

QUARTERLY REPORT

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SPRINGTIME

April is seeing the markets “bloom” once again following a brief swoon during the first quarter of 2007.

In our quarterly updates, we have been following the overheated housing market and this month we look at the limited risks of the “subprime” market for mortgages. Our conclusion is that there will be contained damage to a small portion of participants and that our clients are well-insulated from any fallout in the subprime mortgage arena.

We thank you for your confidence and patronage as Wimmer Associates begins its fifth year as an independent financial management firm.

Cordially,
Kathy Wimmer CFA, CIC
President



FIRST QUARTER 2007

The New Year started out with a bang for both U.S. and international equities continuing their upward arc from late summer 2006. Alas, the end of February brought a dose of reality to the market’s exuberance as a confluence of factors aligned to bring down the Dow Jones Industrial Stock index by as much as 500 points in one trading day. Comments by Alan Greenspan seemed to suggest a possible U.S. recession later in 2007. Even though Mr. Greenspan is no longer Chairman of the Federal Reserve, apparently the opinions of this octogenarian are still “market moving.” Not to be outdone by Mr. Greenspan’s dour influence, the domestic Chinese stock market (Class A shares can only be held by Chinese citizens) took a nine

percent dive overnight as rumors swelled that authorities might impose new regulations to prevent further speculation (the Shanghai market rose 130 percent in 2006) in the shares of Chinese companies. Finally, fourth quarter U.S. industrial output was revised downward from a previously estimated 3.5 percent to 2.2 percent. These three factors were enough to spark a wild 24 hours of panic selling on a global basis. It seems that fear remains in the marketplace and developments overseas can have real effects on the U.S. market.

As we discussed with our clients at the time of the market’s hiccup, there does not appear to be a strong case for recession in the U.S. and the market

KEY FACTS FOR 2007

- Annual gift exclusion
\$12,000
- Estate tax exemption
\$2.0 million in 2006-2008
- Highest marginal estate tax rate
45% in 2007
- IRA contribution limits
\$4,000, plus another
\$1,000 for those over fifty
- 401(k) contribution limits
\$15,500, plus another
\$5,000 for those over fifty
- SEP IRA contribution limits
25% of compensation or
maximum of \$45,000
- Top Federal tax rate is 35%
on income over \$349,700.
Highest combined effective
tax rate for California
residents is 41%

INSIDE THIS ISSUE:

FIRST QUARTER 2007 1

SUBPRIME MORTGAGES 3

FIRST QUARTER 2007 (CONTINUED)

Continued from previous page:

appears to be fairly valued in historical terms. Recession is defined as two consecutive quarters of negative growth and present prospects are more indicative of slowing yet healthy advances in domestic GDP. We do not see an “Asian contagion” scenario reoccurring whereby emerging market countries’ currencies are abandoned as debt-holders panic over liquidity concerns and sovereign nations’ ability to service scheduled debt payments. In fact, the Asian tiger economies are structurally much stronger today than in the “Asian Contagion” of 1997 as debt levels and government deficits are vastly reduced!

And, as for growth prospects for the United States, the ongoing GDP growth rate of 2.2 percent remains commendable, albeit, shy of the more optimal, non-inflationary 3.0 percent calibration. Much of the decline in the growth rate can be attributed to an overall slowing in construction, and the housing market, in particular, but services and to a lesser extent, manufacturing continue to be solid performers.

After three and one half years of consecutive quarterly earnings growth of 10% or better, it now appears that the S&P 500 group of companies will see a quarterly growth rate in the single digits as a result of a general slowing of the US economy. Nevertheless, with negligible earnings “warnings” and real earnings growth trajectory of 8-10%, we remain confident that stock values should continue to rise, albeit at a more moderate pace this year.

Jobs and employment growth are phenomenally strong at this late point in

the economic cycle, which augurs well for continued expansion in the United States. The March employment figures show 180,000 new jobs generated and the lowest rate of unemployment (4.4%) since before the September 11 attacks in 2001. The strength of the employment market would argue against the Federal Reserve moving to lower interest rates in the near future as a tightening labor market often precedes wage inflation.

The two major sectors of economic weakness that we continue to see are in the overall housing market and in the automotive arena. Both sectors have a rippling effect on the overall U.S. economy but neither alone nor together should the fallout in housing construction and sales and automotive manufacturing have a substantially negative effect to prevent the continued expansion of the U.S. economy. None of our portfolios at Wimmer Associates have holdings in the auto sector or in the housing market. However, we do monitor our bank holdings to ensure that we do not have an over-exposure to the housing market via lending. In fact, we are seeing tighter lending standards evolve which should enhance the stability of the banking sector while acting as a further brake on the highly-inflated housing market.

