

March 28, 2007

Dear Client,

As I expected, markets in the first quarter were volatile, reflecting concerns about inflation and the impact of the weak housing market and sub-prime loans on consumer spending. As we noted in our newsletter last quarter, the third year of a presidential term is traditionally good for the markets. We expect things to do fairly well for much of the year, but we do have concerns about the global political outlook and possible slowing of consumer spending. As of Mok Capital Management's tenth anniversary on Tuesday, March 27, the Dow and NASDAQ are essentially flat or down less than 1% from the final closing price of 2006. Our accounts have generally performed better than that.

We remain optimistic about foreign and developing markets, but we see concerns for inflation growing rather than abating, at least domestically. The developing markets such as China, India, Russia and Brazil continue to exhibit strong growth, but are operating near their industrial capacity, and key resource reserves such as oil are not being replaced. Presumably these nations will need to raise or hold interest rates to prevent their economies from overheating. Meanwhile, the dollar is showing the kind of significant weakness one would expect in a country running an immense trade deficit. We expect that dollar weakness to continue and worry about this happening at a time when the US consumer may start to slow spending.

As we noted in a newsletter last year, we are concerned about the impact of both sub-prime loans and more conventional variable rate loans on domestic consumer spending. As so-called "teaser" introductory interest rates are reset to higher monthly rates, consumers will have less discretionary spending money. This should reduce consumer spending, much of which has been driven by home equity loans. If consumer spending drops off and the economy slows, the Federal Reserve traditionally lowers interest rates to allow for a "soft landing". Unfortunately, with interest rates climbing abroad, any drop in U.S. rates could further weaken the dollar. Such a decline would make foreign goods more expensive in the US, which is inflationary in its effect. As a result, the Federal Reserve has only a limited ability to lower interest rates, and this condition may lead to a mix of economic weakness and inflation. This condition, known as stagflation, has not been seen here since the 1970s.

Geopolitical risks also remain high, with oil prices remaining strong, continuing problems in the Middle East and Korea, and with little political or economic leadership from Washington. Nevertheless, I continue to see good value in selected investments, and continue to believe that the best portfolio today is one well diversified by geography and industry, mindful of valuations, and cushioned by a reasonable amount of blue chip stocks bearing dividends. I am somewhat concerned with the impact of inflation on the price of domestic debt instruments, but believe that a portfolio containing a reasonable representation of energy stocks and foreign holdings (and US issues with high foreign sales) will provide a measure of protection against both inflation and a drop in the dollar. As usual, we remain vigilant to the economy and its changing impact on your investments.

Regards,

Stanley Q. Mok  
Principal