk we do not find fully priced into the markets is the possibility that the US economy is slowing more rapidly than the consensus view. Traditional indicators of recession have been flashing yellow since the middle of last year. Many economists, even in the face of an inverted yield curve and slumping consumer confidence, indicators that typically presage a recession, have come to the conclusion that “it’s different this time.” These are words that should generally cause investors some concern.



Recently, no less than former Federal Reserve Chief Alan Greenspan commented that there is a 30% chance of recession later this year. Paul Kasriel, chief economist at Northern Trust, points to the recession predictive powers of the neglected Leading Economic Indicators (LEI) Index¹. Even a cursory look at the data in the accompanying chart shows that every major decline in this index (red line) since 1960 has been followed by a recession (grey bars).

One of our principal duties is to protect investor capital as substantial declines in the value of one’s portfolio can be

the single greatest impediment to long-term wealth creation. A recession, while far from the most likely outcome, nevertheless represents a serious short-term risk to equity prices. Should the economy become more sluggish than is currently expected or even tip into recession, stocks would likely sell-off and bonds rise. This would be our “opportunity” to overweight the equity exposure in our model portfolios for the upswing that would follow.

Portfolio changes

For the past six years, small company stocks have outperformed their larger cap counterparts, contributing significantly to the performance of our model portfolios. Typically, smaller companies tend to grow more rapidly than large companies and thus their stock prices will grow at a relatively faster rate. However all asset classes have their cycles. According to research by Litman Gregory, valuations of small cap stocks have reached valuation levels, relative to larger caps, that have historically been followed by multi-year relative underperformance.

During February and March, we further reduced small cap fund holdings in client accounts in favor of funds that focus on larger companies. Target allocations for US small cap funds now range from 1-4% of value, depending on the portfolio model. These allocations are significantly underweight relative to our “neutral” allocations and represent the lowest allocations to small cap stocks in the eight-plus years since we began our portfolio models. Proceeds from the reductions in our core small

¹ Leading Economic Indicator chart Northern Trust Global Economic Research

cap funds – Laudus Discovery and Small Cap, Artisan Small Cap Value and Baron Growth – were used to increase our core large cap fund holdings and added tactical allocations to two large cap Exchange Traded Funds (ETFs). These latter are the Powershares RAFI US 1000, an enhanced S&P index fund, and the iShares S&P 100 index fund, representing the very largest 100 US stocks. While adhering to this strict valuation methodology has often caused us to be early on tactical switches in the past, we expect client accounts to profit from this shift over the coming 2-3 year period.

For the balance of our portfolio allocations, we remain overweight in non-dollar denominated stock and fixed income funds. While the timing is impossible to predict, we do see the dollar under continuing long-term pressure, the outcome of the enormous US budget and trade deficits.

Company highlights

On a more personal note, I sat for the Certified Financial Planner™ exam in March. This ten-hour marathon culminates two years of study. Results for this exam, which has had a 50% pass rate, will be posted in late May.

While “recuperating,” I caught up on accumulated professional reading. Among my favorite reading materials are the quarterly and annual reports from the mutual funds you, as our clients, are invested in. Many of our fund manager reports, particularly those by Chris Davis at Selected American, Bill Nygren at Oakmark, and Mason Hawkins at Longleaf, are exemplary of how managers best communicate with shareholders. These short narratives present a clear window into their investment thinking and process. I highly recommend their thoughtful and honest commentaries to anyone interested in becoming a wiser investor.

On a final note, a Federal Appeals court in March overturned the Securities and Exchange Commission’s “Merrill” rule. This hotly-debated regulation provided a special exemption to stock brokers, so that they might promote themselves to the general public as financial advisors without the more rigorous conflict of interest disclosure and fiduciary responsibilities otherwise required. Those of us in the industry view this ruling as a welcome victory for the rights of individual investors.

With my best regards,

Martin Weil
President

Model Portfolio Performance Disclosures:

- a) Performance data is for model portfolios and is not a composite of actual client accounts.
- b) All MWI managed client accounts are based on one of four diversified mutual fund model portfolios. These four models are geared to different investor levels of risk tolerance, generally expressed as a one-year maximum loss threshold. New accounts are invested following one of these models, typically using dollar-cost averaging over a period of months, not to exceed one year. Once an account is fully invested, it is expected to track the performance of its underlying model. Exceptions to this include accounts with restrictions such as: the client-directed retention of legacy holdings and/or excess cash, substantial withdrawals or additions. Accounts smaller than \$100,000 are restricted by purchase minimums at certain mutual funds and the performance of these accounts may differ somewhat from the models. Taxable accounts employing municipal bond funds in place of the taxable bond funds used in the models will slightly underperform on a pre-tax basis.
- c) Benchmarks are custom created following the neutral asset allocation shown for each portfolio. Components of the benchmark allocations are Vanguard's S&P 500 index fund, iShares Russell 2000 index, Vanguard Total International and Total Bond index funds, and cash. The S&P 500 index data is based on the performance of the Vanguard S&P 500 fund and includes dividends.
- d) Net of fees: The performance for MWI model portfolios is calculated net of our maximum annual management fee. The returns of the portfolio benchmarks and market indices do not include these management charges. All returns assume dividends and income are reinvested.
- e) Rebalancing: Model portfolios are routinely rebalanced every six to twelve months on the last day of a quarter. Actual client accounts may be rebalanced at other times. With tax-efficiency a part of our decision criteria, taxable accounts may be rebalanced less often and/or less completely than retirement and other accounts not subject to current taxation. This may result in performance discrepancies between taxable and non-taxable accounts managed following the same portfolio model.
- f) Model allocation changes: Changes to model allocations are infrequent but can and do occur at any time. When a model is changed, allocations to client accounts are changed as soon as is practical. However, changes to the model portfolios are only recorded, for performance purposes, on the last day of any quarter.
- g) Closed funds: From time to time, mutual funds that form part of MWI model portfolios close to new investors. Clients already owning closed funds in their accounts will generally continue to hold and/or add to their positions. New client accounts will be invested in alternate funds. At year-end, MWI will substitute in its models for any funds that have closed during the year with alternate funds available at that time to new clients. As a result, performance disparities may develop between older and newer client accounts, and between older client accounts and current model performance.
- h) Historical performance is not a guarantee of future results. While the performance period since January 1999 includes both rising and falling stock markets, there can be no assurance that the portfolios will perform as well under future market conditions. In particular, the performance of our Conservative and Balanced models relative to the S&P benefited from the severe bear market in US stocks during 2000-2002. In a rising equity market, the Balanced and Conservative models would be expected to underperform a similar investment in the S&P 500.