

SELECTOR[®] Money Management

2007 First Quarter Review

The first quarter of 2007 ended on a relatively flat note. Equity markets started the year with a decent follow-through from the 2006 fourth quarter rally. At the end of January, the S&P 500 Index (S&P 500) was up +1.41%, and on February 20th it closed +2.89% for the year. On February 27th, the first correction in over six months began with a bang, and a -3.59% one-day decline for the S&P 500. The correction is ongoing at this writing, although equity markets have consolidated a majority of the declines seen the first few weeks. At the end of the first quarter, the S&P 500 was +0.64% for the year, the NASDAQ +0.26%, the Russell 2000 +1.95%, and the Dow Jones Industrial Average -0.87%. International equities fared slightly better, with the S&P Euro 350 finishing the first quarter +2.49%. The MSCI Emerging Markets Index ended the first quarter +0.43% after a volatile performance.

Bond prices were relatively quiet in the first quarter, although they did demonstrate relative strength when equities exhibited the most volatile downside action. In the first quarter, the S&P 500 traded in a range of +2.89 % to -3.10 %, while the Lehman Brothers Aggregate Bond Index traded in a range of +0.92% to -0.71%. More importantly, the Lehman Brothers Aggregate Bond Index rose in price on February 27th and March 12th, the two days in the first quarter that the S&P 500 experienced its sharpest declines. This price action showed how bonds can dampen equity volatility by exhibiting price strength when equities are exhibiting price weakness.

Market corrections are as natural a part of equity investing as market rallies, and generally constructive when they occur within the context of a long-term Bull Market. We continue to view this market as a long-term Bull Market for equities. The undesirable aspect of a correction, however, is that it usually introduces higher levels of volatility to equity markets, and this correction is no exception. This increase in volatility has been addressed. Late March, as markets rebounded, we made adjustments to our asset allocations to include a higher percentage of bonds in SELECTOR[®] managed portfolios. In general we reduced equity percentages by a factor of 20% of the portfolio, increasing bond percentages by a factor of 20%. The purpose of this adjustment was to reduce portfolio volatility.

As previously mentioned, SELECTOR[®] allocations were adjusted in late-March to better manage portfolio and market volatility. SELECTOR[®] Aggressive Growth and SELECTOR[®] Growth model allocations are now 80% equities/20% bonds. SELECTOR[®] Conservative Growth model portfolios are 60% equities/40% bonds, while SELECTOR[®] Balanced Growth model portfolios are 40% equities/60% bonds. SELECTOR[®] Income & Growth model portfolios are now 20% equities/80% bonds. Should the correction resolve itself, we are prepared to fully reengage equities. However, should market conditions prove to be even more difficult, we are well-positioned to take further defensive actions. In the meantime, we are intent on managing market volatility.

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