

Markets



A Year of Stark Contrasts and Scattered Gains

THE MARKET BEGAN 2007 STRONG, continuing the previous

year's fourth quarter rally. Then in late February stocks skidded, but the panic didn't last long. By April the Dow reached 13,000 for the first time and then barreled past 14,000 in mid-July. But, after a decent first half and roller-coaster third quarter, broad U.S. market indices fell in the last quarter, the first fourth quarter loss in ten years. Foreign markets, particularly in developing countries, did better.

While the broad U.S. market struggled under the weight of the credit crisis, sectors like technology, energy and materials posted remarkable gains. Uncertainty about the housing market, credit-crunch and strength of the economy took its toll. Financial company earnings suffered from huge markdowns on the value of their mortgage-related holdings. But earnings in many other sectors remained strong.

Of the major U.S. indices, the tech-heavy NASDAQ ended with the calendar year's biggest gain, 9.8% - its best showing since 2003. Next came the large-cap DJIA with a total return of 8.7%. The broad market S&P 500 Index, including dividends, gained 5.4% for the year. Coming in last, the small-cap Russell 2000 Index lost 1.6% in 2007.

Despite the fourth-quarter slide, diversified U.S. stock funds rose 6.9% on average for the year. Overall, annual returns were the smallest since 2002 and below the U.S. market's 10% historical average, but 2007's top fund groups suggest that investors would do well to recognize that following market leadership can be profitable even in mediocre years.

Natural-resources funds surged 40% for the year and 7% in the last quarter. Utility funds came in second with a 20% annual gain, 5% in the final quarter. Technology funds staged an impressive comeback, up 16% on the year, and health-care funds added 10%.

On the downside, the subprime debacle sacked real-estate funds for a 15% annual loss after a 12% quarterly hit. Financial-services funds fared only slightly better, down 13% on the year and 10% in the quarter.

Global Gains Continue

Foreign stock markets extended their winning streak in 2007, outperforming the U.S. for the fifth year in a row. The Dow Jones World Stock Index, excluding the U.S., returned 12% last year in dollar terms, compared to the 6.4% gain for the domestic DJIA. Emerging markets funds once again enjoyed the largest gains. Latin American funds extended their winning streak to a fifth straight year of tremendous gains. Outside of Japan, Asia was strong. The biggest winners were China, Hong Kong and India. Japan was down 11%.

Hold the Predictions

As to the many forecasts we hear this time of year, we simply won't know what the future holds. Although it's traditional in January to forecast the markets for the next 12 months, predictions rarely hit the mark. What we do know is that, as always, fund selection and the discipline to stick to your strategy will play the most important role in your long term investment success.

Thank you for your business,

P. Michael Valley II

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