

Investment Perspective

Third Quarter 2007

"It's amazing how difficult it is for a man to understand something if he's paid a small fortune not to understand it."

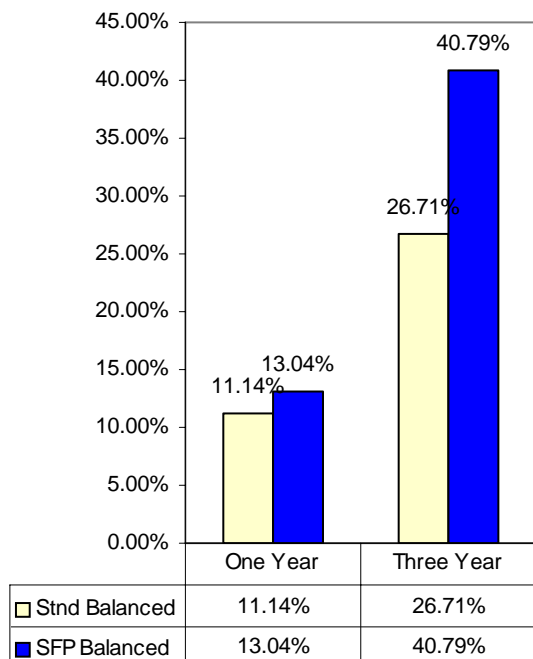
- [Upton Sinclair](#)

SFP Core Strategies*	Quarter 3	
	2007	One Year
US S&P 500	2.02%	16.35%
US Large Value	-5.62%	11.05%
US Micro Cap	-4.03%	11.55%
US Small Value	-8.59%	7.80%
US Equity Real Estate	1.52%	3.64%
International Large Value	1.08%	28.24%
International Small Cap	-1.70%	26.01%
International Small Value	-2.35%	26.33%
International Real Estate	0.69%	NA
Emerging Markets	9.44%	54.43%
Emerg Mkts Small Cap	7.40%	66.88%
Emerging Mkts Value	10.49%	68.42%
Ultra Short Fixed Income	1.20%	5.20%
Shrt/Inter Global Fixed Inc	1.67%	4.92%
Inflation Protected Sec	4.62%	4.73%
Model Portfolios		
SFP Balanced Portfolio	0.33%	13.04%
Non SFP Std Balanced	2.65%	11.14%

If you didn't look at your monthly statements, check your balances online or listen to the business news, you might think we had a sleepy summer quarter. The SFP Balanced Portfolio eked out a barely noticeable gain of 0.33 percent for the third quarter of 2007. But all of those who watch at the daily movements in the market could tell you how tumultuous the quarter really was. Concerns about sub-prime mortgages were absolutely rampant – these are the loans made to folks who are higher credit risks.

The strongest quarterly returns were found in the developing or emerging markets of the world. As can be seen from the performance chart, our strategies in this area returned between 7.4 percent and 10.49 percent for the quarter. This puts the one-year returns at around 60 percent! Growth stocks also did well, to give the S&P 500 a return a bit over 2 percent. But small company stocks and value stocks had a tough quarter, leading to some challenges for our Model Portfolios. The worst position, our U.S. small value strategy, gave up 8.59 percent for the quarter.

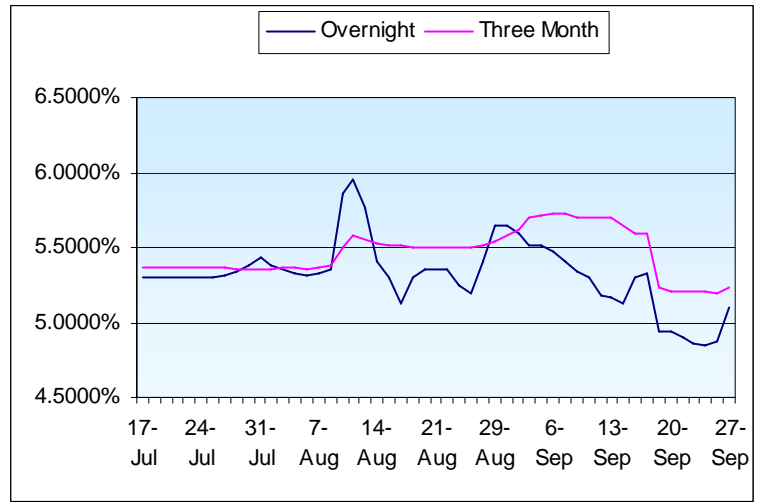
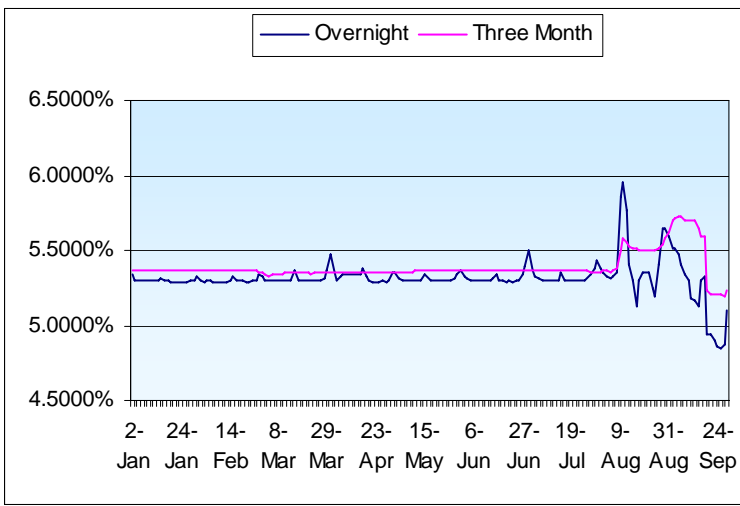
Standard Balanced vs. SFP Balanced



