Godsey & Gibb Associates
Investment Watch
December 31, 2007

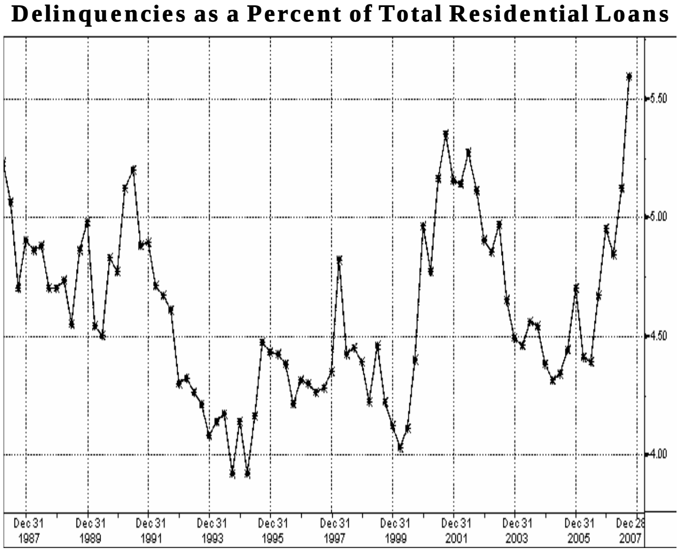
Preparing for Slower Growth: Housing Weakness, Credit Deterioration, and Higher Energy Costs Combine to Increase Risks for Growth in the Overall Economy, Consumer Spending and Corporate Earnings

2007 Review and Outlook

In the fourth quarter, intensified weakness in the housing market measured by rising delinquencies and falling house prices increased the risk that U.S. consumer spending may be weakening and that corporate profits may suffer a downturn as a result. Mortgage delinquencies rose to the highest levels in over 20 years and home prices also declined the most in two decades, reducing home sales, and the wealth effect created by equity withdrawals and putting consumer spending levels at risk. What started as a sub-prime problem spread to the overall market, increasing volatility and sending the stock market averages down over 10 percent from their October record highs. As risk aversion in the markets increased, investors drove U.S. Treasury yields to their lowest levels in over three years.

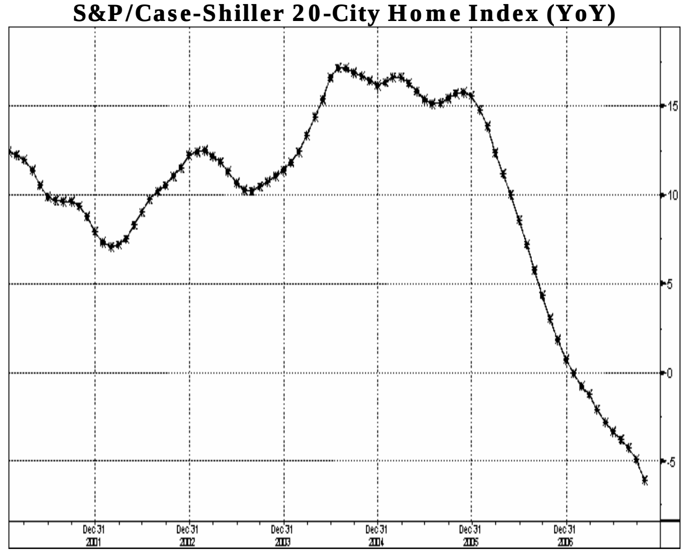
In the fixed income credit markets, complex, structured products such as mortgage-backed securities (MBS), collaterized debt obligations (CDOs) and structured investment vehicles (SIVs), which package debt into new securities backed by the cash flows from mortgages and sub-prime loans, lost value as the prices of the underlying collateral fell. The major credit rating agencies lowered their ratings for billions of dollars worth of MBS, CDOs and SIVs linked to sub-prime mortgages. Write-downs by corporations related to these instruments totaled over $100 billion and cost the CEOs of three major Wall Street firms their jobs. The sub-prime debt fallout has been wide spread, from Wall Street firms to government investment pools and even money market funds.

Delinquencies as a Percent of Total Residential Loans



Source: The Mortgage Bankers Association and Bloomberg

S&P/Case-Shiller 20-City Home Index (YoY)



Source: S&P/Case-Shiller and Bloomberg

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At least a dozen investment firms contributed more than $3 billion to prevent their money market funds from declining below a $1 net asset value per share or "breaking the buck".

