Investment Overview

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Economic and Markets Summary

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Fourth Quarter 2006

The Economy

Economic growth was at its peak for 2006 during the first quarter of the year just ended. Real Gross Domestic Product grew at a 5.6% rate during the first three months of the year. From that point, economic growth showed a marked deceleration as the year progressed. The second quarter grew at a 2.6% rate while the third quarter showed a growth rate of 2.0%. The growth rate for the quarter just ended should show a similar rate of growth from the third quarter. The first estimate of GDP for the fourth quarter of 2006 will be released on January 26th.

At this stage, the weaker economy is being portrayed as a mid-cycle economic slowdown with expectations of improved growth resuming in the second or third quarter of 2007. Some economists have termed this as a "soft landing" for the economy with the implication that the economy will not continue to worsen and drop into a recession marked by negative growth. This is the optimistic case for the economy going forward and is supported by the Federal Reserve who, through their actions and words, are in a position to stimulate the economy toward higher growth if need be. It is their opinion that the mid-cycle slowdown or soft landing is consistent with the economic framework that its new chairman, Dr. Ben Bernanke, laid out early in his term. Keeping inflation forces at bay is the primary objective of the Federal Reserve and the temporary economic softness is expected to assist the Fed in accomplishing that goal.

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The biggest contributor to the economic slowdown has been the weakness displayed in the housing sector. The momentum for this sector could not last after a number of years of unusually strong gains. At this time the housing slump continues to worsen, affecting not only building materials, but other associated industries such as appliances, furnishings, and home improvement manufacturers and retailers. Those economists, who are in the minority predicting further economic weakness resulting in recession, believe that there will be further significant weakness in housing. What happens with the housing industry is very important to the course of the economy in 2007. At the very least, the consumer has become more cautious regarding spending as noted by a pullback in auto sales and softening retail sales trends.

Other consumer fundamentals reflect a more positive outlook for the economy. Personal incomes are growing in trend line fashion. New job creation has been positive despite the statistical noise created by the frequent data revisions occurring almost on a monthly basis recently. Consumer confidence has remained steady, and the unemployment rate stands near a 5 ½ year low.

Regarding the manufacturing and capital spending sectors of the economy, again the fundamentals are more positive than negative. A number of economists expect the industrial side of the economy and exports to provide the best growth prospects in 2007. A strengthening global economy is helping U.S. exports to grow and international strength is fostering spending on infrastructure throughout the world. Capital goods producers should also benefit from the need to boost capacity domestically, the pressure to provide continued productivity gains and the need to increase energy efficiency and ease commodity pressures. This capital spending need comes at a time when corporations have the ability to open their wallets and spend. Corporate cash balances are far above average compared to previous cycles as a result of solid earnings growth, continued attention to costs and a constant emphasis on productivity gains.

Probably the most important event of the fourth quarter was the November elections. A strong showing by the Democratic Party has allowed them to take control of both houses of Congress. This was a big surprise, unforeseen by nearly everyone up to Election Day. This change of control will have a considerable effect on legislation that will be proposed. Needless to say the priorities of the Democratic Party are much different from the path the Republicans were going down. Senate and House committee chairmanships will all shift to the Democratic side of the aisle and with them goes the power to affect legislation favored by them. President Bush will still control the executive branch of government for another two years, but as a lame duck he will clearly be on the defensive and have only the threat of a veto to slow down the agenda of the Democrats.

Based upon the campaign rhetoric and the views of the new House and Senate leadership and committee chairs, the following are just a few of the ideas being mentioned as new legislation that could be introduced:

1. A raise in the minimum wage is a virtual certainty.

2. Revive windfall profits taxes on big oil.

3. Downward pressure on drug pricing and Medicare costs.

4. Immigration reform or amnesty that poses less threat on illegal immigrants.

5. Raise taxes on dividends and capital gains.

6. Cut interest rates on student loans and increase the Pell Grant program.

7. Adopt a new direction in Iraq.

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Near the end of November the Administration came out with revised economic projections regarding economic growth. Due to the weakness in the housing market, real GDP estimates have been adjusted to 3.1% for 2006, 2.9% in 2007 and show an increase to 3.1% in 2008. Unemployment is expected to dip to 4.6% for 2006, hold steady at 4.6% in 2007 and cycle up to 4.8% in 2008. On the inflation front, consumer prices are expected to advance only 2.3% in 2006 and rise only 2.6% for both 2007 and 2008. These forecasts by the Administration are issued twice a year and developed by a team from the Council of Economic Advisers, the Treasury Department and the Office of Management and Budget.

Interest Rates

As mentioned, the primary objective of the Federal Reserve is to guard against inflation. They also have the ability and desire to keep the economy growing at a sufficient level to promote sustainability. The Federal Reserve Board, under the leadership of Alan Greenspan and now Ben Bernanke, has done a very good job of accomplishing both over many years. Their job becomes more difficult when the economy is at an advanced stage of the economic cycle.

