Tillar-Wenstrup Advisors, LLC

Newsletter
3rd Quarter 2007

Third Quarter 2007 - Review

What a wild quarter – the housing market continued to implode, toxic subprime mortgages caused pain to financial institutions across the globe, the asset-backed commercial paper market stopped functioning, banks stopped lending to each other at market interest rates, Countrywide Financial, the biggest independent mortgage lender, endured a liquidity crisis that almost put it out of business, there was a run on a bank in England, the takeover boom came to a screeching halt, and the stock market has its first 10% correction since the bull market began in 2003. But, by the end of the quarter the S&P 500 had gained 2% after the Fed cut interest rates by a surprising 0.5% in mid-September!

One theme emerges from all the chaos: Investors worldwide are becoming more risk adverse and are favoring large-capitalization, globally-focused, high-quality stocks. Our portfolios were structured to benefit from this theme and significantly outperformed the market. Best of all, there are many reasons to believe this trend will endure.

First, global growth remains robust despite the slowdown in the U.S. The largest U.S. companies have significant business overseas which should keep earnings moving higher.

Second, money flows should favor large-cap stocks. Over the past decade institutional investors have moved money out of large-cap stocks and into private equity and hedge funds, which in turn tended to buy mid- and small-cap companies. We expect this trend to slow, and eventually reverse, as large-caps outperform.

Finally, there is the emergence of Sovereign Wealth Funds. These are huge investment funds controlled by overseas governments formed in response to the growth in their foreign exchange reserves. The most active are from the Middle East and Asia and have an estimated value of $3-$4 trillion. These funds are getting more aggressive in their investments, diversifying out of U.S. Treasuries and other bonds and into stocks. Since these types of investors typically prefer the liquidity of large-cap stocks the additional investment assets coming into our markets could act as a price support or even added buying pressure for undervalued Blue Chip stocks.

The stock market has rallied impressively from its August lows. However, the economy and financial markets still have a lot of baggage to work through. There are two risk factors that we will be monitoring closely. First is the global housing market. Although the media focuses on the problems in the U.S. housing market, the housing bubble is a global phenomenon. If the housing markets in the rest of the world follow our path, the worldwide economy could be derailed. The second big risk is more trouble in global financial markets. We certainly have not seen the end of major write-offs for the esoteric debt that was purchased over the past few years and no doubt some players still have way too much leverage. As these positions are unwound the stock market is likely to be volatile.

On a positive note, monetary conditions are bullish. Official inflation measures are trending down. The housing recession and credit crunch are both deflationary events which should keep inflation tame. However, it can be argued that inflation on a personal level is problematic. For many people food, energy, education and healthcare costs are big budget items. These prices are all rising well above the official inflation rate and will likely keep U.S. consumers constrained prompting more rate cutting from the Fed. A sustained rate cutting campaign by the Fed has historically been good for equities.

Stock market volatility is on the upswing and we expect it to increase. However, conditions for permanent stock market losses are not in place yet. More importantly, we believe the long-term outlook for high-quality, globally focused companies is excellent.

Thanks again for your business.

Jim Tillar, CFA and Steve Wenstrup

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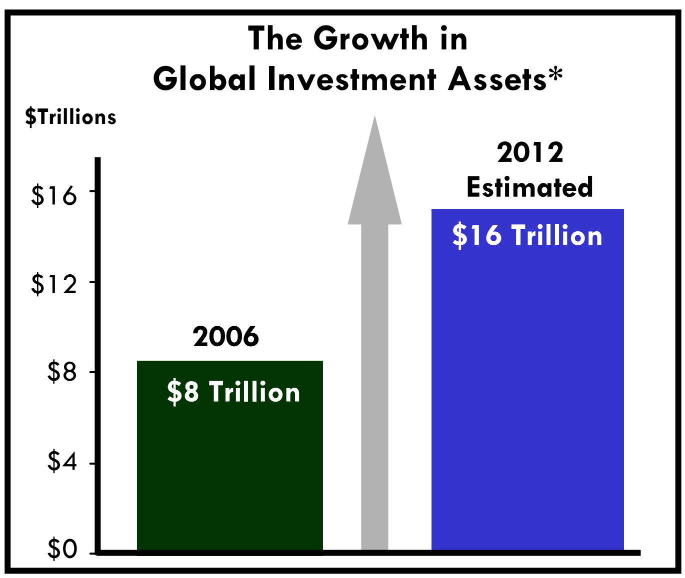

*Estimated Growth in Assets in Global Capital Markets from Petrodollars, Asian Central Banks, Hedge Funds and Private Equity from 2006 to 2012. Source: McKinsey & Company, October 2007