In conclusion, the U.S. economy and the equity markets should see a moderation in growth in contrast to the robust growth we have experienced over the past five years. Moderating growth or the “soft landing” course as set by the economic navigators of the Federal Reserve, should keep our sails full with a light wind edging us forward through occasional bouts of heavy weather. ~



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SUBPRIME MORTGAGES BY WARREN R. WIMMER

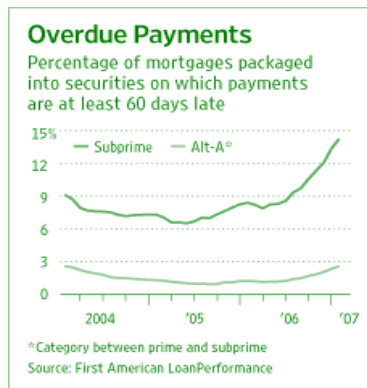


The mainstream media has fed us a steady diet of grave warnings regarding the subprime lending market as loan originators, lenders, investment banks and investors have all been seen as dangerously exposed to the market. Just what is a subprime loan? Well, there are many variants of an answer but it is first fair to say that subprime means that the loan or borrower is not creditworthy of a “Prime Rate” loan from a lending institution. Typically, a subprime borrower has a FICO credit score of less than 620. Subprime loans provide access to the housing market to individuals who otherwise would be excluded based on normal underwriting criteria.

The subprime market is comprised of borrowers who may have a spotty credit history, a high level of debt to income ratio and a minimal collateral level (usually less than a 20% down payment without Private Mortgage Insurance). Generally speaking, subprime loans are characterized at the time of the origination of the loan and do not reflect later changes in the financial status (whether positive or negative) of the borrower, the strength or weakness of the housing market as reflected in housing prices or the rise or fall of interest rates. As subprime loans are inherently riskier

than Prime or conforming loans, interest rates are higher to reward lenders for the greater likelihood of loan delinquency. As a truant might be tardy or even “skip” school, loan delinquency consists of late or missed mortgage payments.

Historically, housing markets have seen their greatest decline when unemployment rises and borrowers are unable to make loan payments. Unemployment is not a factor in today’s weak subprime market, whereas higher short-term interest rates, the conclusion of “interest-only” loan periods and tighter lending standards have weakened certain borrowers’ ability to meet higher monthly debt obligations. Interest-only loans have been popularized so that borrowers can stretch to make their mortgage payments without



having to pay towards the principal of the loan for a designated period. Upon the conclusion of the interest-only period, the loan’s interest rate resets to a market level and the borrower must begin amortizing the principal balance of the loan. With the current market

Together, subprime and Alt-A accounted for nearly 40% of the U.S. home-mortgage loans originated last year.

Source: Moody’s Economy.com, a research firm based in West Chester, Pa.

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We're on the web
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We strive to optimize our clients' financial well being by coordinating investment decisions with other professionals in the fields of taxation and estate planning.

SUBPRIME MORTGAGES (CONTINUED)

Continued from previous page:

reflecting higher interest rates than in the previous five years and banks tightening their lending standards, many subprime borrowers find that they cannot refinance into another interest-only loan or refinance at all as their homes may have depreciated and are now "under water" and therefore do not meet today's lending standards.

We are sanguine as to the effects of the subprime market on real estate, in general, and the economy as a whole. According to the Mortgage Bankers Association (MBA), subprime delinquencies reached a rate of 13.33% at the end of last year compared to 2.27% for prime, fixed rate borrowers. Adjustable, subprime borrowers consist of only 8.5% of the

total mortgage market. Thus, as badly as the subprime market seems to be performing, it is not large enough to upset the housing sector as a whole.

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And with the economy's strong employment picture and continuing growth in corporate profitability, it is unlikely that a recession is on the horizon to smite the housing market.



It is likely that certain investment banks that have loaned money to subprime lenders, as well as bond investors in securities backed by subprime loans will bear some losses as the market continues to see fallout. None of our clients at Wimmer Associates have been put into mortgage backed securities that are backed by risky subprime loans. We have never seen a favorable tradeoff between the increased risk of subprime loans and the minimal premium they afford. As subprime loans have continued to deteriorate in creditworthiness, we will continue to abstain from partaking!~

Disclosure: "Be careful about reading health books, you may die of a misprint." Mark Twain Keep that in mind as you read these articles. We obtain data from sources we believe are reliable but they should not be relied upon for making life-changing decisions.