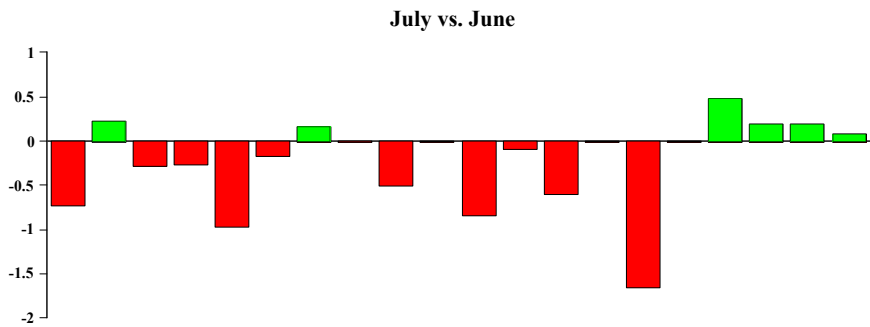
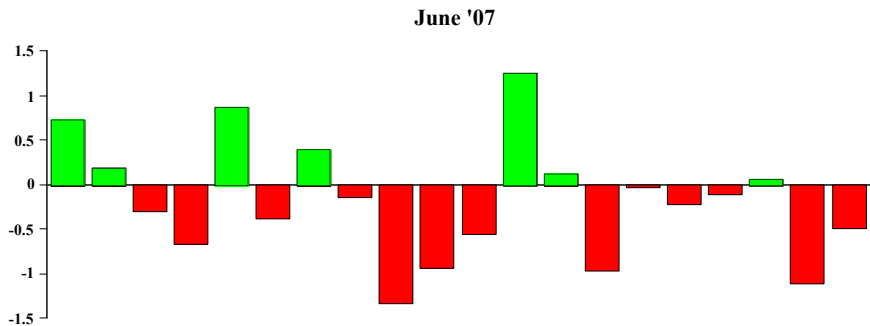
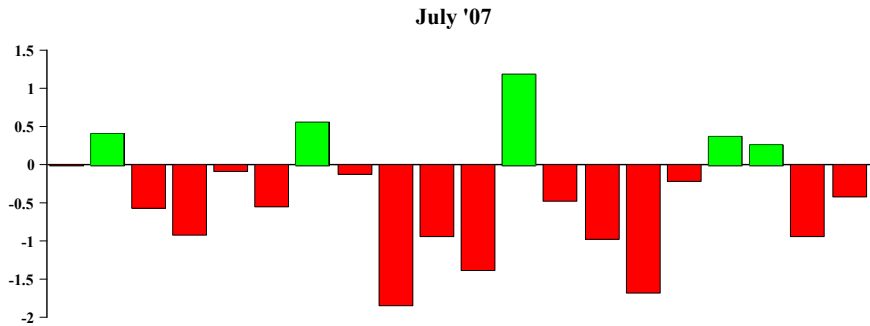


Economic Conditions Deteriorate

July 19, 2007

The following charts show fact based trends in ASC Economic factors as of July 2007 as compared to June 2007 and changes expressed in standard deviations around the norm, hereinafter referred to as “units.”



* = inverted

[-----Domestic-----][-----International-----]

ASC Factor indicators of future activity show that the economic conditions continue to be inflationary. Following are significant changes in trends last month expressed in standard deviations around the average rate of change or "units." Initial unemployment claims rose by .72 units. Consumption fell by .95 units. Inflation rose by .5 units once again. Long Rates rose by .83 units. The CRB Index fell by .59 units. Productivity rose by .48 units. With a composite score of 91.9 as compared to 96.6 last month, the health of US economic growth worsened last month mainly owing to a higher inflationary content.

There have been several economic services taking comfort in the depressing effect that the surplus of condos for sale and conversion to rentals is having on the core CPI. Indeed the core CPI is benefiting from the softer rental market since housing is such a large component, 40% of the total. However, the core personal consumption expenditures (PCE) deflator is not as highly affected by this technicality. The PCE is based on actual purchases of goods and services which make up approximately 70% of GDP. Housing is a much less of a contributor to the PCE than for the CPI. Housing as a contributor to GDP is between 6-10%, excluding the indirect benefit as a source of funds to finance consumption. There is mounting evidence that inflation is continuing to be problematic.

There are signs of renewed weakening with the big three auto sales and last month's retail sales. It appears that the down draft in housing and higher fuel costs are finally affecting middle and lower income consumers. Real Income growth has been lacking in this business cycle and is presently at .55 standard deviations below normal. Further declines in housing are likely to reduce wealth effect spending and also lead to diminished job growth because

of cutbacks in residential construction. With inflationary pressures continuing, one should expect the return of stagflation.

