

## **Q1 2007 Economic Review**

Numbers can sometimes be deceiving. The first quarter performance of the markets showed all three major financial indices within 1% of where they started the year. However, the past three months have been much more of a roller-coaster ride for investors with periods of big gains and losses, only to have the indices end near the flat line.

The Dow Jones Industrial Average ended the quarter down 109 points, or (0.9%), at 12,354 after some sharp moves up and down. The broad Standard & Poor's 500-stock index was little changed for the quarter, up 0.2% or less than 3 points, to 1,421, also after some wild gyrations over the past two months. Yardsticks tracking riskier companies fared somewhat better. The tech-stock-focused Nasdaq Composite Index ended the quarter up 0.3%, or 6 points, at 2,422 while the small-stock Russell 2000 index gained 1.7%, or 13 points, to end at 801.

The year got off to a good start in January with equities rising 1.4%—the typical advance since 1945—on carryover momentum from the strong performance that started in mid-summer on falling oil prices as a result of the end to Israel/Lebanon hostilities, a calmer-than-expected hurricane season, the continuation of double-digit corporate earnings growth, and the prospects of an imminent start to a new Fed-easing program. This favorable reading for the January Barometer gave investors the hope that the current bull market had a good chance of celebrating its fifth birthday later this year.

Yet soon after another record close for the Dow Jones industrial average and the new recovery high for the S&P 500, efforts by the Chinese government to curb speculation triggered a 9% decline in local markets. This contributed to what turned out to be a near 6% sell-off in U.S. equities. The blue-chip Dow Jones average plunged 416 points, or 3.3%, on Feb. 27. It rebounded 2.5% since hitting a closing low March 5, but remained 2.2% below its level before the one-day sell-off. Investors continue to speculate if more downside lies ahead.

Expectations for the next few months are modest at best with little hope for a significant rally as investors battle fears about the impact of mortgage defaults and the housing downturn on the economy. Other looming hazards include slowing corporate earnings growth, energy prices that have crept higher lately, and lingering uncertainty about the Fed's next move.

Many economists have been ratcheting down their estimates for growth in the first quarter and for all of 2007. These revisions are primarily being blamed on what is starting

to look like a housing recession. Getting a sub-prime mortgage has become all but impossible with lenders tightening standards. Some, including New Century Financial, have filed for bankruptcy protection.

Home sellers are finding that potential buyers can't get approved. While housing prices appear to be holding up, sales are still plummeting on a year-over-year basis. Furthermore, prices aren't always what they seem to be. Sellers, including home builders such as KB Home, Hovnanian Enterprises and Lennar, are increasingly making all kinds of concessions to close deals. A seller of a previously owned home might even agree to pave the driveway, install new roofing shingles or remodel the kitchen just to close the deal. But these improvements do not show up in the transaction price.

Housing is not the only thing to worry about. Energy is on the forefront once again. The heating season is coming to an end, but the driving season is just beginning. After being lulled into complacency with \$2-per-gallon gasoline, consumers are watching prices surpass \$3 again. If you factor in slowing corporate earnings growth and evidence of inflation high enough to worry the Fed, it becomes increasingly difficult to maintain a bullish outlook.

Amid the recent contradictions, however, readings of employment and wages have remained surprisingly strong, supporting consumer spending. Nevertheless, the annual rate of inflation has stayed stubbornly above the level generally regarded as the Fed's comfort zone for cutting its interest-rate targets.

Investors and professional traders alike have been reassessing their hopes for a Fed rate cut which would lower borrowing costs throughout the economy, encourage investment and consumption, and spur corporate profits. In late December, futures contracts in Chicago indicated that a rate cut by the middle of 2007 was a near certainty. Futures traders now place the likelihood of a Fed cut by July at less than 30%.

In the weeks ahead, analysts say, the market will have to deal with good-but-not-great earnings reports for the quarter just ended, probably the slowest growth in three years. Analysts' consensus expectations are for a gain of around 4% which would snap a record streak of double-digit percentage growth every quarter for more than three years.

Few stock-market predictions came true last quarter. In the same vein, we don't expect a worst-case scenario to play out now that the data looks more worrisome. We maintain our view that the market will reach high single digit returns by year-end, but the real run will be towards the latter half of the year, mostly because of the murky economic picture. In many ways, we'd be more worried if the market continued in a heady ascent from last year's second half. That would mean the mood had gotten so upbeat that investors were overlooking risks they shouldn't be overlooking. The roller coaster of the past three months is a reminder that markets can swing up and down very quickly...and for investors, market losses are never deceiving.

## Advance Billing Notice

This is to provide you with notice that Centurion Counsel will charge your account for the **second quarter 2007** management fee. Your management fee for this quarter will be \$1,007.62. This was calculated by multiplying your account value as of the end of the previous quarter by 1/4 of your annual fee rate, as stated in your client agreement. If assets are deposited into your account during the quarter, a pro-rata share of the quarterly fee will be charged. If you are currently paying your management fee by check, your check should be received by **May 15, 2007**. All checks should be made payable to **Centurion Counsel**. Please direct any questions regarding this advance billing notice to your registered representative.

## SEC Rule 11Ac1-6: Quarterly Report on Routing of Customer Orders

SEC Rule 11Ac1-6 requires all brokerage firms to make publicly available quarterly reports on the order routing practices. This report provides information on the routing of “non-directed orders” – any order that the customer has not specifically instructed to be routed to a particular venue for execution.

<i>Total Centurion Institutional Orders</i>	<i>Market Orders</i>	<i>Limit Orders</i>	<i>Material Aspects Relationship</i>
NYSE, NASDAQ, AMEX, Options	>1%	+99%	Clearing Broker/Dealer

## Privacy Policy

Centurion Counsel’s privacy policy is consistent with that of our clearing firm, Bear Stearns.

We do not disclose non-public, personal information to anyone, except as permitted by law. In general, the law permits us to disclose information to our affiliates, or to non-affiliates if the information is required in the ordinary course of business. Additionally, safeguards are taken within the firm to insure that access to your information is limited to those employees that are involved in administrating your account.

## Administrative Update

Our updated Form ADV, as filed with the Securities and Exchange Commission, describing Centurion Counsel and its methodology will be mailed to you without charge upon receipt of a written request. If you would like a copy, mail your request to: 365 S. Rancho Santa Fe Road, Suite 300, San Marcos, California 92078.