J.J. BURNS & COMPANY, LLC

FINANCIAL PLANNING • WEALTH MANAGEMENT

FIRST QUARTER 2007

Market Rattling

Equities rebounded in March, putting returns back into positive territory for the year. Both the large-cap S&P 500 and the small-cap Russell 2000 gained approximately 1% in March. Year to date through March, the S&P was up 0.6%, while the Russell 2000 gained a more robust 1.9%. Foreign equities had a strong March, gaining almost 3%, and posted a first-quarter return of almost 4%. On the fixed income side, a model Total Bond Market Index was flat in March, but was up 1.4% for the quarter. Finally, commodity futures performed well in the first quarter.

Tremors of Globalization Continue

Investors were spooked by the big drop in the Chinese market in late February and the subsequent dip in US stock prices. The main fear was that a slowdown in the Chinese economy would impact global growth. We were a little surprised to see the markets react as they did. The main Chinese market is mostly limited to domestic Chinese investors, so any movement in that market is of questionable relevance to an outside, developed economy like the U.S. It is true that the economic expansion in both the US and China has been going on for a long time, and investors know that at some point the cycle will ebb. Any evidence suggesting that this could be materializing sooner rather than later is likely to concern investors.

Financial liquidity has also been a major issue globally in so far as that it has been easily accessible, and there is quite a bit of cash sloshing around the world. For example, institutional and hedge fund managers may utilize easy credit and low borrowing costs in Japan, trade yen to other world currency, and utilize portfolio leveraging tactics which could be sensitive to drops in any world market.

JJBCO IN THE NEWS

Men'sHealth

April 2007 Issue

Millions Made Simple: 3 Money Movies That Will Cost You Big

J.J. Burns joins Men's Health once again to provide guidance for those who are aiming for a wealthy retirement. To help you avoid those bumps in the road, J.J. lists and explains the three financial mistakes that can damage your retirement planning significantly.

Bankrate.com
Comprehensive. Objective. Free.

March 26, 2007

Mortgage Ignorance Rampant

As concerns about subprime mortgages plague the nation's leaders and lenders, America's homeowners are confused and worried about their own mortgages. Anthony LaGiglia, Managing Director for J.J. Burns & Company, states that with less experienced borrowers finding today's array of loan choices confusing, it's creating a situation ripe for abuse."

BALTIMORE BUSINESS JOURNAL

January 5, 2007

Corporate Citizenship – Setting New Standards

At a time where Non Profits find themselves and their methods of self-regulation under scrutiny, J.J. Burns joins other professionals in the non-profit industry to discuss the new financial regulations that non profits have to adopt. He estimates that compliance with the regulations costs more than $1 billion.

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More and more investors are realizing the benefits of investing globally; therefore, the world is becoming flatter when it comes to the financial markets. The concern here is that when a market moves lower, these investors, who may be overexposed, need to reallocate quickly to save the integrity of their portfolios. Fortunately, we are long-term investors, and so shorter term market declines that are driven by fear rather than fundamentals represent opportunities to us. For those clients who are retired hearing this statement may leave an uneasy feeling, because they might think they have no time for market declines. What investors should focus on is that the portion of the portfolio containing stocks is an inflation hedge for the income side of the portfolio. Therefore, don't worry that there is not enough time to come back from a decline. By way of context, a 3.5% one- day loss (as we had back in February) is by no means unprecedented and is not by itself a big source of concern. The equity market had gained almost 14% in the seven months prior to the recent retrenchment, and investors may have been concerned about giving back those gains. During this pullback we took comfort from our observation that big market declines in the past have generally been preceded by stretched valuations. This does not appear to be an issue right now as valuations are on the lower side, certainly not stretched by any means.

Looking ahead for the balance of the year, our investment team expects the following to play itself out:

- We expect more volatility in the market in the coming weeks.
- Markets will perform based on US economic data which appears to be sound.
- Subprime mortgages are a concern, but should not derail the US economy.
- The housing market is working through its problems of inventory overhang.
- Chinese and global markets will have increased volatility.
- Globalization will be a key to portfolio growth going forward

The Trouble With The Housing Market and Subprime Loans

Most of us—especially those living in areas with very high housing costs—are aware that lenders have pushed the envelope in recent years to come up with loans to enable people to buy homes they would otherwise be unable to afford. In so doing, many of these buyers have stretched themselves financially to the point where they have no margin for error. With rates having climbed, and low starter rates and temporary interest-only terms winding down or expiring, defaults among subprime mortgages have climbed sharply. Consider that loans in this segment accounted for 24% of originations in 2006, defaults in this sector are in the 13% to 14% range, and some subprime lenders have either experienced big financial losses or have gone out of business. Firms we respect like PIMCO have posited that this is a meaningful source of risk to the housing market, since these subprime lenders are the first rung on the housing-market food chain. So on its face, rising delinquencies in a high-growth part of the market could be a serious concern.

