Sound Investments Inc.

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Fourth Quarter 2007

Agricultural and Materials sectors continue to lead as global demand remains strong. Conversely, Financials and Consumer Discretionary groups were in negative territory … obvious victims of the mounting housing and credit troubles. Overall this market favors stocks that thrive in the late–stages of the economic expansion.

We upgraded based upon the observation, that few, if any money managers 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, and 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.

A Short Review of 2007 -- Stark Contrast and Scattered Gains

This may seem like ancient history, but I always like to review the previous year as to put things into context. The markets began in 2007 strong continuing the previous year fourth quarter rally. Then in late February, stocks skidded, but the panic didn't last long. By April the Dow reached 13,000 for the first time and then barreled past 14,000 in mid-July. However, after a decent first half there was a roller coaster in the third quarter. Stocks fell in the last quarter causing the first fourth quarter lost in 10 years. Foreign markets, particularly in emerging markets did better.

While the U.S. broad market struggle under the weight of the credit crisis, sectors, like technology, energy and materials posted good gains. Uncertainty about the housing market, credit crunch and the strength of the economy took its toll on the markets. Financial company's earnings suffered from huge mark downs on the value of their mortgage related holdings. However, earnings in many other sectors remained strong.

Below are results of the major averages including dividends for the year for the year ended 2007:

	Year to Date	One Year	Three Years
NASDAQ (Technology)	9.8%	-6.5%	7.1%
Dow Jones Industrial	8.7%	-1.5%	7.8%
S&P 500	5.4%	-7.2%	6.1%
RUSSELL 2000 (SMALL CAP)	1.6%	-13.6%	6.8%

It is interesting to note overall that the average diversified U.S. stock fund rose on average 6.9% for the year. Annual returns were the lowest since 2002 and below the U.S. market's 10% historical average. Our returns have been higher as we upgrade to the best returning funds and follow the market leadership. For example foreign markets extended their winning streak in 2007 outperforming the U.S. for the fifth straight year in row. The Dow Jones World Stock Index, excluding the U.S., returned 12% in dollar terms.

Last Year's Forecast

In writing this quarterly report last year, I pretty well bet the farm that the power of the Presidential Election Cycle would make 2007 a "very good year, but not spectacular year for the stock market.

Well, 2007 definitely was not a spectacular year for the stock market and there is even some doubt whether that it was even satisfactory. It was not as good as I had hoped for, but it still gave us a lot of opportunities for profits and that what really counts. So what about 2008?

<u>The Year Ahead</u>

<u>Odds are Growing of an Economic Recession</u>

In a nutshell, I don't think 2008 is going to be all that great for stock prices. The market has been acting tired for several months now and the general perception is that the economy and earnings growth has been slowing down. Worse yet the fear of inflation is increasing and investors don't believe the new Chairman of the Federal Reserve Board, Dr. Bernanke, is lowering interest rates fast enough to prevent a recession. Trying to put the fragile economy back on a firm footing is the biggest challenge for Bermanke since taking over the Fed 2 years ago. His job requires a deft reading of the economy's vital signs and keen insight into what makes people and business tick. It's their behavior that shapes the economy in these turbulent times the Fed needs **to booster public and investor confidence.** The fear is that people will clamp down on spending and business will put a lid on hiring and capital investment. The current housing slump, made worst by the credit crunch doesn't help matters much either. Currently, Goldman Sacks, the biggest bank on Wall St., gives the odds of a recession at 50-50. Now I know these perceptions may not necessarily be true, but it is hard to see where the spark is going to come from to push stock prices higher?

<u>Even though 2008 is the fourth year of an election cycle and fourth years traditional are very good for stock prices, I am not expecting much for next year.</u> The latest news doesn't appear too strong, with economy in a near stall, growing at a feeble pace of just .6%. So how bad will the stock market get in 2008?

Well, I don't think it's going to be that bad. For one thing, the economy is still growing, albeit at a slower pace; and earnings are still going higher year over year. Earnings are the key. The market is going to remain in a bullish scenario as long as earnings are going up. If stock prices go down while earnings are going up there will be more bargains to feast upon. This feast will push the market back up. So I am not worried if the markets not going to be so hot in 2008. <u>I'm prepared to go bargain hunting in the year ahead.</u>

I recently bought another financial planning practice from a long time friend, Mo Wright, of the Wright Direction. I knew Mo for about 6 years, he was a valued colleague. Every time we met, the first thing we would talk about is the market action. Mo died in early January and I sure will miss him. We had planned to merge our practices for some time, but keep putting it off. I want to welcome the new clients and wish it could have happened under better circumstances.

<u>Conclusion</u>

As our defensiveness increases in an aging bull market, <u>we expect to leave some profits on the table.</u> At this point, we are well positioned for what lies ahead and can easily make adjustments for what lies ahead depending how the technical and economic activity unfolds.

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