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Leaders in Structured Portfolio Management

MARKET COMMENTARY

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Tom Seto

Director of Portfolio Management

Domestic

The Federal Reserve kept interest rates unchanged for the seventh and eighth Federal Open Market Committee meetings in a row during the second quarter, citing inflation risks. Investors seemed unfazed by waning prospects for lower borrowing costs, and drove the US equity market to one of its best quarters in the last 2 ½ years, the S&P 500 Index up 6.3% for the second quarter.

Energy was the best performing sector last quarter, up 14.9%, as crude oil rose to a 10-month high at the end of June and gasoline reached a record high in late May. The cyclical technology and industrial sectors also performed well, both up over 10% for the quarter. Utilities was the worst performing sector for the second quarter, down -0.5%. Size was not much of a factor in driving returns last quarter, as mid-cap and small-cap stocks performed similarly to large-cap stocks (S&P MidCap 400 Index, +5.8%; S&P SmallCap 600 Index, +5.2%). There was also little difference between value and growth styles among large cap stocks (S&P 500/Citigroup Value Index, +6.0%; S&P 500/Citigroup Growth Index, +6.6%).

Record mergers and acquisitions activity likely fueled much of the stock market rise in the second quarter. Even so, the recent record prices for US equities is supported by gains in corporate profits, with companies in the S&P 500 trading at 17 times their earnings, close to the long term average. However, the Federal Reserve has now kept interest rates unchanged for 12 straight months, stressing that inflation continues to be the biggest risk to the US economy. Whether the Fed is successful or not in taming inflation, our broadly diversified, sector-neutral Tax Managed Core portfolios will provide a great opportunity to capture the next market leaders, while doing so in a tax efficient manner.

International

The rallying of emerging markets led the international markets in the second quarter, the MSCI EM Index up 15.1% for the period. The developed international markets registered an eighth straight positive quarter, with the MSCI EAFE Index up a respectable 6.4%.

Notable were the across-the-board gains in global markets, where almost every country in MSCI All Country World Index (which includes EAFE, Emerging Markets, USA and Canada) posted positive returns during the second quarter. One of the few exceptions was Japan, down -0.6%, largely attributable to the weakening Yen. The second quarter gains were somewhat muted in late June, after the European Central Bank (ECB) raised interest rates to combat inflation. Leading the way in the developed markets last quarter was Germany, up 16.2%, helped by strong performance of its industrial and chemical conglomerates.

Strong corporate earnings appear to be the main driver of second quarter international stock market returns. However, all eyes are on the ECB, US Federal Reserve and central banks worldwide, as concerns about higher interest rates may cause some anxiety among equity investors.

About Parametric

Parametric is an industry-leading provider of structured portfolio management, headquartered in Seattle, Washington. Parametric and its affiliate, Parametric Risk Advisors, offer a variety of structured portfolio solutions, including customized core equity portfolios (U.S., Non-U.S., Global Tax-Managed Core™), options strategies (DeltaShiftSM), and overlay portfolio management (OverlayOne™).

Parametric

1151 Fairview Avenue N.

Seattle, WA 98109

T 206 694 5500

F 206 694 5581

www.ParametricPortfolio.com