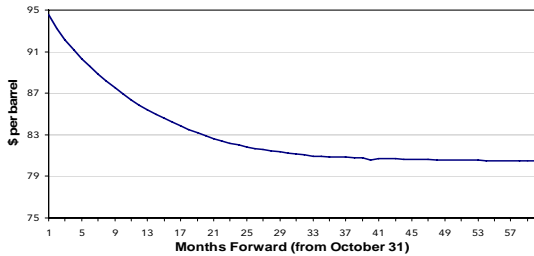


# Economic Review

October was a month punctuated by political tensions. Turkey came dangerously close to invading the Kurdish region of northern Iraq, following attacks by PKK militants, whose aim is to create an independent Kurdish homeland in Iraq and Turkey. Diplomatic talks with North Korea resumed, with the U.S. offering aid and access to frozen funds, in exchange for an end to the North Korean nuclear program. Past efforts have failed as North Korea habitually violated covenants of those agreements. The U.S. tightened sanctions against Iran, including limiting access to the world banking system, following ongoing defiance of world pressure to end its nuclear ambitions. A Syrian target bombed by Israel in September was identified as a likely nuclear reactor under construction.

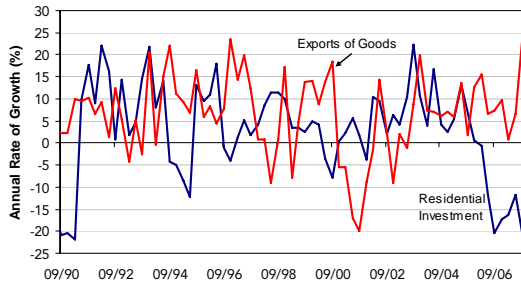
## Crude Oil Backwardation



Source: Bloomberg  
Condition where current prices are higher than prices at a future date

Crude oil prices skyrocketed to an all-time high of \$96.24 per barrel. Oil prices rose 16% in October, and are up over 55% since 2006. The detachment of prices from actual supply and demand levels reflects the elevated premium from potential supply disruptions and increased investor funds moving into energy. Homeowners in the Northeast are expected to see heating bills 20-50% higher as heating oil prices adjust to the current oil market tumult. Gasoline prices have yet to see the full impact, as refiners processed oil purchased at lower prices during the summer.

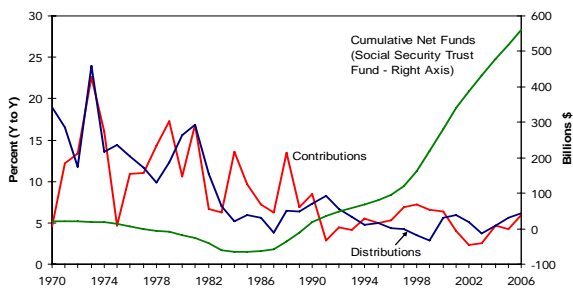
## Exports Soar, Housing Falls



Source: BEA

World food prices rose on higher wheat prices, which have increased significantly in 2007. Copious amounts of spring rains in the Midwest and a dramatic drought in Australia pared harvest levels substantially. Corn prices moderated as the ethanol market softened, due in part to a short-term overcapacity in production. The highest yielding corn harvest since the 1940s reflected the displacement of wheat and soybean planting in favor of corn, intended by farmers to capture high prices early in 2007.

## Social Security Outlays Set to Expand Rapidly



Source: BEA

GDP expanded at a 3.9% rate in the third quarter. Boosting the rate were strong exports and a pullback in energy prices during the first two months of the quarter. Goods exports rose at a 23% rate, receiving support from a sharply weaker Dollar, which continued to fall in October. Residential construction contracted for the seventh consecutive quarter, retreating 20% during the quarter. The decline has been a necessary component to any rebound in housing, as oversupply continues to remain a problem.

The Federal Reserve cut interest rates 25bps on October 31<sup>st</sup>, citing adverse effects on near-term growth from housing and potential financial market disruptions. The Fed Funds Rate stands at 4.50%.

The first baby boomers began receiving payments from Social Security. Over 80 million additional people are expected to begin receiving benefits over the next two decades, straining the system's ability to meet its obligations under its current structure. Currently, 49 million people receive benefits averaging \$11,200 annually. The cumulative net contributions and distributions, since the Trust's inception in the 1930s, are \$550 billion. The Treasury currently owes the Trust \$1.9 trillion, reflecting the diversion of collections into the general funds of the federal government.

Georgia and the southeast U.S. faced water shortages following a prolonged drought. Reservoir levels plummeted dangerously close to empty, stirring tensions among residents, agriculture, and fishing interests. California fires damaged thousands of structures and caused over \$1 billion in damages. The largest mass evacuation in state history displaced over one million residents.

### As of October 31, 2007

	October	3 Months	YTD
<b>S&amp;P 500</b>	1.6%	7.0%	10.9%
<b>Russell 1000 Value</b>	0.0%	4.6%	6.0%
<b>Russell 1000 Growth</b>	3.4%	9.5%	16.5%
<b>Russell 2000</b>	2.9%	7.0%	6.1%
<b>MSCI EAFE</b>	3.9%	7.8%	17.6%
<b>LB Agg</b>	0.9%	2.9%	4.8%
<b>3-Month T-Bills</b>	0.3%	1.2%	4.2%