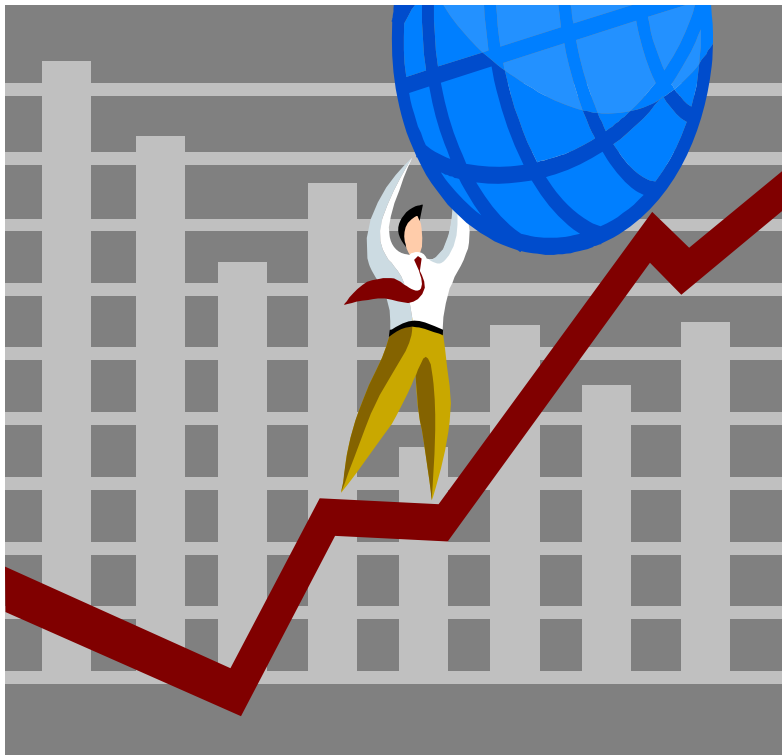


“Is it safe?”

2007 Q1 Quarterly Commentary



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“Is it safe?”

As some of you may recall this is a quote from the 1976 movie Marathon Man. In the movie a fiendish ex-Nazi concentration camp dentist, Dr. Christian Szell (played by Laurence Olivier), kidnaps and tortures an innocent graduate student Babe Levy (played by Dustin Hoffman) thinking the student knows the location of a huge cache of Nazi diamonds in (then) present day New York. Szell tortures Levy with all sorts of gruesome dental instruments, all the time asking Levy, “Is it safe?”

The problem is that Levy has no idea of what Szell is talking about.

Markets have been good this year. In fact, our portfolios are up 5% to 6% through mid-May. But the lingering and haunting question for Frank and me is... Is it safe?

What concerned us coming into this year (which we articulated in our 2007 Outlook and Investment Strategy) was:

The risks to the economy and the stock market are greater than they were in 2006. We are in the late stage of the economic cycle, which tends to have higher than average volatility (although a 1995-style soft landing is possible).

And above average volatility is precisely what we experienced briefly in late February and early March. On February 27 when the S&P 500 lost a whopping 3.5%, I had a flashback to Q3 1998 (specifically August 31) when the S&P 500 lost 6.8% of its value in one day due to the meltdown of the hedge fund Long Term Capital Management. It was not pleasant. However, unlike 1998, the market shook off its recent weakness remarkably quickly. The conventional wisdom believes this is a reflection of how much money is sloshing around the globe today. Tough to disagree - right now, the S&P 500 is 3% higher than its February high and is on the verge of breaking out to all-time highs.

So it seems safe - but is it? What continues to concern us, and what has led Frank and me to some modest changes in our portfolios, is the high correlation of all asset classes – particularly equity asset classes.

Bob Henkel
Chief Investment Officer

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