

Third Quarter 2007 Commentary and Outlook

Equity markets moved to historic highs early in the third quarter before succumbing to the turmoil that had already engulfed credit markets. The market fell about 10% from its July high to a mid-August bottom and then recovered in impressive fashion in the closing weeks of the period. Investors' expectations of Fed action to prevent the developing crisis from spreading bolstered the advance and proved prescient. For the quarter, large cap stocks posted gains, mid caps were flat and small cap indices recorded modest losses. Growth oriented stocks outperformed value stocks in all capitalization segments.

With turbulence in financial markets showing signs of easing, equity markets have moved back to the area of historic highs but a continuation of this upward trend is dependent on three key components: consumer behavior, capital spending and trade.

Consumers Facing Headwinds

Consumer spending, which accounts for almost 70% of domestic economic activity, will likely be buffeted in the months ahead by strengthening headwinds of a housing recession. The combination of tighter lending standards, low affordability and greater buyer caution will continue to crimp demand for homes. At the same time, the supply will continue to rise as foreclosures increase along with the rising numbers of mortgages scheduled for rate resets. We expect higher mortgage interest rates to further reduce affordability just as builders and investors seek to monetize their real estate holdings. The growing supply-demand imbalance is likely to translate into falling home prices.

The decline in home values will dampen consumers' propensity to spend and is of great importance to the general economy. A 10% decline in home values translates into \$2 trillion dollars of lost wealth. This compares to household total equity of around \$50 trillion. The well-documented wealth effect in housing prices explains the close correlation between changes in housing prices and consumer behavior. Simply stated, swelling household balance sheets, attributable to rising home equity, cause homeowners to feel wealthier, leading to higher levels of discretionary spending. Conversely, when housing slumps, homeowners feel less wealthy and tend to spend less. The magnitude of the change in spending resulting from the developing housing recession is difficult to forecast because much depends on psychology and confidence. In addition, other household assets, such as equities and mutual funds, which are about equal to the net worth represented by housing, may also contribute wealth-effect changes in consumer behavior.

An expanding economy could act as a countervailing force to these wealth-effect declines. In coming quarters, any source of economic growth that creates jobs or adds to incomes holds potential to buoy consumer spending.

Capital Spending Suspect, Trade Holds Potential

While corporate balance sheets are strong and cash levels high, earnings growth has been slowing and business confidence has recently begun to deteriorate. As a result, domestic capital spending is unlikely to accelerate and to bolster growth in a meaningful way. However, while economic growth is slowing in the US and Europe, the economies of the developing world, particularly Brazil, Asia and India, continue to accelerate. This benefits US exporters in the industrials and technology sectors. The trade outlook bodes well for the US competitive position, which benefits from depreciation of the dollar. The prospects for improvement in net trade are constructive and should bolster economic growth.

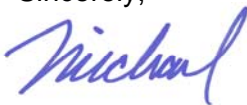
Opportunities

On balance, US economic growth appears likely to decelerate, rendering current earnings forecasts too optimistic. These changing prospects for US companies may not be fully incorporated into the fabric of the market. Adjusting to lower expectations could cause additional volatility in share prices particularly in the consumer and financial related sectors. There are, however, grounds for measured optimism: while credit is tighter, liquidity remains ample. If the consumer retains confidence and the dollar remains orderly, then a serious decline in economic activity may be avoided.

In the current setting, we remain cautious and opportunistic. We will continue to exploit the inevitable periods of downside market volatility. We look to establish or build positions in the equity of businesses we believe hold the potential to produce superior long-term investment returns for your portfolio.

In this regard, we continue to build your position in uranium-related equities. We are attracted to the long-term potential this industry offers. We believe the supply of uranium will not keep pace with future demand, driven by an unprecedented global expansion of nuclear generating capacity. The bulk of the forecast increase in demand for uranium is a result of government policies promoting national security through energy independence. This gives us confidence in the long-term outlook for healthy growth in demand and a substantial supply-demand imbalance for the commodity. The companies we have identified in this area have strong managements, are soundly financed and appear well-positioned to demonstrate large gains in free cash flow in the years ahead.

Sincerely,



Michael A. Steinberg
Managing Partner