On a relative basis, this hurt the Skaggs Financial Planning, LLC model portfolios. While the SFP Balanced Portfolio was nearly flat for the quarter, the Non-SFP Balanced portfolio was up 2.46 percent. This is a nice quarterly return that outpaced our portfolio by 2.32 percent. The primary reason for our flat returns was our strong weightings in small and value stocks domestically. It would be nice to always have our money with the winning team, but we know that's not always possible. Our one-year numbers are still quite nice at 13.04 percent for our balanced portfolio versus 11.14 percent for the Standard Balanced Portfolio.

The sub-prime melt down revolves around a lack of cash available for securities backed by mortgages for the lower credit-grade borrowers. The fall in housing prices, and the resulting inability of riskier borrowers to pay back loans has led to a sharp rise in the foreclosure rate. But the reduction of real estate values is not the real concern. The real problem is the reduction in cash available to fuel the economic engine.

Stick with me here and take a look at the following charts:



The chart on the left shows the three-month LIBOR rate and the overnight LIBOR rate. The LIBOR rate is what banks charge each other to borrow money. As you can see from the left-hand portion of this chart, the difference between the two lines - the rate banks charge for both a three-month loan and for an overnight loan - was small and not irregular. You can think of this as the supply of fuel to the economic engine. Then look at what happens around the beginning of August. The chart to the right shows a closer view.

The fuel supply has gone haywire. At first, the overnight rate shot up, indicating the unwillingness of banks to loan cash to each other for a night. Then world central banks stepped in and lowered the rates they charge for overnight loans to banks. The overnight rate shot down, but significantly, the three-month rate was barely affected. That means with encouragement, the banks were now willing to give a loan for a day, but they wouldn't do it for three months.

That hesitancy continued - as indicated by the large spread between the overnight rate and the three-month rate - until the Fed stepped in on Sept. 18 and lowered the target rate banks charge each other. Since then, the stock market rallied to new highs for many of the most reported indexes. But while short-term interest rates are now lower, you can still see the spread between the two lines is wider and more erratic than earlier in the year.

Targets for blame in the sub-prime debacle are plentiful: The buyers who purchased more home than they could afford. The commission-based brokers who processed shaky loans for dishwashers claiming \$150,000 in income are but two. A common thread has been the belief that there was no risk in the housing market. This willing suspension of disbelief was a key ingredient in financial bubbles from Tulipmania in the 1600s to the dot.com craze of the 1990s.

We view the early slide during the quarter as a healthy correction to excess speculation. Markets can and will go down, and not for just a month here or there. They can go down quarter after quarter, year after year. But: they can also provide the returns needed to enjoy life and support our families.

It is easy to increase the expected returns of your portfolio by simply add more risk. The challenge in building appropriate portfolios is balancing the risk and reward in the context of your goals and preferences. If the tremors during this quarter left you uneasy, then there is a good chance your portfolio is out of balance and more needs to be done to prepare for the earthquakes that can occur. Please don't ever be shy about sharing your concerns with us.

I hope that you have a wonderful holiday season with the ones you love.

Sincerely,

Brian J. Skaggs, CFP

The information in this newsletter should not be construed as investment advice. Investment advice is only given in the context of individualized interactions that ideally result in the development of a continually evolving financial plan. *Total returns as measured by the performance of associated DFA funds - advisor fees not included in strategy performance. Advisor fees are subtracted from model portfolio performance at 8.3 basis points per month. This information is believed to be reliable, but we do not guarantee the accuracy of the information. **Past performance is not an indication or guarantee of future performance.**