



FERGUSON ASSET MANAGEMENT, INC.

Investment Counseling & Asset Management for Individuals & Institutions

Quarterly Report and Commentary

July 2007

In this report we look at:

Market results for April-June 2007 quarter
Market returns over the past 206 years.
Hedge funds and Two and Twenty
A pat on the back for another accolade
Scams, you better watch out!
Some alternative indices

Market results for April-June 2007 quarter

During the quarter that just ended the gains to the portfolios have been further extended. Second quarter percentage changes for various indices and fund categories were:

S & P 500 stock index	+6.9%
Bloomberg US equity funds	+4.8%
Lipper non US equity funds	+7.8%
US Large Cap funds	+6.5%
US Small Cap funds	+6.3%
Morgan Stanly EAFE*	+6.7%
Vanguard Long Term bond index	-2.1%
Lehman Brothers Aggregate bond index	-0.5%

The top performing country funds were in Latin America with a fund composite gain of 20.9% for the April-June period.

During the same period (second quarter) Dimensional Fund gains also continued:

US Large Cap Value portfolio	+6.8%
US Core Equity 1	+4.5%
International Core Equity portfolio	+6.0%
Emerging Markets Core portfolio	+17.2%
International Value portfolio	+7.8%

Second quarter returns are no more than a price/time snapshot of an asset. Alone, they don't make a trend and their meaning is as significant (or insignificant) as an hourly blood pressure reading.

*EAFE means Europe Asia and Far East

The following are the Year-to Date (YTD) changes as reported at the end of month for two of Dimensional's Core portfolios:

	<u>US Core Equity 1 Portfolio</u>	<u>International Core Equity</u>
January	+1.90%	+1.83%
February	+0.78%	+2.36%
March	+1.78%	+5.60%
April	+5.59%	+9.55%
May	+10.83%	+12.60%
June	+9.76%	+11.92%

These changes, while showing a tad of a see-saw effect, are more positive than the normal YTD changes. We would expect a period of time when returns for the markets, indices, and funds are negative.

A brief look at a market's returns over the past 206 years

The broad US equity markets, as measured by the S & P 500, peaked during the quarter ending March 31, 2000. They continued to decline for three years before bottoming in the quarter ending March 31, 2003. However, this protracted erosion saw 6 of the 12 quarters gain as well as 6 of the 12 lose. It wasn't a straight down, falling out of bed, type market failure. This up and down price action is typical of both advancing and declining markets. They don't go straight up and they don't go straight down.

Nine of the past eleven quarters have been advancing ones. Eighty one percent of the time the quarterly returns have been positive during the past 2 ³/₄ years. I wondered what percent of the

time a long-term Bull market was up and, of course, what percent of the time it was down, from one period to the next.

An answer came with a Footsie inspection. Foostie is the slang name for the FTSE index. That acronym stands for Financial Times Stock Exchange 100 stock index of stocks traded on the London Stock Exchange. I compiled annual index closes for 206 years beginning December 31, 1800. The FTSE gained (year over year) 113 times and declined (year over year) 93 times. On a percentage basis, it was up 55% and down 45%. During those 206 years, through depression and wars, the market gained over 130 fold, but just a bit more up years than down.

The point of all this is to expect declines. They are part of the market. They are normal. They are anticipated. They are not to be feared, but welcomed. Too much advancing, bullish froth is not normal, but corrections are.

Two and Twenty and an explanation and examination of hedge funds.

Hedge funds, with billions of dollars in their coffers, are garnering a lot of press. Several years ago they were only available to investors with million dollar minimum investments. Now some admit investors for as little as \$5,000.

This is a brief simplified look at Hedge funds in general, returns, fees, and why we are not investing your money in them.

In general, hedge funds can do just about anything they want to when it comes to the “markets.” Some simultaneously buy and sell stocks within the same industry; these are known as “equity long/short hedges.” Some are “event driven.” Others are “merger arbitrage” and trade in those companies that are acquiring or being acquired. There are “distressed security” hedge funds that only invest in those companies with serious financial problems and depressed stock prices.

There may be as many as thirty or more different hedge fund categories and the numbers are growing. These funds are not regulated by the SEC, and most operate in a highly leveraged manner. They might be effecting transactions worth hundreds of millions of dollars with only tens of millions. This leverage results in the opportunity for big returns and big losses. In fact, some billion dollar hedge funds don't exist anymore.

So why do folks invest? Darn good question, and I've concluded that it is only due to ignorance and hedge fund marketing. It isn't due to results!

<u>Dow Jones Hedge Fund Index</u>	<u>Inception Annualized Return*</u>
Convertible Arbitrage	5.50%
Distressed Security	12.41%
Equity Long/Short	9.65%

Equity Market Neutral	2.63
Event Driven	8.11%
Merger Arbitrage	5.86%

Those returns don't turn heads. A balanced low risk portfolio of 60% stocks and 40% bonds would have whipped these index returns soundly. That is why we don't invest your money here. Oh! The two and twenty, what does that mean? The usual hedge fund manager takes a 2% management fee and 20% of the profits, and they don't share in the losses. Guess we could all get rich by creating a Dimensional Fund hedge fund!

*Through 5/31/2007