DIXON, HUBARD, FEINOUR & BROWN, INC. investment counsel

INVESTMENT OUTLOOK

Year 2007 Review and Outlook for 2008

by Whitney Brown

- Bull market advances for fifth year.
- Credit crunch lingers.
- Economy slows.
- Federal Reserve continues to ease.

Though finishing on a down note, the stock market rewarded investors with another year of positive returns. The major market indexes, with the exception of the small-cap Russell 2000, offered modest single-digit returns for the full year. 2007 marked the fifth consecutive year of positive stock market returns following the 2000-2002 bear market.

Market Measures	4th Qtr	YTD
S & P 500	-3.8%	3.5%
Dow Jones Industrial Average	-4.5%	6.4%
NASDAQ Composite	-1.8%	9.8%
Russell 2000	-4.6%	-1.6%
Morgan Stanley EAFE	-3.0%	3.5%
Lehman Bros. Aggregate Bond Index	3.0%	7.0%
	12/31/07	12/31/06
10-Year Treasury Bond Yield	4.04%	4.71%
Three-month Treasury Bill Yield	3.23%	5.02%

The sub-prime mortgage debacle that came to light at mid-year seemed to snap investors awake and remind them that investing entails risk, not just reward. Renewed concerns surrounding the credit crunch and mounting fears of a recession in the U.S. overwhelmed the normal tendency of the stock market to rally in the fourth quarter of the year. The recognition that there would be no quick resolution to the credit market problems prompted investors to sell risky assets and flee to the safety of government and high quality corporate bonds. As prices have surged, yields on U.S. Treasury notes have been driven back down to levels last seen in 2004-2005. The chart on page 2 illustrates the dramatic reversal in treasury yields.

Large-cap growth stocks also benefited from the flight to safety based on their perceived ability to weather recession as well as their reasonable valuations after having been shunned for the past seven years. The comparatively higher return on the NASDAQ Composite, which is dominated by tech giants such as Microsoft and Apple, supports the case that the market has turned in favor of large faster growing companies after riding small-caps and cyclicals for the past few years.

As mentioned, the problems in the credit markets do not appear to be subject to a quick fix. The long period of easy credit fostered by the Federal Reserve in the aftermath of the 2000-2002 bear market and the September 11th attacks created an environment that encouraged smart people in the financial world to do foolish things with borrowed money. Namely, originations of sub-prime mortgages went through the roof and the reselling and securitization of those loans spread the risk far and wide around the world.

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The issue now is not so much the amount of the problem loans but identifying who has them and what they are worth. There has been a loss of confidence in the global credit markets. Banks are reluctant to lend to each other until all have their cards out on the table. They have also tightened standards for loans to businesses and consumers.

The Federal Reserve and central banks have taken steps to provide ample liquidity for banks and to cut short-term rates until normalcy can be restored and recession averted. For their part, the financial institutions that have been burned by the sub-prime fiasco are working to write down the bad loans and shore up their balance sheets with new capital. Despite all the hand wringing in the financial press, that process appears to be proceeding in an orderly and expeditious manner.

The economy, both at home and abroad, is slowing. The credit crunch has heightened fears of recession. Housing in the U.S. is still in trouble with inventories high, prices still falling, and building activity down. Affordability has improved, but fewer buyers can qualify for mortgages now. The bright spot has been the labor market. While there has been an up-tick in unemployment, overall levels of employment and income remain favorable. The consumer's willingness to spend is much more dependent on having a steady job than what might be happening in the local real estate market.

