

# ***SELECTOR® Money Management***

## ***2007 Third Quarter Review***

**The third quarter of 2007 gave investors a performance that revisited Robert Louis Stevenson's 'Strange Case of Dr. Jekyll and Mr. Hyde.'** A correction in equities that started in July deepened into a -10% decline for the S&P 500 by mid-August. Other indexes experienced even sharper drops, such as the Russell 2000's -13.4% decline, and the MSCI Emerging Markets' -18.0% decline. But unlike Stevenson's novel, the equity market's good Dr. Jekyll prevailed by quarter's end. Equity markets found the antidote and the transformation/recovery was impressive.

**The most casual observer would dismiss the third quarter as a mere blip for this Bull Market.** But professional investors recognize that tremendous energy was expended in this period. The recovery momentum was impressive at quarter's end and will likely carry over into year's end. That being said, there were chinks in the market's armor exposed during the correction. Market volatility increased dramatically at the nadir of the correction, and then gradually receded as the recovery proceeded. More fireworks are inevitable, however, for this late stage Bull Market.

**International equity markets continued to demonstrate their relative strength, especially Emerging Markets.** The MSCI Emerging Markets Index gained +14.78% in the quarter, despite its sharp drop, and has gained +34.50% year-to-date. The broader MSCI EAFE Index gained +3.02% in the quarter, and stands at +13.15% for the year. These overshadow the S&P 500 Index's respectable third quarter performance of +2.03% and year-to-date gain of +9.13%. The Russell 2000 Index had the weakest quarter, down -3.09% and now up only +3.16% for the year.

**Bond markets remain under pressure from sub-prime issues, but were beneficiaries of the equity market correction.** There was a flight to the safety of bonds in the third quarter. The Lehman Brothers Aggregate Bond Index gained +2.84% in the quarter to sit at +3.85% for the year. High yield bonds also regained territory lost in sub-prime sell-off, as the iBoxx Liquid High Yield Index gained +1.57% for the quarter and is now +3.36% year-to-date. The high yield bond sector has been a stellar performer for several years now, and its now-average numbers are noteworthy.

**There were additional institutional shifts in emphasis in the course of the correction.** During the selling phase emerging markets saw massive profit-taking. Both mid cap and small cap equities were sold far more aggressively than large cap. As money flowed back into equities, large cap was favored over small cap. Growth equities increased their separation over value equities, especially in the mid cap arena. Energy and basic materials sectors, however, continued their dominance.

**SELECTOR® Aggressive Growth and Growth models remain 100% invested in equities.** SELECTOR® Conservative Growth models are 80% equities/20% bonds, SELECTOR® Balanced Growth model portfolios are 60% equities/40% bonds, and SELECTOR® Income & Growth models are 40% equities/60% bonds. Changes in allocations were initiated at the end of the third quarter to increase portfolio exposure to Growth versus Value equities, as well as increase large cap equities over small and mid cap equities. Adjustments were also made to bond portfolios as we reduced exposure to high yield bonds and shifted towards high quality bonds.

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