CENTURION
COUNSEL, INCORPORATED
Investment Management

365 S. Rancho Santa Fe Road, Suite 300
San Marcos, CA 92069-2338
(760) 471-8536 Fax (760) 471-0399
e-mail: info@centurioncounsel.com

Q3 2007 Economic Review

It has been fondly known in financial markets as the 'Greenspan put.' Starting with the 1987 stock market crash, Mr. Greenspan repeatedly provided massive liquidity when events like the Russian and Asian crisis or the dot-com hangover suggested a possible meltdown. For this, he has been praised, but also criticized for interfering with 'moral hazard'; the notion that investors should lose money when they are foolish so they don't repeat past mistakes.

Following the Fed rate cut late last month, the 'Greenspan Put' seems to have morphed into the "Bernanke put." The Fed appeared to aggressively mitigate the market's concerns with the housing meltdown and the credit crunch that has followed. Investors seem to be putting a lot of hope in the Federal Reserve's ability to ride to the rescue tomorrow. Maybe too much hope.

Amidst a volatile 3 months with a whirlwind of tumultuous ups and downs, the markets finished up for the quarter. The Dow Jones Industrial Average ended the quarter up 486 points, or 3.62%, finishing at 13,895. The NASDAQ closed up 3.78% or 98 points to finish at 2,702 whereas the broad Standard & Poor's 500-stock index rose 23 points to 1,527 or 1.55%for the quarter.

Now comes the question of how the Fed is able to navigate the tricky road that lies ahead. Even another aggressive rate cut would offer little immediate help for the fundamental problems weighing on the nation's economy and financial markets. Beyond a worsening housing slump, these include high gasoline prices, which are damping consumer spending, and fears of further defaults on the billions of dollars of low-quality loans that have been used to finance mortgages and corporate takeovers.

In the near term, however, the big problem is that it takes months for rate cuts to translate into economic growth, by affecting things such as investment, consumer spending and exports. In credit markets, some banks have become less willing to extend credit for purposes like takeover financing, because of a fear of default. A half-point change in base rates isn't going to change that very quickly.

What the Fed rate cut - or series of cuts - could change quickly is investor psychology. If investors believe the Fed will do all it can to get credit markets going again and keep the housing market from pulling the economy into recession, they may be willing to bet on the future by buying stocks.

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The Federal Reserve cut rates in order to address a pressing concern: the risk of recession and a breakdown in credit markets. By lowering rates before it really wanted to, however, the central bank has revived another fear that had been dying down: inflation.

If the Fed gets it just right, the economy will slip through this crisis and keep expanding with only modest inflation, making investors happy. If the Fed's rate cuts are too little, too late, recession fears will return, sending another cold wind through credit markets and the stock market. If the Fed cuts rates too much, inflation could loom.

Lower rates typically stimulate the economy by making it easier for companies, consumers and investors to borrow. Inflation could come from the still-booming global economy and from the lower rates themselves, which push more money into the economy, making it easier to raise prices.

A weakening dollar also adds to inflation. It makes foreign holders of the dollar, such as the Chinese, less eager to own dollars. While a weakening dollar helps U.S. exports, boosting earnings for companies that compete with foreign multinational companies, it also pushes up import prices, which can make inflation quicken.

Some investors aren't concerned about signs of inflation in import prices because they believe global competition is holding prices down. Inflationary pressures are already evident however, in the pricing of many commodities such as gold, agricultural products and energy, all of which are near multi-year highs.

Hedge funds and other large investors appear to have been reducing the amount of leverage -- or borrowed money -- they use to invest. Leverage seems safe when the economy is stable, but dangerous in a downturn. If investors use less of it, that will cut back on the flow of cash into the markets.

Short-term credit markets, on the other hand, are showing extreme levels of risk aversion. The London interbank offered rate, or Libor, has risen far above the Fed's overnight target rate, a rare occurrence that suggests banks around the world are very wary of what lurks on each other's balance sheets. Maybe they know something everyone else should be more worried about.

At long last, financial markets have lurched toward higher risk premiums, the extra interest that lenders receive for eschewing Treasuries in favor of less-safe loans. High yield, or junk bond, prices have fallen sharply in recent months, driving yields higher. At the beginning of June, the Merrill Lynch High Yield Bond Index yielded 2.41 percentage points more than comparable Treasuries. At quarter end, that "spread" over low-risk Treasuries had widened to 4.73 percentage points. That's a massive shift for the tortoise-like debt market.

How much danger lurks ahead? Like skiers who venture across the ropes into avalanche country, investors in debt instruments today are dodging an unprecedented overhang of

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supply. In the so-called "golden age of private equity," banks vied to commit to lend massive amounts of capital to private equity buyouts that would take months to close. Each new promise seemed to bring lower pricing, ever-loosening strictures ("covenants") on the borrowers, and fewer pre-closing escape hatches for lenders as banks, thirsty for fees, scrambled for market share. When the music stopped in July, $330 billion or more of these commitments was outstanding. By comparison, that's in the range of the total annual lending volume to similar borrowers as recently as 2005.

As intimidating as it may seem, the supply overhang is not our biggest worry, which is the prospect of many of these loans going bad (the seminal reason for the collapse of the mortgage market.) Never before in the history of capital markets has so much money been lent to so many challenged borrowers.

So what of the Bernanke Put? Unfolding events will test the wisdom of choosing the larger, half-point rate reduction, which at least modestly undermined the goal of protecting us from moral hazard. But lenders and investors should beware that for all Mr. Greenspan's willingness to provide liquidity, plenty of money was lost in the markets in the early 1990s and again in the post-bubble swoon a decade later. The rerun of that movie has barely begun to play out.

Advance Billing Notice

This is to provide you with notice that Centurion Counsel will charge your account for the **fourth quarter 2007** management fee. Your management fee for this quarter will be $550.22. 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 **November 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.

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

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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.