The challenge is to keep interest rates low enough to sustain the economic expansion, but high enough to discourage inflationary excesses in labor and raw materials from taking hold. This balancing act going forward will not be easy to pull off given the recent economic softness and the selective up-tick in inflation. Inflation volatility has been pronounced this past year due to the large swings in the price of oil and other commodities on world markets.

The markets have tried to adjust to the volatility in key commodities by concentrating on the core rate of inflation rather than the headline numbers for the Producer Price Index and the Consumer Price Index. There can be a big difference between the two numbers. Toward the end of the fourth quarter of 2006, the core rate of inflation had risen to 2.7%, higher than the goal established by the Federal Reserve of 2.0%. It is hoped that the recent economic softness will result in the core rate of inflation to return to desirable territory.

The Federal Open Market Committee of the Federal Reserve had two meetings on their schedule during the fourth quarter of 2006. The first meeting lasted two days and ended October 25th.

The Committee voted to hold Fed Funds at 5.25%, as they had done their previous two meetings. This three-month period of no change follows a two-year period of constant 25 basis point increases. From June 2004 to June 2006, the Federal Reserve lifted interest rates seventeen times after each meeting of the FOMC. Having rates go from 1% at the beginning of this period to 5.25%, at this time, the Fed is hopeful that they will need to go no further to accomplish their goal.

In their post meeting comments, the FOMC again mentioned that they are relying on lower energy prices and slowing growth to reduce inflation. Their comments were very similar to those made after previous meetings. "Some inflation risks remain. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the data for both inflation and economic growth." Nearly all meeting participants concurred that inflation was uncomfortably high at that time.

The other meeting of the FOMC during the fourth quarter occurred on December 12th. Again the committee voted to hold Fed Funds at the 5.25% level. Their post-meeting comments reflected thoughts expressed at recent meetings regarding the economy. They said "growth had slowed, partly reflecting a substantial cooling of the housing market." Their bias was tilted toward raising rates rather than lowering them, as the bond market is expecting, because inflation is their principal focus and inflation risks remain "elevated."

The yield curve remained somewhat inverted on the short end during the 4th quarter. The movement of interest rates and the change in the yield curve can be seen in the table below, which shows various rates at the beginning of 2006 and the beginning and end of the fourth quarter.

%	Treasury Bill		Treasury Notes			FED
	3 mo.	1 yr.	5 yr.	10 yr.	30 yr.	Funds
12/31/05	4.08	4.45	4.35	4.39	4.54	4.25
09/30/06	4.88	4.93	4.58	4.63	4.76	5.25
12/31/06	5.00	5.00	4.69	4.70	4.81	5.25

The narrow movement in interest rates created slightly positive returns for various bond fund categories during the fourth quarter and entire year. Below are some examples of different bond fund returns for 2006 according to the *Wall Street Journal*.

2006 Percentage Returns

Short Investment Grade	+4.40	Intermediate Investment Grade	+4.47
Long-term U.S. Gov't	+0.85	High Yield Taxable	+10.27
GNMA	+3.88	G.O. Municipal Debt	+4.40

High-yield, or junk bonds, were the better performers in 2006. They were helped by a strong economy, low default rates and above-average relative yields.

Prospects for a slower economy had most commodity prices on the defensive during the fourth quarter of 2006. The price of oil briefly hit $80 per barrel during the second quarter, and like most other commodities, oil proceeded to decline from that lofty level. The price of oil, which began the fourth quarter at $62.91 per barrel, ended 2006 at $61.05. The price of oil at the beginning of 2006 was $61.04 per barrel.

The price of gold was somewhat more resilient than other commodities in 2006. Gold began the year trading at $517 per ounce. Gold ended the year priced at $635 per ounce. At the beginning of the fourth quarter an ounce of gold traded at $599. Gold tends to exhibit volatility, particularly on the upside, whenever investors are fearful about inflation, whenever the dollar is depreciating and/or whenever international tensions are running high. The worldwide economic rebound has put money in the hands of many consumers and wage earners around the world. In countries such as India, where prosperity is on the rise, gold may be the preferred form of savings.

The Stock Market

The outlook for an economic slowdown did not seem to bother the stock market during the fourth quarter of 2006. Investors continued to favor stocks as their preferred asset class for their liquidity. Most of the concerns mentioned in the previous edition of the *Investment Overview* have not worsened and some have ceased to be a concern, at least for the time being.

1. Concern that the economy could fall into recession affecting corporate profits in a very negative manner.

2. Concern that inflation will continue to rise, even if the economy slows or not, and cause the Fed to continue to raise short term interest rates.

3. Continued fears of oil prices resuming an upward path.

4. Worries of the hurricane season affecting the gulf coast and Florida, particularly disruption of gulf coast oil facilities.

