Baldwin Investment Management, LLC

RECAP…

As we look at the record of our predictions for 2006, it is a rather middling score from a statistical point of view. With four of eleven predictions, we were clearly wrong. We thought that the dollar would continue to be strong – in hindsight, obviously it was not the case. We thought that the Republican Party would lose seats but maintain control of Congress. The mid-term elections certainly did not turn out that way. We thought troops in Iraq would be drawn down by some twenty percent. The situation in Iraq has deteriorated and now there is talk of increasing troops. Finally, we have thought incorrectly for several years that Osama would be caught.

Two out of eleven predictions were somewhat right and somewhat wrong. We believed that the Fed would stop raising interest rates in the first quarter of 2006. The Fed indeed did stop raising interest rates in 2006 – but it occurred in Q2 and not in Q1. So, we give ourselves a positive mark for being right in predicting that the Fed would pause rates – but our timing was a little off. We also thought that politics in Europe would remain confusing and that this would be a negative for markets there. Indeed politics in Europe were confusing during 2006 with a great deal of turmoil in Italy, France and Great Britain. Nevertheless, a number of markets in the Eurozone performed quite well, ignoring political quagmires which have in the past often hurt market performance.

Finally, on five of eleven issues, we seemed to be right. Japan’s economy, we thought, would continue to gather “steam”. In fact, the second largest economy in the world moved ahead and the outlook for 2007 seems even better. We surmised correctly that exchange traded funds would boom as an investment vehicle. Investors now own over three hundred billion dollars in market value of exchange traded funds. We thought more U.S. money would flow into international markets. Indeed, foreign markets have been hot. We projected that corporations would continue to hike their dividends. Corporate America has increased, in a rather dramatic fashion, dividends paid to shareholders. Finally, and perhaps most importantly, we thought that the U.S. stock market would perform better in 2006 than in 2005. For awhile in the Spring of this year, it did not look as though this important prediction would come true. Happily, we can report that 2006 will go down as quite a good year for investors in the U.S. stock market.

AND NOW THE OUTLOOK…

There is a "sea of money" sloshing around the world looking for an "investment home". It is this liquidity, whether it be in the developed world or in the emerging world, which has and will continue to support equity and fixed income prices both in America and around the globe. There are pundits who worry aloud about investors' seemingly insatiable appetite for risk. This is evidenced in the markets by the explosion in issuance of so called "junk bonds" and the yield compression between low and high quality issues. No doubt there are companies being financed today which should not. Consequently, their investors will come to rue the day that they put money into the enterprises. But what was considered risky yesterday, primarily because it was unfamiliar, might well today not be considered risky because it is more familiar to investors.

Interestingly, it has become evident that New York City is no longer the only seat of financial power in the world. London and Hong Kong have risen. In London, numerous Russian companies have found a new financing center. Many Russian enterprises shun the United States' regulatory labyrinth to more simply raise public funds for financings in London. Hong Kong was the sight of the largest initial public offering ever - a Chinese bank. The rise of London and Hong Kong as alternate financing centers is another symbol of the globalization of business.

One of the signal events of 2006 has been the dramatic growth of Islamic finance. Sharia-compliant issues (i.e. equity or debt which does not finance gambling, liquor, and a number of other human vices) have exploded as the Middle East has been discovered as a new source of investment finance. The underwriting of Islamic bonds, sukuks, increased 12% in 2006 versus 2005. With the price of oil at current levels, there will continue to be a lot of cash in the Middle East looking to invest around the world. In addition to investment monies available in the Middle East, private equity in Europe and in the United States will continue to fuel the mergers and acquisitions fire. In 2006, 3.9 trillion dollars of deals were completed. This value eclipsed the record established in 2000 at the height of the "dot.com" bubble by 16%.

There continues to be considerable worry about the value of the dollar. It is not unusual to read newspaper articles about the dollar's decline versus the Euro or the Yen. However, on a trade weighted basis, which reflects the flow of imports and exports, the dollar has declined minimally over the past five years. Versus the Euro and the Yen, we project the dollar will continue to slide in value. While the U.S. currency still yields more than either the Euro or the Yen (and thus one might expect it to be a stronger currency than either of those two), and while the U.S. economy is still growing more quickly than either Japan or the Eurozone (and again one would think that the currency would reflect strength), there are a number of major dollar holders who have decided for "portfolio management" reasons to diversify their future holdings of currencies out of the dollar and into the Yen or the Euro. Specifically, the central banks of Japan, several Arab (i.e. OPEC) nations, Russia and China have decided that they do not want to concentrate all their foreign hard currency reserves in dollars. They want to construct a portfolio of currencies which to a greater degree includes the Yen and the Euro. This makes sense. Importantly, it does not mean that any of these nations, will actively sell the dollar. They will simply not be buying as many dollars in the future with their excess capital inflows. We do not believe that this will lead to any sort of a dollar collapse, probably just a continued slow decline. The dollar is different. It is the world's reserve currency. A freefall in value would hurt too many countries who already have a majority of their reserves dollar-denominated. In essence, the dollar is "too big to fail". While it is generally not good to have a weak currency because of inflation concerns, a weak currency is certainly good for exporters and helpful to this part of the U.S. economy. All in all, if one believes that the dollar will continue to decline, it means it would probably be wise for investors to invest internationally and thus get the benefit of appreciating currencies elsewhere. In addition, investors should invest in U.S. companies with large foreign sales and profits because when translated back into U.S. dollar earnings, those sales and profits will be more valuable and drive corporate growth.