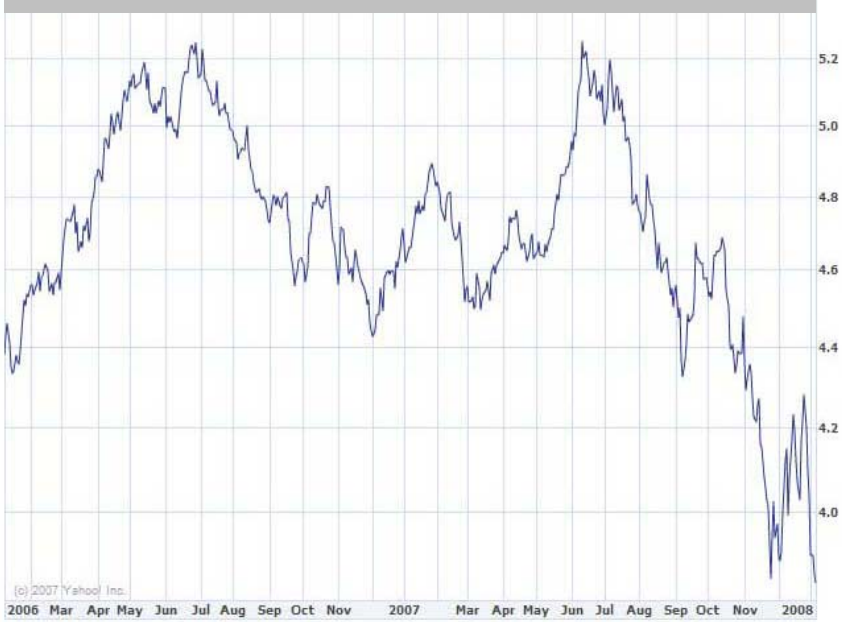
While there is much to be concerned about, there is much to be thankful for. The U.S. has by far the world's largest and most dynamic economy by any measure. Its resilience has been tested many times over. By necessity, U.S. assets are a safe haven for excess foreign savings, specifically Arab oil dollars and the Chinese trade surplus. It is in no major country's interest to see the U.S. in recession or the dollar weaken any further. In fact, foreign investors are finding U.S. assets as attractive as ever. Look no further than the recent capital infusions at Citigroup and Merrill Lynch from sovereign wealth funds.

Despite the hue and cry from Wall Street, the Federal Reserve has proved responsive and resourceful in the recent credit crisis. The Fed has made it clear that is does not intend to bail out the markets but will do what is necessary to keep the economy on an even keel, balancing the risks of recession versus inflation. Due to the high levels of debt in the economy, we believe the Fed will continue to ease monetary conditions to avoid a recession that could tip over into deflation. They will worry about inflation down the road, if and when it becomes problematic.

We can expect the equity and credit markets to remain in limbo a while longer. Until the credit market loosens up, lower interest rates should put a floor under stock prices. Equity valuations have not reached excessive levels, nor has investor optimism. Both argue against a major bear market. The market should fare better later in the year on optimism over the presidential election and renewed economic growth.

Best wishes for a healthy, happy and prosperous New Year.

