Sound Investments Inc.

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First Quarter 2007

Quarterly Investment Commentary

Stocks rose, dropped precipitously and then recovered, ending the first quarter about where they started. The S&P 500 managed a .7% gain so far this year while the Dow Jones index lost .3%. The NASDAQ rose .3% for the three months, while the best performing US index, the Russell 2000, gained 1.7%.

Fund investors who managed not to panic, did better. The average diversified U.S. stock fund ended the quarter ahead 2.1%, while the average World Stock fund gained 2.9%.

International stock funds ended the volatile quarter ahead of their US counterparts. Small and mid-cap foreign funds were the top performers in both growth and value camps. Both European and Latin American funds ended the first quarter with average gains over 4%.

International Funds continues to dominate our portfolios and is extending a winning streak that has continued for 4 years, from late 2003 to date. The rise in the Euro against the dollar helped the European stock market out perform. The Financial Times reported that for the first time since before WW 1, Europe's 24 stock market, including Russia and Emerging Europe, eclipsed the U.S. in stock market value. We are not sure how long this will last. We upgrade to areas that bring to us excellent returns in U.S. dollars. We will not be investing international when superior relative performance is not there.

I thought I would take some time to discuss the merits of upgrading. It is a disciplined approach to aligning our portfolios with current market leadership. Upgrading funds is not unique in using past performance to select which funds to buy. In fact, most strategies select funds based on past performance. The difference is that many conventional strategies focus on the funds long term record, even through long term record performance is not a very good indication of future performance.

Typically, market leadership cycles last four to six years. Therefore, selecting funds based on three to five year track record may get you into funds that are near the end of their out performance, possibly, on the verge of following out of favor.

We select funds based on their near term performance – a combination of the last 12, 6, 3 and 1 month returns- because how the fund performed recently is a better predictor of fund near term success. Academic researchers have found that funds that

International funds continue to do better than their U.S. counterparts. When there is a change in market leadership we will move incrementally to reposition our portfolios.

Upgrading is based upon the observation, that few, if any money consistently excel. Instead we observe a wide range of performance returns, with only a small percentage of professional money managers investing in the right sectors of the equity markets at any given time.

This is because each money manager has a particular style that works well in some, but not all market environments. Market leadership rotates between large-caps and small-caps, growth and value styles, international and domestic areas. Leadership changes because economic conditions change. However, most fund managers do not change their particular styles when the market leadership changes.

Since market leadership is forever changing we move incrementally towards the top ranked funds by progressively selling the lower ranked funds and investing in the new leaders. **This continuous process provides an effective way to invest in a broad range of investment opportunities as they develop.**

We use no load funds as they provide access to the talents and research of the country's leading money managers while they are at the top of their game.

perform well against their peers in recent months tend to continue that performance into ensuing months. They call this phenomenon “persistence of performance”. By upgrading, we are taking advantage of a fund’s performance persistence.

What’s next?

Over the last 4 years international funds did better than U.S. investments and this was where the bulk of our investments are. Last quarter, we thought there may be a change in direction where U.S. stocks would outperform. The facts are as at April 23rd 2007 The U.S market has done well, but foreign markets are doing even better. The World index excluding the U.S. is up 8.5% in dollar terms whereas the S&P 500 up only 3.9%.

The problem is that many analysts see profit growth slowing in the U.S., while still expanding in much of Europe, Japan and the developing world. Traditionally, America has been the main driver of the world economy, sooner or later, it will come back. At that time we will change our investment stance to mirror this performance.

Should we be worried?

At first look, there is real cause for concern. The nasty hit, (i.e. loan losses) the sub prime mortgage industry took in March has continued. Several sub prime lenders are facing very tough times due to loose underwriting standards on mortgage loans. That said, the sub prime fallout should be reasonably contained. The stock prices of the large banks were affected by this, but the sub prime loans are a mere fraction of their loan portfolios.

Three other obstacles face the market. The fears are that 1.) The slowing economy will sink into a recession, 2.) Corporate earnings growth will slow and 3.) the Federal Reserve won’t cut interest rates anytime soon because inflation shows signs of picking up.

At this point, however, I think these fears are unfounded. While its true earnings growth could flatten through the rest of the year, the economy is still working at a very high capacity (82%) with unemployment at it’s lowest in a half a decade. The economy doe not need father Fed stimulation. Although pockets of speculation do exist in hedge funds, not to mention sub prime lending, there are small relative to the enormous speculation in the late 1990’s.

Yes, 2007 should be a much more volatile year than we have seen for some time but could also provide some good opportunities. In the U.S. stocks are relatively cheap. The price earning multiples of the most watched indexes, namely the S& P and the Dow are near the lower end of their range for the past 10 years. So we have to wince a**nd bear it.**

Conclusion

Despite some economic shadows there is good reason to be upbeat about stocks in 2007. We continue to monitor our portfolios and will move incrementally when conditions change.

Yours Truly,
Ken Gilpin CFP

This year we begin our 7th year as a Registered Investment Advisor. I obtained my Certified Financial Planner (CFP) designation in 1999 and was able to set up with TD Ameritrade. It has been a pleasure to serve you and am looking forward to many more profitable years.