Oil prices will probably remain in a band around $60.00 a barrel for West Texas Intermediate. As some of the fear concerning the integrity of the oil supply chain has left the market, the price of oil has declined from its high of around $78.00 a barrel. OPEC has decided to step in and defend the $60.00 per barrel marker for West Texas Intermediate by cutting back on its production. However, in 2007 it is expected that new non-OPEC production of approximately 1.7 million barrels a day will come onto the market, overwhelming an expected increase in demand of 1 million to 1.4 million barrels a day. OPEC has historically not been a very disciplined group and is filled with "cheaters" who want to make sure they get their production share. Nevertheless, it seems as though the world can live with $60.00 a barrel of oil and OPEC at this juncture appears somewhat cohesive.

Inflation will continue to be quiescent in 2007. The U.S. Federal Reserve continues to be a "hawk" on the subject. If we are correct with regard to oil prices, there will certainly be easy energy comparisons in 2007 versus 2006. Further, the great disinflation forces of China and India continue to impact the world economy. As such we do not foresee inflation to be a risk in the next twelve months.

Following on that theme, we believe that the Fed will reduce interest rates in the coming year – but not as quickly as perhaps the bond market is presently forecasting. We believe a cut in the Fed fund rate will come in the second half of 2007 as the new Fed Chairman continues to define his credibility on the "Street".

The American consumer, often been declared "dead on arrival", will continue to spend money. According to recent pension fund statistics, the amount of money tied up in the American consumers' retirement accounts (largely invested in equities and fixed income) is four times greater than the equity invested in residential real estate. Consequently, in spite of the fact that home values might be stagnant during 2007, with a higher 2006 equity market, the Amercian consumer will continue to feel fairly wealthy. Also, the unemployment rate is at historically low levels. With a regular pay check coming in the door, we do not believe that consumption levels will be troubling in the upcoming twelve months.

As a back stop to consumer spending, it would appear that corporate America has loosened its purse strings. Companies have spent the last several years "scrubbing" their balance sheets, paying off debt and collecting wads of cash. Investors are demanding that companies better use their capital structures by investing in new equipment, buying back stock and increasing dividends. This all has happened and we project that it will continue in 2007.

Besides corporate America, another engine of growth for the U.S. economy will be the emerging countries of the Middle East, China, Southeast Asia, South America and India. With fast growing middle classes who desire to enjoy some of the same things that American consumers now take for granted, we would expect that there will be increasing exports from America and imports into these regions of the world to sop up the mountains of dollars they have to spend. Even the Eurozone and Japan will experience growth in 2007, which should help exporters of American goods.

Obviously, the political landscape in the United States has changed with the Democrats gaining control of both the Senate and the House of Representatives. President Bush is now going to have to "deal" if he wants to get anything accomplished and try to buff up his legacy. When he was a Republican governor in Texas with a Democrat-controlled legislative branch, he was considered a compromiser and surprised many who had characterized him as an idealogue. Currently, with his poll ratings so low and former members of his father's administration now quite evident in advisory roles, we would suppose that "the deal maker" `will come to the fore. There is already talk about a rather large increase in the minimum wage and we would suspect that something will get done there. There also might be something accomplished on immigration. Business could look forward to some potential tax increase as there is a lot of worry on the "Hill" about our current deficits. We expect no roll back of taxes on dividends, capital gains or estates. The Democrats might like to change some of these items but the President would veto their attempts. The Democrats are really looking at 2008 as being the big prize. Consequently, we do not think that Democrats are interested in scaring the electorate by acting too "left leaning" before the all important Presidential election. "Big Pharma" will probably be attacked because everyone wants to keep the cost of health care down. "Big Oil" will probably be attacked because it is making too much money. Alternative energy will likely be a winner because there is more interest in reducing oil dependency. Fannie Mae and Freddie Mac will also be beneficiaries because the Democrats want to encourage home ownership.

We believe that equity prices should continue to rise in 2007 because of continued strong corporate earnings, low interest rates, seas of liquidity and a world economy which continues to grow. Equity prices have done well in 2006, not only in the United States, but in many places around the world. However, there is still "room to run" in the dynamic sort of environment which we have outlined above. No doubt there will be "bumps in the road" and plenty of issues about which investors will worry. However, the markets need "to climb a wall of worry". If everyone were complacent, which they are not, then we would be far more concerned about the immediate future.

We hope you all have a very Happy Holiday Season and a wonderful New Year.

PREDICTIONS FOR 2007

1. The dollar will slowly slide versus the Euro & Yen
2. The Fed will reduce interest rates in second half of 2007
3. President Bush will become a dealmaker in working with Congress
4. Oil prices will settle at “around” $60/BBL
5. Japan’s economy will continue to gather steam along with rest of the world
6. Inflation will not be a worry
7. The U.S. consumer will continue to spend
8. Corporations will spend more
9. Housing will stabilize in 1st half of 2007
10. The U.S. stock market will go up but not at the 2006 pace

A FINAL THOUGHT

The opinions expressed in this Commentary are those of Baldwin Investment Management, LLC. These views are subject to change at any time based on market and other conditions, and no forecasts can be guaranteed.

The reported numbers enclosed are derived from sources believed to be reliable. However, we cannot guarantee their accuracy. Past performance does not guarantee future results.

A list of our Proxy voting procedures is available upon request.

A current copy of our ADV Part II is available upon request or at www.baldwinim.com/disclosure.htm 12/31/06