

**2007 – Market Review**

Despite how it may have felt, 2007 was a pretty good year in the financial markets. Broad measures of U.S. stocks rose about 5%, taxable bonds were up 7% and cash earned nearly 5%.

The economic forecasts for 2008 appear to be split down the middle. Almost all prognosticators see an economic slowdown in the first half of 2008, but half seem to think that the U.S. economy will skirt a recession and begin to pick up later in the year. The other half see falling home prices and continuing credit market issues dragging the economy into a mild recession. Some of these forecasters believe that the economy may already be in recession.

Of course, predicting whether the economy will have a recession may be exciting for some, but not all that relevant for strategic investors. Expansions and contractions are all a natural part of economic cycles. Recessions correct the excesses generated by expansions and provide a base from which further growth can be made. In the financial markets, the weakness today sets the table for stronger future returns as investors price in all their worries. The good news is that investors with longer time frames (say, three or more years) benefit from uncertainty and the erratic behavior of other market participants provided they don't abandon a sound investment plan. Lower prices allow investors to purchase investments at more attractive prices, reduce taxes by harvesting losses and capture additional returns by rebalancing their portfolios to targets.

**Market Review:** Domestic stocks declined in the fourth quarter. The declines may have felt worse than they really were because it's been a few years since we've experienced a negative quarter. In fact, it was the first time since March 2003 that the S&P 500 Index has declined by more than 3% in a quarter. For the year, the S&P 500 Index managed a 5.5% gain.

Asset Class Returns - Before the Impact of Inflation						
	Investment Type (Index)	4th Qtr	1 Yr	3 Yr	5 Yr	10 Yr
<b>Equity</b>	Large Cap (S&P 500)	-3.3%	5.5%	8.6%	12.8%	5.9%
	Broad-Market (Russell 3000)	-3.3%	5.1%	8.9%	13.6%	6.2%
	Large Cap Growth (Russell 1000 Growth)	-0.8%	11.8%	8.7%	12.1%	3.8%
	Large Cap Value (Russell 1000 Value)	-5.8%	-0.2%	9.3%	14.6%	7.7%
	Mid Cap (Russell Mid-Cap)	-3.6%	5.6%	11.1%	18.2%	9.9%
	Small Cap (Russell 2000)	-4.6%	-1.6%	6.8%	16.3%	7.1%
	International Equities (MSCI EAFE)	-1.8%	11.2%	16.8%	21.6%	8.7%
	Commodities (Dow Jones AIG)	4.7%	16.2%	12.9%	14.3%	9.0%
	Real Estate Investment Trusts (NAREIT)	-12.7%	-15.7%	8.5%	18.2%	10.5%
<b>Bonds</b>	Gov't & Corporate Bonds (Lehman Gov/Credit)	3.1%	7.2%	4.4%	4.4%	6.0%
<b>Cash</b>	Cash (T-Bills)	1.0%	4.8%	4.2%	3.0%	3.6%
	Inflation (CPI)	1.0%	4.4%	3.4%	3.1%	2.7%
Asset Class Returns - After Inflation						
	Investment Type (Index)	4th Qtr	1 Yr	3 Yr	5 Yr	10 Yr
<b>Equity</b>	Large Cap (S&P 500)	-4.3%	1.1%	5.2%	9.7%	3.2%
<b>Bonds</b>	Gov't & Corporate Bonds (Lehman Gov/Credit)	2.1%	2.9%	1.0%	1.4%	3.3%
<b>Cash</b>	Cash (T-Bills)	0.0%	0.4%	0.7%	-0.1%	0.9%

“People do not decide to become extraordinary. They decide to accomplish extraordinary things.”

Sir Edmund Hillary

In 2007 there was quite a disparity between Large-Cap Growth and Large-Cap Value investment styles, which were up 11.8% and down 0.2%, respectively. A large proportion of the companies in the “Value” index are financial companies caught in the cross hairs of the sub-prime and the credit market situation. On the other hand, a large proportion of the companies in the “Growth” index are companies viewed by many to be less impacted by economic slowdown and turmoil in the financial sector. These types of differences will often result in large deviations among the various style indexes.

Small-cap stocks fell during 2007. While a decline of 1.6% was modest, it appears that in general the smaller the company the weaker the results. For example, the Russell Micro-Cap index, an index of very small companies lost 8.0% in 2007. Small-cap and micro-cap companies tend to be more sensitive to economic weakness in the U.S. than their larger brethren. Larger companies tend to have a large proportion of their revenues from international sources. For example, Intel gets about 80% of its revenue from international markets, while companies like 3M, McDonalds, Procter and Gamble and Caterpillar all obtain more than 50% of their revenues from overseas.



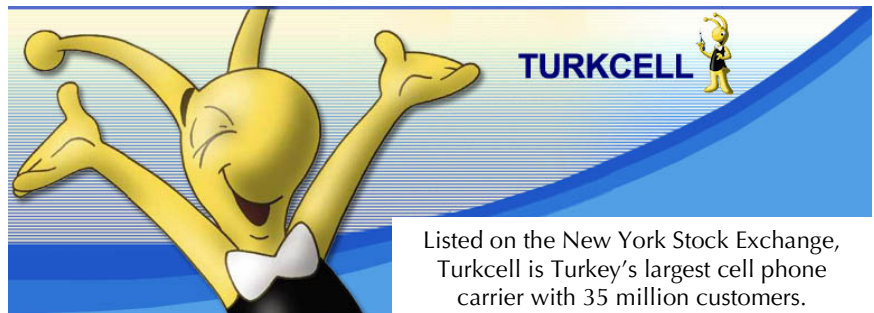
McDonalds has about 1,000 restaurants in China.



The 797B Mining Truck carries up to 380 tons

Speaking of international markets, the return from foreign stocks as measured by the MSCI EAFE index was 11.2% in 2007. However, the majority of this return was due to the weakness of the U.S. dollar against many foreign currencies. Had the U.S. dollar not lost ground in 2007, the return from foreign stocks would have been closer to 3.5%. Thus, removing currency gains means that returns on U.S. stocks in 2007 were not as weak, relative to other developed countries, as might first appear.

Emerging market stocks rose 39.4% in 2007. While that result is very high, some individual countries experienced even better results. Chinese stocks rose 63% in 2007. Indian stocks rose 71%. In Latin America, Brazilian stocks rose 75%. In eastern Europe, Turkish stocks rose 70%, while those in the Czech Republic gained 52%. These are astounding returns, driven both by real economic growth and a good deal of market speculation. It's the later that always gives us cause for concern. In China, for example, many companies are investing in the stock market and in some cases generating more earnings from stock market gains than from their business operations. This is great while it lasts, but in our view, not the best way to producing lasting results for shareholders!



Listed on the New York Stock Exchange, Turkcell is Turkey's largest cell phone carrier with 35 million customers.

**“Never mistake motion for action.”**

**Ernest Hemingway**

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