10-YEAR TREASURY YIELD



Presidential Cycles and the Stock Market

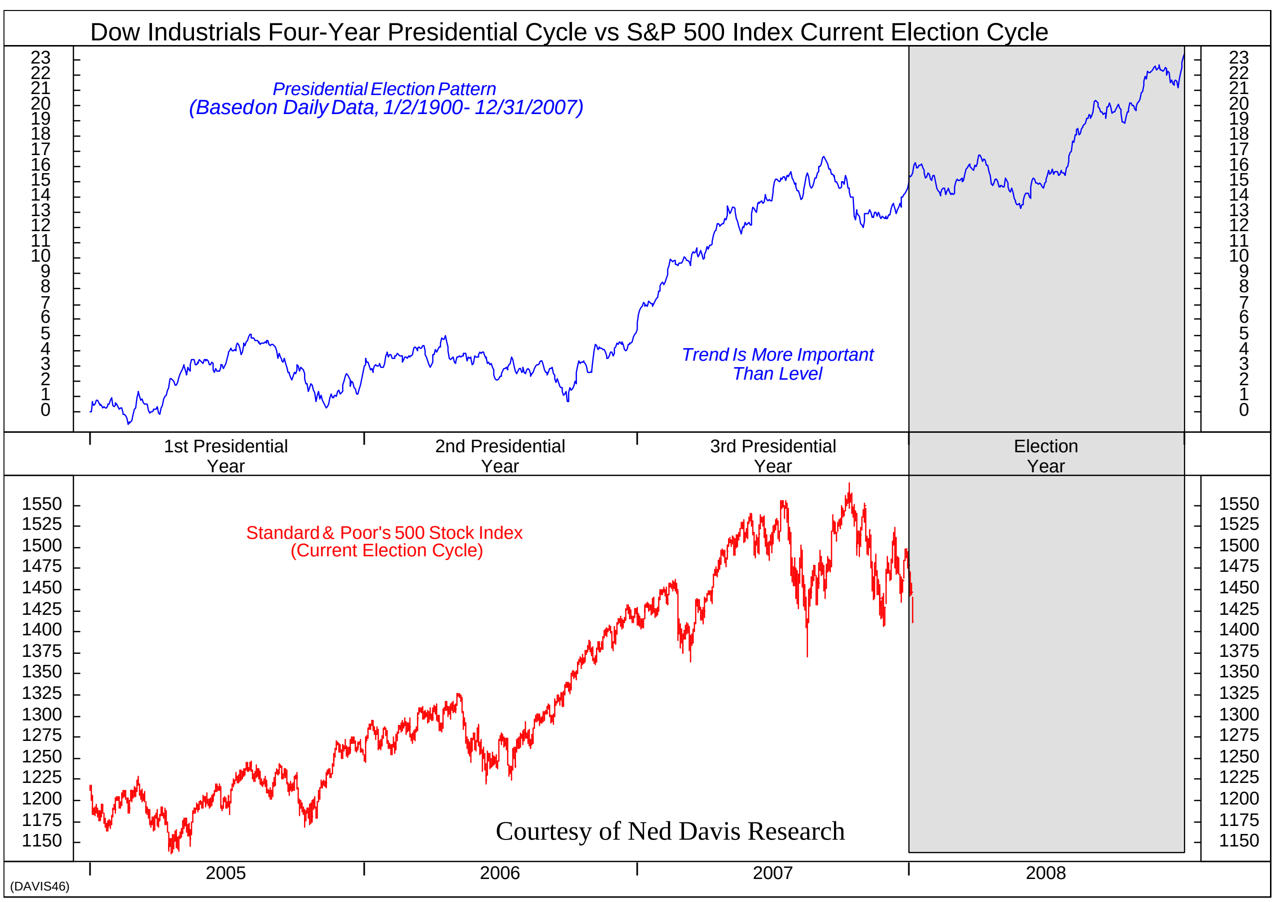
by Watt Dixon

From time to time we have taken a look at how politics or world events can influence the direction of stock prices. We have also pointed out that the stock market moves in cycles or repeating patterns. There are many patterns and indicators that investors can follow in hopes of gaining insight as to the future direction of stock prices. One of the more reliable patterns is the Four-Year Presidential Cycle. This cycle tracks the stock market through the four years of a presidential term.

Looking at the upper half of the chart below, one can see that years three and four of a president's term are usually up years for the market. Focusing on the current election year, we should expect to see higher stock prices in 2008, based on previous trends. Election years have been good to investors. For the 44 presidential cycles since 1833, the stock market has logged an average gain of 7% in election years. That's not quite as good as the 11% average logged in pre-election years, but much better that the 2% gain in year one and the 4% gain in year two. Two-thirds of election years have been up years, and there have been only two down ones since 1960.

One explanation behind this Presidential Cycle is that during years three and four the current administration uses fiscal policy to boost the economy in hopes of keeping the current party in office. They want to make voters feel as good as possible about their own economic situation.

Looking at the lower half of the chart below and remembering that the trend is more important than the absolute level, one can see that the current four-year cycle has held close to the pattern based on the data going back to 1900. While a presidential election year is typically a good one for stocks, 2008 will have its share of challenges. A weak housing market, a slowing economy, the ongoing wars, high oil prices, and growing tensions with Iran all could dampen the election year effect in 2008.



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Health Savings Accounts

by Ted Feinour

Health savings accounts (HSA) have risen in popularity since being established four years ago. Investors can use these accounts as another way to fund their retirement savings. A HSA permits one to pay for current health care expenses, such as co-payments and deductibles, and save for Medicare premiums on a tax-free basis. Permitted contributions for 2008 are $2,900 for individuals and $5,800 for families. Individuals who are 55 and older can make additional catch-up contributions of $900 in 2008 and $1,000 in 2009. There is no restriction on who may make contributions to the plan. It may be the individual, his or her employer, or relatives.

There are three main tax advantages: 1) a HSA may be funded with pre-tax dollars or tax-deductible contributions; 2) withdrawals made for qualified medical expenses are not taxed; and 3) investment returns on unused funds are tax-deferred. Thus, money not spent or withdrawn grows from year to year tax-deferred. A HSA may be invested in stocks, bonds, mutual funds and certificates of deposit. If one changes employment, the health savings account may be transferred to the new employer.

In order to qualify for an HSA in 2008, the person's insurance plan must be HSA-eligible, which means having a deductible of least $1,100 for individual coverage or $2,200 for family coverage. HSA-eligible health plans are often less expensive than other health insurance plans due to the higher deductible.

After the account holder attains age 65, distributions from the plan for non-medical expenses are treated as ordinary income. Distributions prior to age 65 that are not for qualified medical expenses are subject to a 10% penalty.

We would be glad to work with you on establishing a HSA to complement your other retirement savings plans.