

June 28, 2007

Dear Client,

As we expected, inflation proved challenging in the second quarter, with bonds dropping in value, and stocks climbing. The impact of sub-prime loans also continues to work its way through the economy. The long-term impact of these loans remains obscured by unknowns: the quality of analysis by credit rating agencies, the extent of leverage on pools of mortgages sold to investors, the impact of future interest rate increases, and the effect of declining real estate prices and home sales. Nevertheless, the domestic economic outlook is improved for the coming quarter, largely due to global business, with recession and stagflation less likely.

Globally, we are enjoying economic growth on an unparalleled scale. Latin America is reaping the benefits of strong resource production and conservative fiscal policies, which have led to pay-down of debt and declining interest rates. Eastern Europe has strong growth and provides cheap, educated labor for Western Europe. Asia continues to drive demand for industrial equipment from US manufacturers like GE, Boeing and Caterpillar.

Although global growth is straining capacity in raw materials and energy, as well as commodities like steel and cement, innovation seems to be extending this bull market. We are seeing major technology gains in alternative energy, new materials, manufacturing and construction processes, energy efficiencies, and biotechnology. One area where we are long-term bullish is in solar technology, where lower production costs should make solar competitive with many fossil fuel uses within the next 3-5 years. Solar sales are booming.

The threat of inflation should continue in the months ahead, but for the near term we believe that global prosperity will somewhat outweigh inflationary pressures. In the meantime, we will closely watch capacity constraints, labor and commodity prices, and the sub-prime fallout. As the dollar continues its long-term decline, import prices should rise considerably, making US products more competitive overseas, but challenging the pocketbook of US consumers. At the same time, US exports may, in the short-term, moderate the fall of the US dollar, which was considerable this year.

We worry about the usual summer and fall stock market doldrums, and the impact of the sub-prime debacle, but believe that barring an unexpected chain reaction from sub-prime defaults, global growth will exceed the effect of any swoon this year. Some analysts worry about a "bubble" in China's stock and real estate markets, where speculation has seized the day. Out of concern, we have reduced client exposure in this market. However, we believe that most foreign markets offer reasonable equity values, and that at this point a significant drop in Chinese share prices will not set the stage for a large shock in other markets. We also believe that the Chinese government is likely to intervene to moderate any drop in their markets prior to the 2008 Olympics.

Geopolitical risks remain high, with continuing problems in the Middle East, but a possible accommodation with North Korea. Apart from continuing challenges from Iran, we see less immediate threat than at any time in the last year.

Regards,

Stanley Q. Mok
Principal