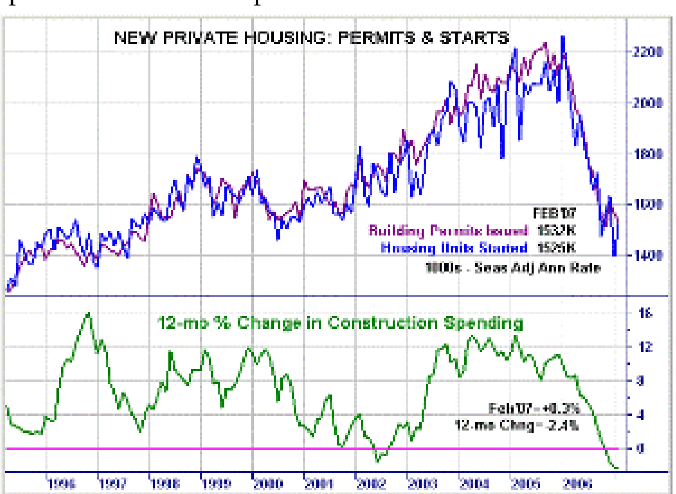
Volatility is back!

Your Most Trusted Advisor

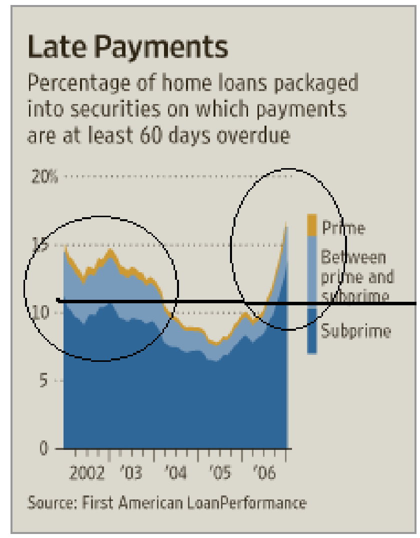
Despite a quarter where the market showed extremes to the up and the down, the Dow Jones Industrial was the only major index to finish in negative territory. The Dow Jones Industrial Average, S&P 500 Index and NASDAQ posted returns of -0.33%, 0.64% and 0.38% respectively. The Russell 2000 Index continued its strong performance with a gain of 1.95% while the foreign markets led the way once again with the MSCI EAFE Index gaining 4.15%.

The Federal Reserve altered their key language after their last meeting emphasizing an increase in inflation concerns and stating their belief that the recent subprime woes will likely be contained. All that being said, the short term rate remains at 5.25%. The 4th quarter GDP figure did get revised up from 2.2% to a final number of 2.5%. Unemployment continues to be extremely low with the rate taking an unexpected dip to 4.4% on April 6th. The ISM Manufacturing recovered to 50.9 for March, indicating the sector is once again in expansion mode. Due to supply issues and additional unrest in the Middle East, oil prices have moved up finding a range in the mid to high $60s.

The 10-Year Treasury note ended the quarter relatively flat with a yield of 4.651%, down slightly from 4.708% in December. The Lehman Aggregate Bond Index returned a healthy 1.5% while the Merrill Lynch High Yield Bond Index gained 2.67%. Fixed income seemed to once again be the safe haven for investors as equities plotted their volatile path.



Subprime mortgages caught the majority of the headlines during the quarter as default rates spiked. These types of mortgages only represent a small fraction of the mortgage market, but the question remains on whether this will bleed into the core mortgage arena. If this were to happen in conjunction with a rise in jobless claims, the economy could set itself up for a setback due to the consumer's lack of spending power. The counter to that is the amount of liquidity that still appears to be in the market. The explosive growth in private equity buyouts is an example of this liquidity and suggests plenty of "dry powder" waiting on the sidelines to invest.



We at AFS continue to believe that the overall economy is healthy and that the upward trend should continue. Corporate earnings are projected to dip below double digits for the first time in several years, but are still very healthy. As a side note, 2006 marked the seventh year in a row where "value" stocks have outperformed growth (as measured by Russell investments). This happens to be the longest period by either style since 1979. Could growth finally come back into favor? We'll have to wait and see. Have a great Spring!

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