

# MCM Market Outlook

OCTOBER 2007

## 3rd Quarter Letter

Over the past three months, the global financial markets dealt with the sub-prime mortgage melt down. The Federal Reserve responded appropriately by pumping money into the banking system and lowering the Fed Funds rate by one-half of one percent, from 5.25% to 4.75%. The cut marked a significant reversal in Federal Reserve policy and we expect additional cuts in the future.

Both the stock and bond market responded positively to the Fed's action. Through the first 9 months, your stock portfolio is up over 13% after fees and that compares to 9% for the S&P 500 and 12% for the Russell 3000 Growth Index, our benchmark.

In the last few client letters, we expressed our frustration that the stock market was not fully recognizing the superior earnings growth of the companies in your portfolio. That changed in the third quarter and so far this year the stocks are up in line with their earnings growth.

Investments in the energy and technology sectors led the strong performance this quarter. The demand for oil pushed prices above \$80 per barrel and which increases the profitability of deep-water exploration. FMC Technology and Oceaneering International are the leading service providers for deepwater applications and both stocks increased 40% over the last three months. Strong demand for technology products, aided by a weaker dollar, continues to drive growth for Cisco, FLIR Systems and Garmin.

Despite the severity of the problems in the residential housing sector, the U.S. economy is still growing at about a 2% rate. Unemployment is low. Inflation is well contained and personal income is up over 6% versus a year ago. All this data indicates the expansion is on track. The global economy is growing at closer to a 5% annual rate and that is importantly helping the U. S. export sector. Your portfolio now has 40% of its earnings coming from international markets. We expect that percentage to increase as companies expand their international presence and as international operations grow at a rapid pace.

We anticipate another strong quarter of earnings reports starting later this month. Kirby Corporation announced last week that they expect stronger than anticipated earnings and demand for barge transportation is increasing as they continue to raise prices. These reports should be the catalyst for future price appreciation.

Anticipating declining interest rates, we increased your portfolio's average maturity to five years during the third quarter. In a declining interest rate environment, bond prices appreciate and that contributed to the total return (appreciation plus interest income) in the bond portion of your portfolio.

The problems in the credit markets are in the sub-prime mortgage sector and the below investment grade sector. With our strong preference for high quality bonds, we have avoided the significant losses experienced in both sectors.