Additional evidence of a credit crunch has appeared in the bank overnight lending market. Banks appear less likely to lend, evidenced by the widening difference in short-term interest rates, specifically short-term rates for LIBOR (the London Interbank Offered Rate) and short-term U.S. Treasury Bills. The widening spreads indicate a higher cost and an unwillingness to lend. In economics, this situation is referred to as a paradox of thrift - when individual lenders choose to wait until conditions improve to start lending. Unfortunately, by waiting to lend, institutions further reduce available credit and thereby exacerbate the situation.

Given the historic fall in housing prices and subsequent rise in mortgage delinquencies, Wall Street's multi-billion dollar mortgage securitization industry appears to be broken. With mortgages bundled and packaged into various different complex products based on the values of underlying loans, it turns out that a housing price downturn combined with a rise in fraudulent loans and loose underwriting standards proved to be detrimental.

Additionally, consumers are facing higher energy prices. Crude prices soared over 57 percent in 2007, crossing over $98 per barrel on November 23, which topped the inflation-adjusted all-time high of $84.73 set in March 1981, as demand outpaced supply and political tensions increased geopolitical risks. As a result of commodity price increases, the average American household's heating bill almost doubled from 2002 to 2007, according to the Consumer Federation of America.

These factors combined to hurt corporate earnings in some industries, as well as the outlook for consumer spending and GDP growth. The housing downturn and related mortgage crisis have added a "greater than usual" uncertainty to the economic outlook, according to Federal Reserve Chairman Ben Bernanke. Moreover, consumer confidence measured one of the lowest numbers in years in the fourth quarter and auto-loan delinquencies moved up to the highest level in several years. While U.S. GDP growth measured a healthy 4.9% in the third quarter, consensus estimates for fourth quarter GDP growth are dramatically lower at approximately 1.0%. The Fed's forecast for 2008 GDP growth falls in the range of 1.8% to 2.5%.

Despite the uncertain outlook for the economy and the financial markets, not all indicators are negative. Several positives include the strong earnings growth in many industry sectors, the policy responses from Washington, impressive international growth and relatively strong employment figures, although unemployment is forecast to trend up if the economy weakens.

S&P 500 Earnings Growth by Industry for Q307

Industry Sector	Market Cap Weighted Percent Change
Technology	30.6%
Industrials	21.3%
Health Care	16.1%
Consumer Staples	13.2%
Telecommunications	12.2%
Materials	11.6%
Utilities	7.4%
Energy	-8.5%
Consumer Discretionary	-11.4%
Financials	-14.7%
Total Universe	**2.6%**

Source: Bloomberg

Recent Investments By Sovereign Wealth Funds

Investor	Dollar Amount	Recipient
Gov't of Singapore & Middle East Investor	$11.5 billion	UBS AG
Abu Dhabi Inv. Auth.	$7.5 billion	Citigroup Inc.
China Inv. Corp.	$5.0 billion	Morgan Stanley
China Dev. Bank and Temasek (Signapore)	$5.0 billion	Barclays
Temasek	$4.4 billion	Merrill Lynch
Citic Sec. (China)	$1.0 billion	Bear Stearns
Total	**$34.4 billion**	

Source: Bloomberg

Third quarter earnings were bifurcated, with negative results in the Financial, Consumer Discretionary and Energy industry sectors; however most industry sectors generated double-digit gains. The Technology, Industrials, Healthcare, Consumer Staples, Telecommunications and Materials sectors generated double-digit earnings growth in the third quarter. Utility sector earnings rose in the high single digits. Moreover, most corporations remain financially healthy as evidenced by dividend increases and share repurchases this year.

According to Standard & Poor's, more than 60 percent of the companies in the S&P 500 Index either increased or initiated dividend payments in 2007. Also, the companies in the S&P 500 Index are on track to repurchase more than half a trillion dollars in share buybacks, up from $436 billion in 2006.

The tone in Washington appears to favor easier monetary policy. In addition to its interest rate reductions on Sept. 18, Oct. 31 and Dec. 11, the Fed has extended loans for longer-than usual terms, allowing lenders a longer time period in order to resolve sub-prime related issues. Moreover, the Fed joined with four other major central banks in December to inject additional liquidity into the market through a series of loan auctions.

The Bush administration also released a plan to help hundreds of thousands of homeowners who are having trouble making their adjustable rate mortgage payments. The agreement can help homeowners with one of three options: freezing rates that would have reset higher, refinancing into a new private mortgage, or obtaining a loan backed by the Federal Housing Administration. While the plan will not provide assistance for homeowners that have already foreclosed, refinanced or that are delinquent by more than one payment, it should provide a modestly positive impact to borrowers facing higher rates.

