

QUARTERLY REPORT

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SUMMER BREEZE...

As the Dow and the S&P 500 have reached all-time highs this summer, it is a good idea to take a moment to consider just how we came to this elevated plateau. The United States and the world have seen continued growth in equity values since we opened our doors at Wimmer Associates four years ago. Over that time, we have focused on objective factors in our analysis of economic fundamentals to anchor our views on investing.

By monitoring productivity, unemployment, commodity prices (especially oil), inflation, interest rates, housing data, budget and trade deficits,

exchange rates and government taxation, we have maintained a positive outlook for equities during the breadth of our time at Wimmer Associates.

As it is summer, we continue to have a sunny disposition towards the equity market but remain concerned that the season may be getting a bit too hot, too early! As such, we continue to recommend a protective layer of diversified stocks and bonds that should shield you from potentially damaging overexposure to the hot summer market.

Cordially,

Kathy Wimmer CFA, CIC
President

SECOND QUARTER 2007

The second quarter of 2007 was fruitful for investors as the broad-based S&P 500 index continued its upward trajectory by showing a three-month return of 5.8%. The large capitalization Dow Jones Industrial Index of 30 stocks advanced an even more impressive 8.5% during the Spring quarter. After many years of seeing small-cap and medium-capitalization stocks outperform larger and more economically mature Dow and S&P 500 equities, we are seeing investors fly to safety in the more established names of industry. This often reflects the tail-end of a long economic expansion which would fit snugly into the current

environment. Surprisingly, after a sharp slowing of growth in GDP to 0.6% in the first quarter of 2007, the second quarter GDP number rebounded nicely with a 3.4% jump. Future growth is estimated at a moderate 2.0% level.

The global demand for energy and natural resources has continued to benefit our holdings at Wimmer Associates. Rapid industrialization in emerging markets inexorably requires oil to fuel factories and copper and iron ore to build facilities and products.

Worldwide demand for energy is growing at nearly a 2% annual rate while major oil production declines in Mexico

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%

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“The global demand for energy and natural resources has continued to benefit our holdings at Wimmer Associates. Rapid industrialization in emerging markets inexorably requires oil to fuel factories and copper and iron ore to build facilities and products.”

and Venezuela are not being replaced with new sources elsewhere. Similarly, refining capacity in the U.S. remains constrained as the existing plants are ancient and prone to outages. As such, we continue to benefit from our investments in oil and gas producers such as Exxon, Shell and Devon while increasing our exposure to refiners through investments in ConocoPhillips and Valero. Indeed, the natural resource sectors, including energy and materials, were top performing areas of the stock market in the second quarter and year to date. We continue to like BHP, the Australian resource behemoth that mined a 23% return for our investors during the second quarter.

China remains strong with a GDP growth rate of 11.9% in the second quarter after a booming 11.1% rate in the first quarter of the year. Chinese monetary authorities are concerned about a 4.4% inflation rate and an economy that may be growing too fast. Consequently, China has continued to raise domestic interest rates in an effort to reduce speculation in the Chinese equity markets and as a hedge against inflation. China continues to be a source of relatively inexpensive products to the U.S., enabling Americans to purchase more products for lower prices. This process helps put a lid on inflation in the United States. Our interest rates also benefit from the high level of Chinese investments in United States' Treasuries. In a recent development, Chinese investors have expanded their formerly conservative investment criteria to include hedge funds, e.g., \$3 billion in the Blackstone Group's IPO and up to \$5 billion in Barclays Bank.

We have sought investments that will benefit from the global economic expansion particularly in the Far East. We feel it is important to understand that many developing countries now are homes to leading corporations throughout the world. We must recognize that China, with a population of 1.32 billion people, will shortly overtake Germany as the world's third largest national economy, surpassed only by the U.S. and Japan.

As for the broader U.S. economy, job strength continues to grow as unemployment remains steady at a low 4.5% rate, while wage growth is moderate, continuing to aid consumer consumption. U.S. inflation remains low despite higher commodity prices for oil, coal and copper. The Federal Reserve maintains its vigil against the threat of inflation, but has taken no action to raise interest rates, indicating a rather benign view towards inflationary pressures. The U.S. dollar continues to weaken against most major currencies which makes imports into the United States more expensive (the Japanese Yen is an exception). The United States' budget deficit shows continuing improvement and is expected to be below \$200 billion in 2008, as tax revenues grow as a result of higher personal and corporate earnings. The U.S. trade deficit appears to be structural in nature (the U.S. tends to consume more than it produces) but should benefit from the weaker dollar which will make U.S. goods cheaper to foreign buyers and will discourage imports into America as they become more expensive.

