



Parametric™

Leaders in Structured Portfolio Management

MARKET COMMENTARY

3rd Quarter, 2007

Domestic

It was an eventful third quarter for US equities, although the modest broad market return for the quarter obscured the tumult, the S&P 500 Index up an unremarkable 2%. On July 19, the S&P 500 Index set an all-time record high. In the following three weeks the market collapsed, down over -9%, due in large part to a sub prime mortgage led credit crisis. In response, the Federal Reserve, after leaving interest rates untouched for over 14 months, cut the Fed Funds rate by an attention-grabbing -0.5%, which drove the stock market back into positive territory for the quarter.

Energy was the best performing sector last quarter, up 9.8%, as crude oil reached an all-time record \$83/barrel in late September. Not surprisingly, financials were among the worst performers in the third quarter, down -4.3%, as credit markets froze, even in areas unrelated to sub prime mortgages. However, the worst performing sector was consumer discretionary, down -6.3%, as consumers' confidence fell with the value of their homes. Through the turmoil, there was a flight to "quality", and investors favored the steadier, well known large-cap companies over the riskier mid- and small-cap stocks (S&P MidCap 400 Index, -0.9%; S&P SmallCap 600 Index, -1.8%). Growth outperformed value (S&P 500/Citigroup Growth Index, +3.8%; S&P 500/Citigroup Value Index, +0.4%), as investors moved away from the financial and cyclical stocks than dominate the Value Index.

After years of stressing that inflation was the biggest risk to the US economy, the Fed has identified another enemy, a liquidity-based recession. Whether the Fed is taming inflation or preventing recession, 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 third quarter was marked by high volatility in world financial markets due to uncertain credit markets. After numerous liquidity injections by central banks, world markets rallied into quarter end. Overall index returns were positive for the quarter, with MSCI EAFE index up 2.2% and emerging markets MSCI EM Index up 14.5%.

In developed markets, results were mixed with Hong Kong (24%), Australia (11%) and Finland (19%) contributing significantly to positive returns; while Japan and Ireland contributed negatively. Top industries were Metals & Mining (16%) as dollar weakness contributed to a steep rise in commodity prices, and Telecommunications (12%); with only Financial and Consumer Discretionary sectors contributing negatively.

Emerging markets benefited from China's astonishing 40% return and Brazil's 20% return. At the beginning of the quarter, central banks were either raising rates or signaling rate increases. Panicked credit markets triggered a change of course, as the ECB, Bank of Japan and other central banks swiftly added billions in liquidity, sparking a September rally in world equity markets.



Tom Seto

Director — Portfolio Management

Parametric

1151 Fairview Avenue N.

Seattle, WA 98109

T 206 694 5500

F 206 694 5581

www.ParametricPortfolio.com

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™).