Looking more closely, however, the picture is not as clear. The growth in subprime originations has moved in lock-step with a decrease in Federal Housing Authority loans (FHA borrowers are typically first-time home buyers who are unable to make a meaningful down payment). A recent report from Ned Davis Research, explains this as follows: " Essentially, the private market filled a void created by the federal government...The failure of federal rules to keep up with changes in the marketplace allowed the subprime lenders to expand their market share by 10 percentage points at the expense of government-backed loans.

If it weren't for the easier lending practices this cycle, we would have expected little economic impact relative to what we had seen previously, since this effectively was a change in loan composition, not loan quality." As of year-end 2006, more than 76% of all loans outstanding were still prime loans. This means that even if the combined subprime/FHA sector had a default rate of 20%-well above the prior peak in 2002-fewer than 5% of outstanding loans would be impacted. While this would be enough to cause pain, it would probably not be enough to result in a disaster for the economy.

The downside is more likely to be that defaults and tighter lending standards will mean that growth in the subprime arena will stall as PIMCO predicts, and this could cause demand to sag further up the "food chain." PIMCO believes—and this is one of the more bearish views— that we're still only in the middle of the housing downturn and that it this will ultimately cut roughly 1% from GDP growth over the next few quarters. Clearly that's not good, but it is also not as bad as the outcome one might expect given the extensive media coverage that the problems have received.

Looking Forward: What Can Happen to the Markets?

Ultimately earning is what governs stock price movements. Certainly, macroeconomic events play a role in what happens to corporate earnings. It is our job to assess risk and formulate a worst case scenario. However, we believe the biggest risks to stocks are slowing earnings.

What Factors Might Impact Earnings:

1. Further weakness in the housing market
2. Historically high profit margins reverting back to average levels
3. The current economic expansion, already longer than average
4. Unexpected shocks to the economy from terror or geopolitical events

Market Valuations and Forecasts

Market valuations are attractive based on current data, which would lead us to expect above-average long-term returns if there are no material changes. However, in a modestly bearish earnings scenario, returns could be in the low- to mid-single digit range over a five-year time horizon. This tells us that the market is pricing in some, but not all, of the risk to earnings. The good news is that even a mediocre earnings environment could lead to decent returns, and…in all but the worst-case scenario, stocks are still likely to outperform bonds.

While it is always prudent to plan for the worst case scenario, we must not forget to focus on the positives that may drive the economy. Here are some things we are not so concerned about:

Budget deficit – It has improved markedly in recent years. At 1.5% of GDP, the deficit is quite modest.

Politics - Party politics has very little impact on the economy…and it's the economy and earnings that drive stock prices in the long-run. Politics can influence global events, but these are almost always short-term.

Equity Valuations – Currently, the equity market is not overvalued based upon a forward 12 month S&P 500 multiple of 15. Since 1950, there have been 12 earnings troughs. The average P/E ratio during those troughs was about 20 (the median was 18). The last time we saw an earnings multiple of 12 or less was 1983 (and interest rates were very high at that time, which pushes valuation multiples lower). The four troughs since then all saw multiples above 20. There are many variables that influence how much investors are willing to pay for a dollar of earnings, but the historical data gives us some confidence that, in general, stock multiples hold up fairly well during earnings declines.

Current Economic Data

The Federal Reserve has indicated in its most recent meeting notes that the housing market is in recovery and is in the middle of working off its excesses. The Fed is concerned about inflation and, as such, is more inclined to raise rather than reduce interest rates based on current economic data.

The Consumer has had more than 60 quarters of consecutive increases in spending. Whether we are faced with storms, crisis, war, or higher energy costs, the consumer is resilient. The consumer continues to spend regularly. This scenario is further fueled by a healthy employment picture as the labor data recently released shows only 4.4% unemployment. People are employed, and when they are working they will spend money, which ultimately fuels the economy and corporate earnings.

In Closing

It is always a challenge to assess the likelihood of the scenarios and events which may occur. However, even when we take a worst case approach to potential negative events, we are encouraged with the current valuations in the equity markets and state of the economy even after a multi-year expansion. The positives of the economy certainly continue to outweigh the negatives. We are currently in a low interest rate world with low unemployment, tight labor markets, steady consumer spending and a Fed Reserve which remains vigilant in fighting inflation. We will continue to monitor the economy and adjust our asset allocation model accordingly to mitigate portfolio risks as the economic expansion continues into the future.

Enjoy the wonderful weather spring brings to you.

Sincerely,

J.J. Burns

J.J. Burns & Company, LLC • 1895 Walt Whitman Road Melville, New York 11747 • Phone (631) 390-0500
Visit us on the web at www.jjburns.com