



ANCHOR BAY CAPITAL, INC

THE FRUGAL INVESTOR[®]

JULY 13, 2007

ECONOMIC REVIEW AND COMMENTARY

The second quarter got off to a tepid start after a series of weaker-than expected reports on economic growth, the service sector, unemployment claims and factory orders. As the quarter progressed, concern shifted to the housing market with report after report indicating the malaise was deepening. Early reports suggested the slump had bottomed and an imminent recovery would render the short lived slump a blip on the radar screen. Successive reports became gloomier in their outlook, with the most recent reports speculating a recovery may not bloom until 2009 at the earliest. While we are still not out of the woods, the Fed assures us the fallout from the subprime mortgage crisis is contained and is not expected to spill over into the broader economy.

During the quarter the Wilshire 5000 index, representative of the broad U.S. stock market, increased 6%. Bonds, meanwhile, experienced their most volatile period in years, with the yield on the 10-year Treasury spiking as high as 5.25% in mid-

June before settling back to the 5.03% mark by the end of the quarter. Bond rates move inversely to prices, so the yield spike resulted in downside volatility in the bond market. Interest-rate-sensitive preferred stocks and REITs sold off during this period, reflecting concerns over the housing slump, fear of an economic slowdown caused by higher interest rates, and competition for dividend yield from rising bond rates.

We would like to point out that after more than a year of being inverted (short term rates above long term rates) the curve has reverted to a normal, upwardly sloping shape. Economists have noted in the past that an inverted curve heralds an economic slowdown or recession, generally four to six quarters in advance. Our take is that reversion to a normal slope signifies the market is now looking past the growth slowdown in the economy and corporate earnings, and anticipating a resurgence of growth in the months ahead.

PORTFOLIO MANAGEMENT TEAM GROWS

We would like to introduce Jonathan L. Chatfield, CFA (Chartered Financial Analyst) who has joined our investment team. The CFA designation is widely recognized as the pinnacle of competency achievement for investment professionals. Jon earned his CFA designation in 2000.

Jon brings to the table 12 years experience in managing investment portfolios. In his role as

portfolio manager, he will take steps, working with Scott and the rest of Anchor Bay Capital's investment team, to bolster and improve the firm's investment policies, process and portfolios, all in an effort to deliver a better value proposition to our clients, including improvements in the risk/return profile of our portfolios.

EARNINGS GROWTH REMAINS SOLID

The first quarter of 2007 marked the 19th consecutive quarter of year-over-year double digit earnings growth. On average corporate earnings for companies in the S&P 500 grew just over 10% over the same quarter a year ago according to Zacks, which also expects high-single-digit earnings growth in the second quarter.

Following recent announcements of improvement in the manufacturing and service sectors, as well as an uptick in consumer confidence, the market now appears to be looking past the second quarter and propelling stocks higher based on expectations of further gains.

INVESTMENT PORTFOLIO RECAP

In late 2006, when the market was approaching its all-time high, we wanted to protect your assets in the event of a market downturn; therefore we reduced our allocation in equities. In hindsight, that action was premature. While we don't have a crystal ball, the reduction in equities limited our gains during a period of continued bullish sentiment in the equity markets. It is worthwhile to point out that you have hired us for our judgment and asset allocation, which includes analysis of economic factors that may affect the mood of the stock market. Furthermore, it isn't always how much we have earned in an up market, but limiting your

losses in a down market that we view as our highest priority. So, while we may have erred on the side of conservatism, in most cases your allocation to equities performed well in comparison to the relevant indexes. The overall portfolio also was impacted by the unusual volatility of the fixed income securities (bonds and preferred stocks). Based on the recent trend of indicators now appearing to signal renewed economic strength, we are now adding to positions when we find opportunities to do so. We are also continuing to look for opportunities to generate additional income from covered call premiums.

THE FED HOLDS RATES STEADY (AGAIN)

The Fed held steady with its stance that its predominant focus should remain on inflation rather than economic weakness. While noting "readings on core inflation have improved modestly in recent months" the Fed left rates unchanged at its June 28 meeting. Inflation concerns eased as the market di-

gested news that inflation has fallen to a level that is within the Fed's comfort zone. If the inflation number remains contained, the Fed will have the flexibility to lower rates before year-end in order to aid in the recovery of the housing market.

INVESTMENT POLICY GUIDELINES

Based on the depth of experience of our investment policy committee, we do not expect to alter our investment allocation dramatically based on short-term or market timing decisions. We buy stocks as a long-term investment and have instituted a more systematic process that relies on buying stocks at a discount to their intrinsic value, or when the expected rate of return exceeds the security's specific risk-based required rate of return. We will trim positions as they approach or exceed our price targets, or when in our judgment the fundamentals have deteriorated, rendering the stock unattractive.

We have also adopted a process of evaluating the price relative to fair value of the total stock market, and decisions regarding changes to your portfolio's stock/bond/cash allocation weights will be based mainly on our assessment of that metric. Unless our indicator signals the stock market is well above fair value we expect new accounts to be invested in two steps, and to be fully invested within 60 days of the

funding date.

We set strict allocation targets based on your investment goals and risk tolerance. We have tightened our portfolio management parameters to limit the amount we allow your portfolio to fluctuate around its long term target allocation by no more than plus or minus 10%. We do this in an effort to control your risk exposure yet maintain the targeted equity position to meet your long term performance goals. It is important for clients to realize that in order to achieve their goals the portfolio must have equity exposure, and that from time to time we will experience market corrections, sometimes lasting more than one year, which may negatively impact performance. We are most concerned with a company's profitability and long term growth of earnings and dividends. Secondly, we look for stocks that are attractively priced, preferably at a discount to intrinsic value, where we expect superior returns based on earnings growth and a narrowing of the discount.

ANCHOR BAY CAPITAL, INC.

5780 FLEET STREET, SUITE 308, CARLSBAD CA 92008 - PHONE 760-602-3470 - FAX 760-602-7811

WWW.ANCHORBAYCAPITAL.COM - EMAIL: INFO@ANCHORBAYCAPITAL.COM