To use the analogy of the fox and the chicken house one would think that farmers would assume the worst of the fox's behavior. In other words, if the fox got into the chicken house he would kill as many chickens as he could. The farmer would err on the worse case side and not be deluded into thinking that maybe the next fox that gets in could be tamer. Well, when it comes to monetary policy the Fed has chosen the personal consumption deflator, excluding food and energy, which has certainly behaved a lot tamer than headline inflation. That measure can remain tame as long as the "temporary and transitory" effects of food and energy do not spill over into the core rate. Whether the Fed's assumption about the "fox" is realistic or not, remains to be seen. Once the fox gets into the chicken house it is not going to be pretty.

Last month's inflation results were somewhat better than the previous month. The core rate was up .2% or 2.2% year over year. The Cleveland Fed's median rate was up .2% or 3.0% year over year. In Fed Chairman Bernanke's testimony, he indicated that the 4.4% year to date annualized rate in PCE inflation was inconsistent with price stability. He also mentioned that there were risks that food and energy increases could spill over into areas outside the core rate. It is comforting to see that the Fed is not fixating on the core rate. It is going to be interesting to see how the Fed reacts to a serious downward vortex in housing should it occur, if inflation remains problematic. Another factor to keep in mind is that the US has not yet felt much of the inflationary effect of the weaker US dollar because of the significant lag between the cause and the effect.

The foreclosures and down grades in sub primes loans appear to be having a depressing effect on the availability of credit. In addition, some offerings to refinance some overly leveraged funds have met with little interest and have been withdrawn. The extent of the sub prime contagion is difficult to gauge at this point but is likely to spread as housing continues to slump. It seems that with the Bear Stearns' hedge funds, assuming the worse case appears appropriate.

The key to tactical asset allocation for the balance of 2007 lies with the bond market. The US dollar has begun a new round of weakening with a 30 year low against the Canadian dollar and a 25 year low against the Australian dollar as well as new low against the Euro. Despite the dollar's weakness, the bond market has held steady. So far the bond market is acting quite well considering the relatively low level of long rates, the weak US dollar and the high level of headline inflation. Although the 10 year yield is trending higher, the recent flight to quality on credit concerns has dampened the upward progression. Nonetheless, the point and figure chart on the 10 year is indicating a level higher than the recent 5.31%. Bond yields need to be watched closely, to see if the dollar weakness might lead to another contagion similar to October 1987.

The chart by Jeremy Berkovits of National Securities Corporation listed as Appendix A shows that the 10 year Treasury may be breaking out of a long, secular down trend on yields. As bond yields and inflation go hand in hand, the chart may also supports our previous contention that the US economy could be leaving a benign period of disinflation.

From a technical point of view with the recent break out of the S&P 500 and the NASDAQ 100, conditions appear to be im-

proving. From an economic point of view with the reduction in ASC's composite score from 96.5 to 91.9, conditions appear to be deteriorating.

Despite the popularity of stock buy backs, there are a number of reasons they may not be such a good idea. In essence it is a gamble by management that the price they pay for the stock turns out in the long run to have been too low to be sustained. In the process, net tangible assets are diluted and cash, always a key to the health of a company, is replaced with repurchased shares held in the treasury. If the stock subsequently were to fall then clearly the company would have wasted corporate assets by paying for over valued stock. Real business effects mean there is less cash for investing in the business and less cash to get through a difficult economic period.

There are signs that the de facto currency system that has been in place since the Smithsonian agreement in 1971 is about to undergo a significant change. With the Canadian and Australian dollars making long term highs against the US dollar, this appears to be more than just a normal correction. Theoretically, with floating currencies, trade imbalances are supposed to be corrected with increases in the value of currencies of those with surpluses and decreases with those with deficits. However, since first the Japanese, now the Chinese have maintained an artificially weak currency to achieve a trade advantage, the system has not worked as it should have. One thing is for certain the current run rate of imbalances in which the US is running in excess of a \$700 billion trade deficit and is sucking up 70% of the world's savings to finance that deficit can not last indefinitely. Something has to give sooner or later.

Investment Strategy

Equities:

Industries that are well positioned are health care, papers and chemicals. Over weights in S&P groups are advised in Health Care, Basics, and Industrials. Market weights are advised in Energy, Consumer Staples and Information Technology. Underweighted are Financials, Consumer Discretionary and Utilities. Current events are being watched very carefully to see if a repeat of Oct. 87 like conditions materialize and more significant adjustments become necessary.

Fixed Income:

Based on current macroeconomic trends, our view on long bonds is still somewhat cautious. A positive for bonds, the weakness in the economy is being more than offset by higher inflation outside the core rate. Over the intermediate term, the yield on the long bond should be fairly stable. Regarding the issue of duration, on a scale of 1 to 10, with 10 representing a maximum position in shorter term debt and 1 representing a maximum position in Long Treasuries, we would rate the current environment as a 6, up from 5 three months ago. On inflation protected Treasuries, we would add to the position we started three months ago in the 5 year.

Hedge Funds:

We are long Health Care, Materials or Basics and Industrials. The spread of emerging market debt over Treasuries appears to be getting too narrow. With greater economic uncertainty brought about by a slowing US economy, one should get serious about reducing exposure to emerging market debt.

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Appendix A