5. Concern that Iraq will be entangled in civil war.

6. Concern that other Middle-East conflicts will engulf more of that region.

The absence of hurricanes was a big relief and certainly bolstered the stock market. Falling oil prices and lower inflation and interest rates in general teamed up with above forecast corporate profits to put stock investors in a positive mood through most of the fourth quarter. The rally that began in mid-July carried through October and November with very little hesitation. The stock market action in December was on the upside also, with the Dow Jones Industrials making an all-time high of 12,510 on December 27th.

The Dow Jones Industrials that began the fourth quarter at 11,679 ended the year at 12,463 for a gain of 6.71%. The NASDAQ added to its third quarter gains to show additional appreciation of 6.95%. The Standard & Poor's 500 Index provided a total return of 6.70% for the fourth quarter of 2006. International stocks continued their steady performance by again showing good gains.

For 2006, stocks provided very good returns, despite a negative second quarter in which the S & P 500 Index returned -1.44%. The DJIA finished the year at 12,463 for a 16.30% gain for the year. The S & P 500 closed at 14.80% for a total return of 15.80% for 2006. The NASDAQ also finished strongly, overcoming a sub-par first half, to end the year at 2,415. This amounted to an annual gain of 9.50%. International stocks were steady performers throughout the year. The EAFE index of international stocks showed an appreciation of 23.50% for the year.

Within the major indices there was a great deal of variability among the different sub-sectors. Market rotation among different industries was pronounced and was a big factor in the majority of equity mutual funds not being able to best their appropriate benchmark or index. Also, growth lagged versus value stocks and value mutual funds, and small caps performed much better than large caps in general. This variation in performance hit close to home as our Stratus Growth Fund is primarily a large cap growth mutual fund. Happily the fund did better than the average large cap growth fund.

Below is a table showing percentage returns for 2006 for various equity sectors and investment styles as computed by Lipper Inc., and featured in the *Wall Street Journal* on a daily basis.

Stock Fund Indices

	As of 12/31/06
Large-Cap Growth	+4.72%
Large-Cap Core	+13.39%
Large-Cap Value	+18.28%
Multi-Cap Growth	+9.21%
Multi-Cap Core	+14.14%
Multi-Cap Value	+17.07%
Mid-Cap Growth	+11.02%
Mid-Cap Core	+13.44%
Mid-Cap Value	+15.66%
Small-Cap Growth	+10.65%
Small-Cap Core	+13.70%
Small-Cap Value	+17.13%
Equity Income Fund	+18.40%
Science & Tech Fund	+6.73%
International Fund	+25.89%
Balanced Fund	+11.60%

Regarding the domestic stock market, below is a chart of industry sectors ranked by percentage gains by Bloomberg Research at year end.

Percentage Gain by Stock Sector

	Sector	4th qtr.	YTD
1.	Telecommunications	+7.8%	+32.1%
2.	Energy	+10.7%	+22.2%
3.	Consumer Discretionary	+9.8%	+17.2%
4.	Utilities	+8.3%	+16.9%
5.	Financials	+6.3%	+16.2%
6.	Basic Industry	+10.7%	+15.7%
7.	Consumer Staples	+2.9%	+11.8%
8.	Industrials	+5.3%	+11.0%
9.	Technology	+6.0%	+7.7%
10.	Health Care	+1.0%	+5.8%

Although the investment landscape still favors stocks as we enter 2007, it should be recognized that the bull market is at an advanced stage. A vigilant approach to this market should be of high importance. Monitoring the vital signs of the ongoing bull market should take on a high priority as we progress through 2007.

Fund Results

as of December 31, 2006

Equity Funds	Quarter Return	12-Month Return
Allianz RCM Mid Cap	8.43%	7.35%
Dreyfus Premier Emerging Markets	15.29%	27.18%
Fidelity Adv Eqy Income	6.98%	17.42%
Goldman Sachs Mid Value	8.51%	16.06%
Janus Adv Intl Growth	16.73%	44.63%
JP Morgan Mkt Exp Idx Select	7.27%	13.62%
Stratus Growth Portfolio	4.34%	7.35%
Templeton Inst Foreign Equity	11.82%	29.04%
Vanguard 500 Index	6.66%	15.64%
Vanguard Morgan Growth Adm	7.37%	11.32%
Vanguard Small Cap Index	8.47%	15.64%
Vanguard Strategic Equity	7.83%	13.43%
Weitz Partners Value	10.07%	22.53%
Idx: S & P 500	6.70%	15.79%
Idx: Russell 2000	8.91%	18.44%
Idx: EAFE	10.44%	26.98%
Idx: NASDAQ	7.15%	10.39%
Fixed Income Funds		
PIMCO Total Return	0.93%	3.99%
Stratus Gov't Secs	0.81%	3.79%
Vanguard GNMA	1.06%	3.88%
Vanguard Infl-Prot Secs	-1.34%	0.39%
Vanguard Total Bond Idx	1.35%	4.27%
Idx: M.L. Int Term Bond	0.83%	3.76%

Past performance is no guarantee of future results.

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