COMPASS WATCH

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MAKING PERFORMANCE RESULTS *MEANINGFUL*

Thanks to today's excellent computers and portfolio management software, it is no longer difficult to provide clients with accurate and timely performance information. We are able to show precise time and cash-weighted returns not only for an entire portfolio, but also by segment (bonds/stocks etc.) over many time periods. The challenge, however, is in making these returns *meaningful* for clients. Once the return is calculated and displayed, the logical question should be, "what does this return mean?" and "compared to what?" For example, suppose we show a return of 10%. Is this great, poor or somewhere in between? Unfortunately, the challenge of providing succinct, pertinent, helpful, *comparative* answers to these questions may be as difficult as it is necessary.

Finding good stock benchmarks for comparison is particularly problematical. For our "core", individual stock portfolios at Compass, we buy high-quality, large growth companies exclusively, when these companies appear undervalued to us. Moreover, we equally-weight these twenty-five holdings. The best-known stock market indexes are structurally very different, however. For example, the Dow Jones Industrials Average (DJIA) which the media carelessly refers to as "the market", consists of thirty companies, weighted by price (higher-priced shares have proportionally more influence in the calculation). Moreover, at present, thirteen of these thirty companies (43%) would be unsuitable for purchase by us since they are not growth stocks, have too much debt, or have other problems which make them unacceptable given our investment style. For this reason, we no longer show the DJIA for comparison in our client reports. Instead, we show the Standard & Poor's 500 Index; not because it is a perfect comparison, but because it is well-known and is more broadly representative of "the market" than is the Dow. Nevertheless, it contains a great many non-growth companies and has sectors we would be unlikely to be able to invest in, since we are a growth manager --utilities, for example. The S & P index poses another challenge since it is "market-capitalization" weighted: The largest companies have the greatest influence on the S & P's return. (The top fifth of the companies in size comprised two-thirds of the weight in the index as of 12/31/07). As these big companies at the top move up in size in the market, they increasingly dominate the return of the index, somewhat like a dog chasing its tail.

In addition to the S & P 500 index, we are now showing the **Russell 1000 Growth Index** for comparison in our Compass portfolio reports. This index represents the growth companies (as Russell Investments defines them) among the 1000 largest corporations in the U.S. (see www.russell.com). Since we invest in large, U.S. growth companies in our "core", individual stock portfolios, this is a relatively good benchmark. However, here again, the Russell 1000 Growth Index is market-capitalization-weighted, so the biggest companies disproportionately drive the return of the index (whereas, as mentioned, we equally-weight our stock holdings).

The most significant problem, by far, is in determining and comparing the level of risk taken by these indexes in obtaining their results. A 10% return, for example, may be very good if little risk was taken. However, it may be dreadful if a great deal of risk was assumed. It has been our experience that many investors (and their advisors for that matter) spend much time comparing and chasing returns while all but ignoring the level of risk taken to obtain those returns. This practice has proven hazardous to their wealth.

To summarize, we at Compass will continue to provide highly-accurate return information. We will also do our best to furnish comparative indexes to help our clients interpret their results more meaningfully. However, as one can see from this newsletter, good comparative performance analysis is no simple matter. The portfolio managers at Compass are well-prepared to assist with this task. May we help you?

***** For more information regarding Compass, visit and bookmark our website: www.compasscap.com *****

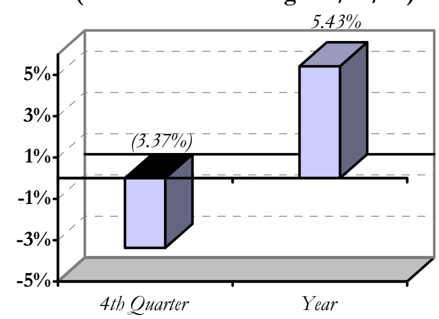
<u>COMPASS MARKET COMMENTARY</u>
(December 31, 2007)

In spite of serious economic and geopolitical concerns, high-quality U.S. bonds and stocks performed reasonably well in 2007. There was much to worry about - - major problems in the credit markets (especially subprime debt), falling home prices, rapidly rising commodity prices (especially oil), a generally slowing economy and continued trouble in the Middle East. Nevertheless, quality stocks and bonds delivered positive returns for the year.

<u>STOCK MARKET</u>

Within the S&P 500 Index, energy stocks were the strongest sector by far in 2007, outperforming the general index by over twenty-eight percentage points on a price basis. Financial and consumer discretionary stocks were the weakest sectors, as problems spread in the credit markets and as the economy showed clear signs of slowing.

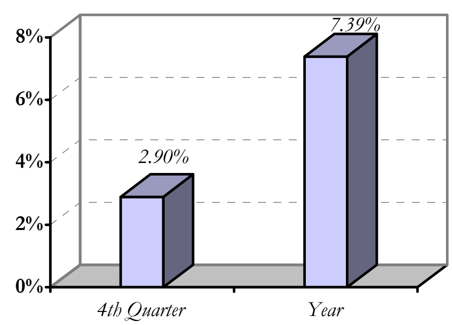
<u>S&P 500 SIZE-WEIGHTED</u>
(Total Return Through 12/31/07)



<u>BOND MARKET</u>

As financial institutions wrote down billions of dollars of value in subprime-related securities, investors rushed to buy high-quality bonds. The Federal Reserve also helped drive up quality bond prices by reducing short-term interest rates three times during the year (in September, October and December). As a result, yields on two-year U.S. Treasury notes dropped from <u>4.81%</u> at the end of 2006 to <u>3.04%</u> at the end of 2007. Ten-year Treasury yields fell from <u>4.70%</u> to <u>4.02%</u> over the same period.

<u>LEHMAN BROS. INT. U.S. GOV'T./CREDIT BOND INDEX</u>
(Total Return Through 12/31/07)



<u>CASH EQUIVALENTS</u>

Short-term interest rates fell dramatically during the year. Yields on three-month U.S. Treasury bills for example, which had been <u>5.01%</u> at the end of 2006, yielded just <u>3.24%</u> one year later.

<u>THREE-MONTH U.S. TREASURY BILLS</u>
(Total Return Through 12/31/07)