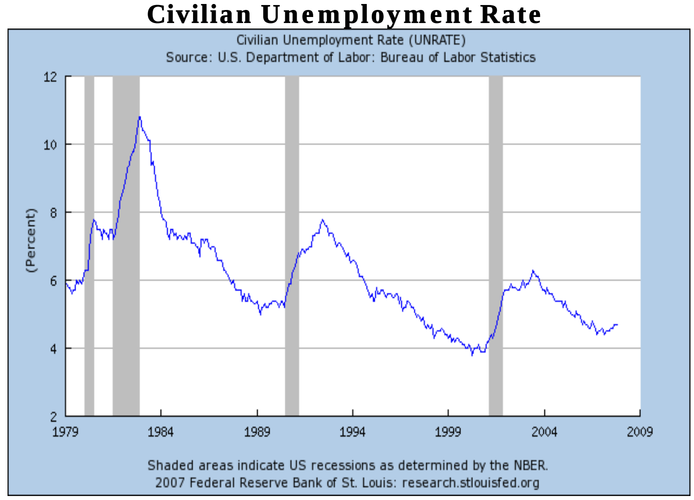
Strong growth remains in emerging markets due to urbanization and industrialization, and it has been a positive contributor to global GDP growth. The International Monetary Fund estimates global growth will measure 4.7% in 2008. Emerging market economies make up an increasingly large portion of world GDP at nearly 30% (approximately equal to the contribution of the U.S.). This stronger global growth has helped to lift U.S. exports. Real U.S. exports rose by 9.8% in the year ending September 30. A weaker dollar, which makes U.S. goods more affordable overseas, has also contributed. Year-to-date, the U.S. Dollar has depreciated versus the currencies of America's major trading partners.

The growth in sovereign wealth funds (pools of government money from a country's trade surplus set aside for investment purposes) created a stabilizing influence on global markets. The estimated $2 -$3 trillion in

Real Net Exports of Goods and Services

Source: The Federal Reserve Bank of St. Louis

Civilian Unemployment Rate



Source: The Federal Reserve Bank of St. Louis

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assets in these funds are larger than all of the world's hedge funds combined. Because most sovereign wealth funds buy long-term investments, they tend to reduce overall market volatility.

Governments in the Middle East and Asia have recently agreed to invest over $34 billion in Wall Street firms. The banks turned to these government investors to help recapitalize their balance sheets after suffering from record levels of sub-prime related write-downs. The government funds are making use of the crisis to buy an interest in the firms at what they believe to be attractive valuation levels.

Given these positives, employment remained stronger than expectations in the fourth quarter. The unemployment rate at year-end 2007 measured a low 4.7%. Moreover, the year-over-year change in hourly earnings measures a healthy 3.8%. To date, the weakness in employment has been contained in the housing related and financial services sectors of the economy.

However, with overall economic growth slowing, we are concerned that near term earnings expectations may be too optimistic and that they may not fully reflect the current level of economic uncertainty. Moreover, the economic weakness generated by the sub-prime crisis is not an isolated event, and unfortunately, we believe it is spreading, as evidenced by higher credit card delinquencies, higher auto loan delinquencies and the slowest holiday shopping season since 2002.

Volatility in financial markets is expected to continue until investors gain more visibility with regard to the future direction of the economy. In calendar year 2008, in our ongoing efforts to minimize risk, we will be monitoring the economic data and the financial markets diligently for any indications of improvement.

Our concerns about the length and depth of the mortgage crisis and its impact on overall economic growth have kept us searching for pockets of relative safety and consistent earnings growth. Borrowing from the old sports adage, the best offense is a good defense, we have adopted a more conservative posture and positioned portfolios accordingly, as follows:

1. In the fixed income markets (including money markets) we continue to focus on the highest quality, investment grade securities issued by the U.S. Treasury, its agencies and large cap, financially strong corporations. Municipals bonds purchased continue to have credit ratings of 'A' or better.

2. We maintain no exposure to real estate investment trusts (REITs). As sub-prime loans decline in value, the prices for property trusts that own office buildings, apartment buildings, shopping centers and hotels are also losing value.

3. Our portfolios maintain no brokerage firm exposure. In fact, our overall Financial stocks, which overweight asset managers and insurers, have proven to be the best relative sector outperformers in 2007.

4. Given the headwinds facing the U.S. consumer and the U.S. economy, we have reduced exposure to the Consumer Discretionary sector and increased positions in more economically defensive industries including Consumer Staples, Healthcare and Telecommunications.

In 2007, Large Cap Growth stocks, as measured by the Russell 1000 Growth Index, outperformed Large Cap Value stocks, as measured by the Russell 1000 Value Index, for the first time since 1999. With slower earnings growth and further deterioration in the credit markets possible, we believe that high-quality large cap growth companies, with strong balance sheets, attractive valuations, ample access to capital and consistent earnings should continue to outperform as a relative safe haven.