SECOND QUARTER 2007 (CONTINUED FROM PAGE 2)

We are optimistic as to the outlook for the economy for the balance of the year and project continued earnings growth for large capitalization stocks in the second quarter. S&P analysts are projecting a 5.5% increase in second quarter corporate earnings while Thomson Financial is a bit more optimistic with a 7% projection. This is, of course, below the four-year record of consecutive quarterly growth in double digits, which concluded at the end of 2006. The moderation in earnings growth reflects an economy that has slowed but remains resilient in the face of higher commodity prices and interest rates, as well as a housing and subprime lending debacle.

A perceived “credit crunch” has led to stock market turmoil at the start of the third quarter. We are not surprised by the up-tick in interest rates on corporate and mortgage bonds as we have felt credit risk has been undervalued amidst excess liquidity in the debt markets. Consequently, certain takeovers are being delayed and underwriting criteria set by lenders are being tightened to reflect the heightened risk premium demanded by the market. This tougher credit environment is a healthy development which should simply slow, rather than stop, the pace of takeovers and stock buybacks.



“Core inflation” has in recent times been a benign view of inflation provided by the U.S. government which seems to fly in the face of higher food and gas prices. Core inflation strips out the volatile and often temporary moves of oil and commodity prices as they tend to have an unpredictable nature and would likely overstate their influence on underlying inflation in the short-term. Nevertheless, oil and commodity prices do find their way into core inflation as they are key inputs into nearly all goods and services and ineluctably flow through to the key core inflation rate like a river to the sea.

ECONOMIC JARGON AND OTHER TIDBITS



“*The Tipping Point*” is the title of a recent book by Malcolm Gladwell that refers to a situation whereby a small amount of weight added to a presumably balanced object can cause it to suddenly and completely topple. Current usage has become popularized in reference to a number of subjects, including the economy, e.g., the collapse in the subprime debt market has led to a “tipping point” in the overall credit markets. We try to dodge “tipping points” wherever they may be imagined.

The Wisdom of Crowds by James Surowiecki of *The New Yorker* is more our style and refers to the efficacy of receiving many considered opinions before selecting a best course of action. This does not encompass a “mob mentality” but rather looks to a diversity and independence of opinions, decentralization which allows for specific information about local situations and a means to aggregate the whole lot into a collective decision. At Wimmer Associates we draw on the collective yet independent wisdom of our experienced analysts... and then do what Kathy says!



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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.

"PRIVATE EQUITY" AND "CARRIED INTEREST" REVEALED

The previously secretive financial world of private equity investors has recently been exposed to the inquisitive light of the business press and members of Congress. The low-profile private investment moguls of the 1990s have been upstaged by the more ostentatious and flamboyant Private Equity and Hedge Fund managers of the 2000s.

In the past six months, a few of the largest, most profitable private equity investment companies have gone public with Initial Public Offerings (IPOs). Going public has required the filing of detailed public financial prospectuses that have provided the business press and Congress with the opportunity to learn about these elusive players and their operations. A great deal has been written lately on the use of unregistered, investment funds

(i.e. "private equity") to buy out publicly traded companies and run them as private enterprises shorn of quarterly reports and various government requirements. There is, of course, nothing wrong with private companies but concerns have arisen that managers of these newly privatized companies are unjustly enriched through an unfair tax advantage known as "carried interest".

"Carried interest" refers to the large share (usually 20-30%) of profits that managers of Private Equity Funds receive as compensation, despite not contributing any capital into the fund. This is in addition to an annual 2% fee charged on total assets managed. The rub is that carried interest is taxed at the low rate of long-term capital gains, rather than as ordinary income.



Several members of Congress have expressed concern that private equity managers are receiving undeserved windfalls by being taxed at the long-term capital gains rate of 15% rather than at a normal individual or corporate rate which approximates to 35% for upper incomes. We naturally prefer lower tax rates and endeavor to minimize unfavorable tax consequences for our clients whenever possible. However, there is a question of fairness which should most likely lead to a revision of the tax code in the near future so that "carried interest" is closed off as a \$4-5 billion annual tax loophole for private equity managers.

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.